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The Florida Securities Act of 1978

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The Florida Securities Act of 1978

SIDNEY T. BERNSTEIN* AND SETH P. JOSEPH**

The authors provide a critical analysis of the new Florida blue sky law. The policies underlying the Florida Securities Act are identified to aid in the construction of an often vague statute. Specific provisions are considered in light of these policies and compared with the prior law in the areas of exempt transactions, exempt securities and professionals in the securities industry.

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I. PRIOR LAW

A. The Historical Development of Florida's Blue Sky Law

The first blue sky law was enacted largely as the result of an ambitious publicity campaign conducted by Kansas Bank Commissioner J.N. Dolley. Although much of the information advanced by Dolley in support of his drive for merit regulation was subsequently determined to be false, the Kansas blue sky law became a model for legislators in other states who desired to increase their followings by propounding concepts which held a Populist appeal. Florida was

1. “Blue Sky Laws” are comprehensive securities laws enacted by state legislatures. For a discussion of the origin of the term “blue sky laws” and their intent, see Mulvey, Blue Sky Law, in 36 CAN. L. TIMES 37, 37-39 (1916). The first legislative scheme to be characterized as a blue sky law was enacted by Kansas in 1911. See 1911 Kans. Sess. Laws ch. 133. Limited regulation of offerings of securities, however, had existed prior to the enactment of the Kansas blue sky law. See IIC H. SOWARDS & N. HIRSCH, BUSINESS ORGANIZATIONS—BLUE SKY REGULATION pt. 1, § 1.01, at 1-1 to -2 (1977).


3. “Merit regulation” can be defined as a varying degree of discretion on the part of state officials to approve or disapprove the sale of securities based upon their substantive merit. See H. SOWARDS & N. HIRSCH, supra note 1, pt. 2, § 7.01, at 7-2.


5. See J. MOSKY, supra note 2, at 11. The Populists were late 19th century and turn-of-the-century politicians who sought support from agrarian constituents by denouncing industrialists and other organizers of capital as “robber barons.” The Populists gained support for the blue sky laws by arguing that economic downturns had needlessly been caused by a failure to regulate capital markets. Id. at 10.
among the first states to follow suit and adopted a blue sky law patterned after the Kansas act in 1913.6

The Florida blue sky law of 1913 imposed several kinds of regulation upon persons selling or offering to sell securities.7 Companies which issued securities were required to file disclosure statements prior to making sales or offers to sell.8 The Comptroller and the


7. 1913 Fla. Laws ch. 6422. The scope of blue sky regulation was considerably narrower under this early act than it is today due to the then prevalent understanding of the operant concepts. The persons whom the Act subjected to the regulatory authority of the Comptroller and the Attorney General were domestic and foreign “Investment Companies” and agents of investment companies. A domestic investment company was defined as:

[Every Corporation, other than municipal Corporations, State and National Banks, Trust Companies, Public Utility Corporations, Corporations under the jurisdiction of the Railroad Commission of the State of Florida, and Corporations not organized for profit, which are now organized or which may be organized in this State, which shall offer for sale within the State of Florida . . . [any security] . . . shall be known for the purposes of this Act as a Domestic Investment Company.

1913 Fla. Laws ch. 6422, § 1. “Foreign Investment Companies” were all corporations organized in any jurisdiction other than Florida. Id. According to these definitions, securities regulation reached no further than to “securities” issued by the class of corporations known as “Investment Companies.”

Perhaps due to the naiveté of an earlier era, the term “security” was not described by a comprehensive series of nouns and adjectives. Language, however, which may be taken as a generic description of “securities” was contained in § 1, which was meant to define investment companies. Section 1 stated that the regulatory provisions of the Act were triggered when an investment company sold “stocks, bonds, debentures, certificates, policies or other securities of any kind or character.” Id.

8. Pursuant to § 2, investment companies were required to file at the Office of the Comptroller:

A Statement showing in full detail the plan upon which it proposes to transact business: a copy of all contracts, bonds, stock or other instruments which it proposes to make with or sell to its contractors; a statement which shall show the name and location of the Investment Company; an itemized account of its actual financial standing, showing the amount, character and location of its property and its liabilities; and such other information touching its affairs as said Comptroller may require. It shall also file with the Comptroller a copy of its Articles of Incorporation, constitution and by-laws and all other papers pertaining to its organization, all of which above papers and documents shall be verified by the oath of the President of such Corporation, or by some duly authorized officer of same.

Id. § 2. These documents were subject to the scrutiny of the Comptroller and the Attorney General. Id. § 4. Since § 4 authorized the administrators to make independent investigations of the financial condition of an issue at the issuer’s expense, investment companies had a strong incentive to provide thorough disclosure. Moreover, this authority provided the administrators with a method of discouraging offerings without having to resort to the fair, just and equitable merit standards of § 4.
Attorney General were vested with authority to prohibit the sale of securities if they found that an offering was unfair, unjust or inequitable. Agents of an issuer who sold an issuer's securities were subject to the regulatory authority of the Comptroller and Attorney General. The Act also contained a limited antifraud provision.

Not all corporations who issued securities were required to file statements with the administrators. Under the definition of investment company provided in the Act, exempted from registration were domestic municipal corporations, state and national banks, trust companies, public utility corporations, regulated railroad companies and not for profit corporations. § 1. In 1915, policies sold by licensed insurance companies were also exempted from the Act. See 1915 Fla. Laws ch. 6862, § 1. Furthermore, investment companies were exempt from the filing requirement when they sold stock solely in the county of their principal place of business. Mortgage Holding Co. v. Summy, 97 Fla. 403, 121 So. 473 (1929). All foreign corporations, however, were defined as foreign investment companies and were subjected to the regulatory provisions. 1913 Fla. Laws ch. 6422, § 1.

Section 4 of the Act provided that the administrators were authorized to examine the documents submitted pursuant to § 2 and to issue a statement that an investment company had complied with the provisions of the Act if: "[The administrator] finds that such Investment Company is solvent, and that its articles of incorporation and association, its constitution and by-laws, its proposed plan of business and contracts, contain a fair, just and equitable plan for the transaction of business." 1913 Fla. Laws ch. 6422, § 4. (emphasis added). There were many grounds for and serious consequences arising from administrative disapproval of an offering:

[If said Comptroller and Attorney General find that such Articles of Incorporation or association, charter, constitution and by-laws, plan of business or proposed contract contain any provision that is unfair, unjust or inequitable or oppressive to any class of contractor, or if they decide from their examination of its affairs that said Investment Company is not solvent and does not intend in good faith to do a fair and honest business, then they shall notify said Investment Company in writing of their finding and it shall be unlawful for such company to sell or offer for sale any of its securities in this State until it shall so change its constitution and by-laws, articles of incorporation or association, its proposed plan of business and contract, and its general financial condition in such manner as to satisfy the Comptroller and Attorney General . . .

Id. The Act failed to provide criteria for the constituent elements of fair, just and equitable transactions. For an illustration of the host of problems created by this omission, see text accompanying notes 24-33 infra.

The merit standard of § 4 was supplemented by § 8, which provided:

Whenever it shall appear to the Comptroller and Attorney General that the assets of an Investment Company doing business in the State are impaired to the extent that such assets do not equal its liabilities or that it is conducting its business in an unsafe, inequitable, or unauthorized manner, or jeopardizing the interests of its stockholders and investors in stocks, bonds, or other securities by it offered for sale, or whenever any Investment Company shall fail to or refuse to file any papers, statements or documents required by this Act, without giving satisfactory reasons therefor, said Comptroller and Attorney General shall at once revoke the license of said Investment Company to do any further business in the State of Florida.

Id. § 8. Thus, the administrators were empowered both to insist upon a certain capital structure at the formation of a firm and also to monitor alterations in the firm's capital structure even in the aftermarket.

Pursuant to § 6 of the Act, investment companies were authorized to appoint agents
In 1931, the Florida Legislature repealed the earlier blue sky law and replaced it with the Florida Sale of Securities Law. This was done in order to promote uniformity among the blue sky laws of the several states. Florida retained its Sale of Securities Law until 1976. The regulatory scheme established by the Sale of Securities Law was far more complete and, therefore, had more of a destructive impact upon capital markets than did the Act of 1913.

**B. The Perils of Merit Regulation**

Ultimately, the Sale of Securities Law contained both a fair, just and equitable standard and proscriptions against offerings which either were based upon “unsound business principles” or tended to work frauds upon the investors. The Florida Securities Commission was authorized to record the registration of securities which were registered by qualification if the regulators found 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 enterprise or business of the issuer is not based upon unsound business principles.” 1931 Fla. Laws ch. 14899, § 8(i). Thus, as originally enacted, the “fair, just and equitable” standard was not perpetuated. But see Jennings, The Role of the States in Corporate Regulation and Investor Protection, 23 L. & CONTEMP. PROBS. 193, 225-26 (1958). After the initial passion for uniformity had cooled, the Florida Legislature amended the Sale of Securities Law specifically to impose the fair, just and equitable standard.
Commission and its successor, the Department of Banking and Finance, perceived these standards as a mandate to promulgate regulations controlling: (1) underwriting commissions and offering expenses;\textsuperscript{16} (2) cheap stock;\textsuperscript{16} (3) stock options;\textsuperscript{17} (4) offering price;\textsuperscript{18} (5) voting rights;\textsuperscript{18} (6) interest and dividend coverage;\textsuperscript{20} and (7) promoters' equity investment.\textsuperscript{21} The combined effect of these substantive controls was to restrict entry by small firms and by firms in the promotional stage into public capital markets as illustrated by reference to the following hypothetical situation:

Thomas Edison organized a sole proprietorship to facilitate the invention and manufacture of the incandescent bulb. After a disaster destroyed all but $150,000 of his equipment and machinery, Edison estimated that he would need to raise $2 million in order to complete the research and development of the product. Edison soon found that no lending institution would finance his project due to the restrictions on interest rates imposed by usury laws.\textsuperscript{22} A limited offering of securities would be inappropriate because the investors would demand too much control over the company.\textsuperscript{23} Edison there-

\textsuperscript{15} The Sale of Securities Law authorized the Florida Securities Commission to "fix the maximum amount of commission or other form of remuneration to be paid in cash or otherwise, not to exceed 20%, directly or indirectly, for or in connection with the sale or offering for sale of . . . securities in this State." 1931 Fla. Laws ch. 14899, § 8(i).

\textsuperscript{16} See Rule 3E-20.04, 1 BLUE SKY L. REP. (CCH) ¶ 13,674.

\textsuperscript{17} See Rule 3E-20.06-.07, 1 BLUE SKY L. REP. (CCH) ¶¶ 13,176-77.


\textsuperscript{19} See Rule 3E-20.05, 1 BLUE SKY L. REP. (CCH) ¶ 13,675.

\textsuperscript{20} See Rule 3E-20.08, 1 BLUE SKY L. REP. (CCH) ¶ 13,679.

\textsuperscript{21} See Rule 3E-20.04, 1 BLUE SKY L. REP. (CCH) ¶ 13,674.

\textsuperscript{22} Prior to July 1, 1979, the maximum lawful rate of interest for loans to both individuals and corporations was 15%. Fla. Stat. § 687.03 (1977).

\textsuperscript{23} See Mofsky, Adverse Consequences of Blue Sky Regulation of Public Offering Expenses, 1972 Wis. L. Rev. 1010, 1022. Private placements made pursuant to the Sale of Securities Law were offers or sales to a maximum number of persons within a limited period of time with the proceeds put in escrow for a promotional firm. See Fla. Stat. §§ 517.06(10)-(11) (1977) (repealed 1978), discussed in text accompanying notes 147-157 infra.

A major reason for the great loss of control involved in a private placement can be explained as follows: purchasers of privately placed stock are generally sophisticated investors. See Casey, SEC Rules 144 and 146 Revisited, 43 BROOKLYN L. REV. 571, 574 (1977). These sophisticated investors will extract offsetting benefits from issuers to compensate for each additional restriction which securities regulation imposes upon the liquidity of their investments. Both Florida and federal securities law place extremely burdensome restrictions upon the resale of securities purchased in a private placement. Thus, investors act to protect themselves by retaining a greater modicum of control.

Under federal law the would-be seller must run the gauntlet of rule 144. See 17 C.F.R. § 230.144 (1978). Until recently, even more restrictive conditions had to be met under Florida law. The only readily available exemption in most instances was the isolated sale exemption. See Fla. Stat. § 517.06(3) (1977) (current version at id. § 517.061(3) (Supp. 1978)), discussed
fore resolved to issue the securities of Edison, Inc. in a public offering.

1. OFFERING PRICE

A major problem which Edison would encounter upon submitting the registration statement of Edison, Inc. for review by the Department of Banking and Finance would be caused by merit regulation of the offering price of the issuer's securities. Since Edison, Inc. would be required to register by qualification, the Department would be authorized by the Sale of Securities Law to deny recordation of the registration statement if, in their estimation, the issuer's plan was based upon "unsound business principles." In past enforcement of this vague requirement, the Department has uniformly denied recordation when issuers sought to raise in excess of 400% of the net capital of the firm. Thus, Edison, Inc. would be limited to a public offering of $600,000.

2. OFFERING EXPENSES

Even if it had been feasible for Edison to complete successfully the development of the bulb on this allowance, the restrictions on offering expenses imposed by the blue sky laws might have frustrated Edison's plan. The Sale of Securities Law provided that the total expenses of marketing an offering of securities must be limited to twenty percent of the total offering price. Thus, Edison, Inc. could not have expended more than $120,000 for: (1) direct and indirect underwriter's compensation; (2) underwriter's cheap stock and options; (3) attorney's and accountant's fees; and (4) printing

in Robinton & Sowards, supra note 6, at 533-34. Sophisticated purchasers aware of the difficulties of disposing of the stock, value the securities according to the restriction. See Greenberg, An Estate Planner's View of Investment, Control and Business Combination Stock, in THE FOURTH ANNUAL INSTITUTE ON ESTATE PLANNING 8-13 to -15 (P. Heckerling ed. 1970).

There are other anticompetitive effects of the restrictions on resale. Larger firms, which have large amounts of capital, can acquire the assets of a small firm at a bonus price. Because the only available escape for holders of restricted securities is through a merger with a public company, large firms can bargain down the price of a small firm based upon the costs imposed by regulation on other forms of sale. Thus, large firms profit at the expense of small, innovative firms. Most sophisticated investors perceive the benefits of participation in a small firm as being diminished because they may not resell their holdings, whereas "the large company that can take over the new company in one bite" can resell. Casey, supra, at 585.

24. 1931 Fla. Laws ch. 14899, § 8(i); see note 14 supra.
25. See Robinton & Sowards, supra note 18, at 7-8.
and filing costs. The expenses associated with a registered offering could not realistically be held to that maximum figure.27

3. THE PROMOTER'S POSITION

As the promoter of Edison, Inc., Edison would be required to invest at least fifteen percent of the total equity investment to be raised by this offering.28 Since the value of the property he transferred equalled twenty-five percent of the total equity investment, Edison met this condition. Edison would lose control of the firm, however, because he would be permitted to receive only twenty-five percent of the common stock, that is, he would not be allowed to take cheap stock.29 With his firm in the promotional stage, Edison could not issue debt or preferred stock or nonvoting common stock to the public in order to increase his own equity position.30 Nor would the conservative accounting bias of the blue sky laws allow Edison to include the value of his genius in the relevant calculations.31

Had he been faced with all of these unnatural obstacles the real Edison might well have been unable to develop the light bulb.32 The

27. An analysis of six of the smaller distributions made in 1976 by companies with assets of less than five-million dollars has revealed that the average cost of registering the offerings was $122,350—an automatic, and in some cases, an insurmountable roadblock for companies interested in entering the public market. Casey, supra note 23, at 575 (footnote omitted) (citing REPORT ON THE TASK FORCE ON VENTURE AND EQUITY CAPITAL FOR SMALL BUSINESS (1977)). See also Campbell, The Flight of Small Issuers Under the Securities Act of 1933: Practical Foreclosure From the Capital Market, 1977 DUKE L.J. 1139, 1140; Mofsky, supra note 23, at 1016-1122 passim.

28. See Rule 3E-20.04(a), 1 BLUE SKY L. REP. (CCH) ¶ 13,674.

29. See id.

30. See id. 3E-20.05,.09, 1 BLUE SKY L. REP. (CCH) ¶¶ 13,675, 13,679.


32. Professor Mofsky has noted that the initial offering of the highly successful Xerox company would not have been permitted in Florida under its merit standards. Roberts, Securities Bill May Be Legislative Headache, Fla. Trend, 63, 63 (Feb. 1975). The promotion of such new industries is a prerequisite to the economic well-being of our society:

The need is clear enough. From the time of Pericles through Elizabeth I down to Polaroid, the cutting edge of dynamic societies has been the innovator, risking his own savings and those of others having confidence in him, whether on the waves of the high seas and new horizons or those of high technology and new services. Almost every new technology that has given a lift to the American economy has come from a new company, struggling in a garage or venturing out to obtain needed capital from the public. For example, railroad car manufacturers did not pioneer the development of automobiles; neither did established automobile companies develop the first airplanes. The most dramatic recent example of this phenomenon has been the development of the semi-conductor industry. Again, the original innovations came from new companies, and not from the
invention and production of the bulb might well have been post-
poned until a wealthy genius conceived the same idea.\textsuperscript{33}

C. The Cry for Reform

Commentators came to criticize aspects of both Florida's blue
sky law and disclosure requirements imposed by securities laws in
general.\textsuperscript{34} Many of these critiques were based upon the growing body
of empirical data which supported the efficient capital market hy-
pothesis.\textsuperscript{35} The efficient capital market hypothesis, which developed
out of the "random walk" theory, postulates, \textit{inter alia}, that the
financial information provided by required disclosure has no corre-
lation with a firm's future ability to generate earnings.\textsuperscript{36} The hy-
pothesis has been supported by empirical demonstrations that in-
vestment advisers, sophisticated in the use of disclosed financial
information, fail to achieve greater increases in the value of the
portfolios they manage than would any investor who randomly
chose a portfolio of similar risk.\textsuperscript{37}

Because blue sky regulators are dependent upon the same
methods or techniques employed by investment advisers in deter-
mining the success of a particular security to generate earnings, the
confidence in the ability of those regulators to determine which
securities are suitable for public offerings has been shaken by the
-growing acceptance of the efficient capital market hypothesis. Even
if the analytical skills of regulators are as acute as those of highly
paid investment advisers, no means exist by which regulators could
more accurately assess the merit of securities than could profes-
sional investment advisers. Furthermore, the regulators' application

\textsuperscript{33} "Unless we keep risk capital flowing into new enterprises our economic progress and
competitiveness in world markets will erode and young people will be denied opportunity."
Casey, supra note 23, at 572-73 (footnote omitted).

\textsuperscript{34} See, e.g., Benston, \textit{The Effectiveness and Effects of the SEC's Accounting Disclosure
Requirements}, in \textit{ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES} 23 (H.
Manne ed. 1969); Kripke, supra note 31; Mofsky, supra note 6, passim; Stigler, \textit{Public

\textsuperscript{35} See generally \textit{J. LORRIE & M. HAMILTON, THE STOCK MARKET: THEORIES AND EVIDENCE
(1973); Benston, Required Disclosure and the Stock Market: An Evaluation of the Securities
Exchange Act of 1934, 63 AM. ECON. REV. 132 (1973).}

\textsuperscript{36} See generally Note, supra note 31.

\textsuperscript{37} See \textit{J. LORRIE & HAMILTON, supra note 35.}
of talismanic merit standards, based as they are upon arbitrary and mechanical formulas, denies investors their choice of securities without regard to whether investors would be benefited by a violation of those standards.\(^8\)

In 1973, the Florida Law Revision Council, a body formed to examine perceived weaknesses in Florida’s laws and to propose curative legislation, undertook a comprehensive study of the blue sky law. The Council solicited and retained as Reporter Professor James S. Mofsky of the University of Miami School of Law on the basis of his expertise in the field of securities regulation.\(^3\) The Reporter’s completed recommendations were adopted by the Council in the form of a proposed bill in 1974.\(^4\) When published, the study won the support of industry participants, the bar and legal commentators.\(^41\)

The study revealed flaws in the existing blue sky law. It became apparent that the Division of Securities could not adequately serve as investment adviser to the investing public.\(^42\) Furthermore, the application of the Division’s human and economic resources to merit regulation diverted Division manpower from enforcement of the antifraud provisions of the blue sky law. It also became apparent that the blue sky laws imposed competitive disadvantages upon small firms.\(^43\)

To reduce the perceived waste of precious resources, the Council proposed to eliminate entirely merit regulation, to emphasize enforcement of the antifraud provisions and to provide disclosure standards which paralleled those of the federal securities laws.\(^44\) To promote a system of disclosure which avoided the economic waste resulting from unnecessary disclosure, the Council proposed to liberalize some of the exemptions from registration.\(^45\) In general, an attempt was made to reduce the anticompetitive effects of blue sky regulation.

The Department of Banking and Finance opposed certain as-

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40. Id. at 63, 67.
42. See generally Note, supra note 38.
43. See Mofsky, supra note 6, at 12, 13, 15, 24, 26, 28-32.
44. Id. at 34.
45. Id. The disclosure philosophy which underlies the Federal Securities Laws assumed from its inception that disclosure, in the form of registration and the distribution of prospectuses, is unnecessary and wasteful when persons purchasing securities from an issuer are in a position to bargain with the issuer and are thereby able to compel disclosure.
pects of the Council’s proposal. A spokesman for the Division of Securities vigorously criticized the incorporation in the bill of a scienter standard as an element of a criminal violation, deeming it a step backward in the prosecution of alleged violators.46

The Council introduced its proposed bill in the 1975 Session of the Florida Legislature.47 The Council, however, withdrew the bill before it was submitted for a vote as an accommodation to the newly elected Comptroller, who required an opportunity to study the bill before making his recommendation to the legislature. When the bill was reintroduced in the 1976 Session, the Comptroller opposed it. The bill was passed by the House of Representatives, but the Senate failed to act upon the bill within the limited time remaining in the 1976 Session. Because the finances for the Council’s operation had been depleted by the end of the 1976 Session and no subsequent funding of the Council was initiated by the legislature, the bill was not re-introduced.48

The efforts of the Council might have been wasted if not for the enactment of sunset legislation in 1976 which mandated the prompt revision of blue sky laws.49 The sunset law required that the legislature subject the blue sky law to the same type of rigorous analysis made by the Council. Thus, the legislature was committed to a consideration of: (1) whether a less restrictive method of regulation which would adequately protect the public existed; (2) the degree to which the regulation increased the cost of the goods or services produced by the regulated person; and (3) whether the increased cost of the goods or services was more harmful to the public than the harm which could result from the termination of the regulation.

Under the pressure of the sunset law, the Comptroller worked out a compromise bill with the Council and its supporters. The bill which was then drafted by the Division of Securities and introduced into the legislature by the Comptroller incorporated most of the provisions proposed by the Council and was grounded in the study prepared by the Reporter. The bill passed and was subsequently approved by Governor Askew on June 28, 1978. For the first time in American history, blue sky laws had been amended by a legislature which looked to the economic impact of regulation.

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46. See Roberts, supra note 32, at 68.
48. Id. at 1.2.
II. THE REGULATORY PHILOSOPHY OF THE FLORIDA SECURITIES ACT

The legislative history of the Florida Securities Act reveals a deliberate effort to reduce the economic waste incident to blue sky regulation. Both the Council’s study and the cost/benefit criteria of the sunset law support constructions of the Florida Securities Act which promote an efficient and free market. Three principal policies can be isolated that ought to be applied in construing the statute.

A. Cost Minimization

When there are ambiguities in the language of the Florida Securities Act, the goal of promoting an efficient market should be reflected by adopting that construction which minimizes the cost to the participants in the capital market: namely, investors, issuers, and underwriters. Such a construction will benefit the general public as well as market participants because the direct costs to investors or costs to issuers or underwriters, which are passed on to investors as indirect costs will be reduced, and investors will thereby experience less dilution of their equity investment. Issuers will benefit from decreased costs because they can better compete with issuers that are exempt from the regulation. Underwriters benefit because they can increase the number of financings they currently undertake. Many issuers who could not economically afford public financing under prior law, but who will now be able to sustain the decreased cost of public financing, will increase the business of the underwriters. The public will benefit as the surplus arising from decreased costs becomes available for further investment and thus for the production of useful goods.

Formerly, the vague notion of “investor protection” was identi-
fied as being the dominant concern of securities laws. The emphasis of the Florida Securities Act upon an efficient and free market, however, displaces this philosophy. It was possible to conclude under prior law that greater investor protection was desirable regardless of the costs imposed by such regulation. Under present law, the costs of the regulation must not exceed its probable benefits. Thus, where a particular individual has committed an abuse, the appropriate response is now the identification and punishment of the individual, not the promulgation of burdensome requirements to be imposed upon the entire securities industry. If an unscrupulous issuer has cheated an investor of $1,000, the issuer should be prosecuted, but neither the courts nor the regulators should formulate rules which will cost other law-abiding issuers great sums to comply with, especially since the costs will be passed on to investors.

**B. Emphasis on Enforcement**

The Council's study exposed the inadequacy of the existent disclosure provisions as a means of combating fraud. The draftsmen of the Florida Securities Act attempted to remedy this problem by allocating the Division of Securities' resources towards enforcement of the antifraud provisions of the Florida Securities Act. This was accomplished by providing broad exemptions from the registration provisions so that most offerings would be exempted from registration. Because some of the newly exempted issues are subject to the scrutiny of the SEC, the task of duplicating the efforts of the federal agency was eliminated. For example, new section 517.061(19) of the Florida Statutes (Supp. 1978) exempts from registration all securities which are registered with the SEC. Thus, the Division will now be able to reassign most of its personnel, including many who were formerly engaged in registration processing and merit regulation, to enforcement.

**C. Optimum Disclosure**

The Florida Securities Act almost entirely abrogates the merit philosophy of securities regulation in favor of a disclosure philosophy. When an issue is registered pursuant to the Securities Act of
1933, the issue becomes exempt from the registration requirements of the Florida Securities Act. The disclosure philosophy of the Florida Securities Act is satisfied because the federal requirements are deemed to exact sufficient disclosure for purposes of investor protection. There are also other occasions when registration is not required. For example, pursuant to the new private placement exemption no formal registration process, with the attendant burden of the merit standards, is involved. Although disclosure is still required in most private placements, the burden has been somewhat alleviated because the investors in a private placement should have sufficient bargaining power over an issuer to exact from him the kind of information they deem useful.

III. REGISTRATION OF SECURITIES

A. What is a Security?

The Florida Securities Act preserves the former definition of the term "security." Because any analysis of securities problems hinges upon the construction of that term, the definition was adopted almost verbatim in order to promote certainty in the practice of securities law. Thus, the definition of a security as an "investment contract" continues to prevail. During the survey period, however, the Florida courts altered the test of investment contracts and hence have changed the scope of transactions deemed to involve securities.

The framework for analysis of investment contracts under both the Florida and the federal securities laws was established by the Supreme Court of the United States in the seminal case of SEC v. W.J. Howey Co. In Howey, purchasers of orange grove acreage were induced to enter service contracts with the seller whereby the seller cultivated and marketed the oranges and divided the profits pro rata among the purchaser-owners. The Court stated that

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57. See id. § 517.061(11), discussed in text accompanying notes 142-147 supra.
58. See note 23 supra.
60. "Investment contract" is one of several catch-all phrases included in statutory definitions of securities in order to prevent evasions of regulation by issuers who labeled the interests they marketed as something other than "stocks" or "bonds." See Mofsky, Some Comments on the Expanding Definition of "Security," 27 U. Miami L. Rev. 395, 397 (1973).
whether the purchasers had entered investment contracts should be determined in the following manner: "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."62

1. THE COMMON ENTERPRISE REQUIREMENT

In Howey, the common enterprise requirement of the investment contract test was satisfied because the purchasers' properties had been pooled and their profits shared on a pro rata basis. For many years, analysis of the common enterprise quadrant of the Howey test centered upon whether a scheme of financing involved some pooling of the investors' interests.63 Under this analysis, a common enterprise is not present if the property and profits of the individual investors are segregated, even when one promoter manages many such investments.64

Consistent with this analysis of the Howey test was the decision of the United States Court of Appeals for the Seventh Circuit in Milnarik v. M-S Commodities, Inc.65 In Milnarik, a single promoter's management of many separate discretionary commodities futures accounts66 did not constitute transactions in securities because there had been no pooling of the accounts.67 Mr. Justice Stevens, then a circuit court judge, wrote:

We find the element of commonality absent here. Although the complaint does allege that [the broker] entered into similar discretionary arrangements with other customers, the success or failure of those other contracts had no direct impact on the profitability of [the investor's] contract. [The broker's] various cus-

62. 328 U.S. at 301.
65. 457 F.2d 274 (7th Cir.) (Stevens, J.), cert. denied, 409 U.S. 887 (1972).
66. Discretionary accounts in commodities futures are brokerage accounts whereby the broker, as agent, purchases options to buy commodities at a specified price at a future date for the investor.
67. 457 F.2d at 277-78 n.7, (quoting Milnarik v. M-S Commodities, 320 F. Supp. 1149, 1151-53 (N.D. Ill. 1970)). The Seventh Circuit subsequently stated: "It is apparent then that this Court's decision in Milnarik was based on the assumption that a sharing or pooling of funds is required by Howey . . . ." Hirk v. Agri-Research Council, Inc., 561 F.2d 96, 101 (7th Cir. 1977).
tomers were represented by a common agent, but they were not joint participants in the same investment enterprise.\textsuperscript{68}

For example, the account of one investor, which consisted of plywood futures, might have produced profits even though another investor's account, consisting of cocoa futures, had produced losses. Because the profits and losses of any given account would not have had any common impact, the scheme was held not to have involved a common enterprise.\textsuperscript{69}

The United States Court of Appeals for the Fifth Circuit enlarged the commonality concept in a manner compatible with \textit{Milnarik} in \textit{SEC v. Koscot Interplanetary, Inc.}\textsuperscript{70} In \textit{Koscot}, the Fifth Circuit expanded the common enterprise concept beyond notions of pooled interests or pro rata returns. \textit{Koscot} involved a pyramid scheme whereby the success of the investment of each person depended on the promoter's efficacy in selling distributorships to other investors. In ruling as to whether the relationship between the investors constituted a common enterprise, the court decided: "The critical factor is not the similitude or coincidence of investor input, but rather the uniformity of impact of the promoter's efforts."\textsuperscript{71} Since any failure of the promoter would spell ruin for every investor in the pyramid scheme, the Fifth Circuit held that the plan of financing involved the commonality required by \textit{Howey}. The decisions in \textit{Koscot} and \textit{Milnarik} were compatible because the test in both was whether the promoter's actions had a uniform impact upon the prospects of the groups of investors.

The Fifth Circuit abandoned the rationale of \textit{Milnarik} and \textit{Koscot} in \textit{SEC v. Continental Commodities, Corp.}\textsuperscript{72} and chose to pronounce a sweeping rule rather than to evaluate critically the scheme involved. In \textit{Continental Commodities}, a broker had promoted discretionary accounts in options on commodities futures contracts to many investors.\textsuperscript{73} The broker carried naked options in

\textsuperscript{68} 457 F.2d at 276-77.

\textsuperscript{69} See note 67 supra.

\textsuperscript{70} 497 F.2d 473 (5th Cir. 1974).

\textsuperscript{71} Id. at 478.

\textsuperscript{72} 497 F.2d 516 (5th Cir. 1974).

\textsuperscript{73} Discretionary accounts in commodities futures options are brokerage accounts whereby a broker sells options on commodities futures contracts. A commodities futures contract is an option to buy or to sell a quantity of commodities at a specified price on some future date. Commodities options are securities subject to the registration provisions of the blue sky laws. See \textit{Wee Mac Corp. v. State}, 301 So. 2d 101 (Fla. 3d DCA 1974). A discretionary account in commodities options involves the purchase and sale of options on commodities futures by the broker for the account. It is common for brokers to act as principals in the sale of such options to the account by purchasing for the customer options which the broker
many of these accounts. If too large a number of investors had decided to exercise their options, the broker would have been rendered insolvent. Thus, the ability of investors holding options with later maturity dates to satisfy their claims against the broker was threatened if other investors’ accounts were too profitable. On these facts, a decision that the discretionary accounts are securities would not necessarily have been inconsistent with *Milnarik*, since *Milnarik* supports the proposition that commonality is present where several investors are put at a common risk by the actions of the promoter. In *Milnarik*, the broker had not risked his own solvency when he, as agent, purchased futures contracts for his customers, whereas the broker in *Continental Commodities* had exposed himself to that risk. The Fifth Circuit, however, explicitly rejected *Milnarik*.

The court then held that a common enterprise exists when a number of investors rely on the judgment of a single promoter:

[T]he critical inquiry is confined to whether the fortuity of the investments collectively is essentially dependent upon promoter expertise. . . . Lacking the business acumen possessed by promoters, investors inexorably rely on Continental Commodities’ guidance for the success of their investment. . . . That it may bear more productive fruits in the case of some options than it does in cases of others should not vitiate the essential fact that the success of the trading enterprise as a whole and customer investments individually is contingent upon the sagacious investment counseling of Continental Commodities.

Thus, the court confused the critical importance of the promoter’s solvency with a notion of promoter sagacity. The court, therefore,
rejected the concept that inherent in the Howey test is the requirement that investors must rise and fall together upon any given act of the promoter.

Until recently, it was assumed that Florida courts would adhere to both the Koscot and Continental Commodities standards rather than the Milnarik interpretation of the Howey test. Thus, in Sunshine Kitchens v. Alanthus Corp., Judge King of the United States District Court for the Southern District of Florida applied the Continental Commodities standard to claims arising under both the Florida and federal securities laws. In Sunshine Kitchens, one corporation entered into a sale and lease-back arrangement with another corporation. The purchaser-lessee attempted to establish that a common enterprise existed under the Continental Commodities standard. The commonality requirement of the Howey test was satisfied, argued the purchaser, because the purchaser’s expected profits were economically interwoven with the success of the seller-lessee.

The purchaser’s argument was not squarely within Continental Commodities, which had involved numerous investors, but more closely resembled the doctrine accepted in Huberman v. Denny’s Restaurants, Inc. In Huberman, the court held that a common enterprise existed in a scheme involving only one promoter and one investor because the success of the investor was tied to that of the promoter. The commonality was not between investors but between promoter and investor. Under this test, apparently most investment involves a common enterprise because investors are invariably reliant on promoters. To adopt Huberman would be largely to eliminate the commonality requirement of the Howey test.

Judge King rejected the argument that commonality was present where a single investor relied upon a promoter. Although the court held that the Continental Commodities standard was controlling on both the Florida and federal definitions of securities, it held that the facts indicated an absence of commonality under the Continental Commodities standard. The court likened the common

77. Since the federal definition of “security” was taken from the prevailing blue sky definition circa 1933 (the heyday of the Uniform Sale of Securities Act), it is substantially the same as the Florida definition. Federal cases construing the term therefore have a compellingly persuasive effect upon Florida courts. See State v. Fried, 357 So. 2d 211, 212 (Fla. 3d DCA 1978).
80. See Brown v. Rairigh, 363 So. 2d 590, 593 (Fla. 4th DCA 1978).
enterprise requirement of the Howey test to a wheel, with the investors as the spokes and the promoter or third party as the hub. "The Continental Commodities Court was unconcerned that one spoke was not connected to any other spoke, but this does not mean that a common enterprise may exist with a hub and only one spoke as [the purchaser] would have the court find." Thus, it appeared that Continental Commodities had become an accepted standard for commonality under Florida law.

Recent decisions of two Florida district courts of appeal raise doubts as to which standard of commonality will govern the investment contract test under Florida law. In the first of these decisions, Blacker v. Shearson Hayden Stone, Inc., the District Court of Appeal, Third District, held that discretionary brokerage accounts in commodities straddles were not securities even when a single promoter handled many such accounts. The Third District explicitly adopted the rationale of Milnarik, quoting profusely from the Milnarik opinion. Continental Commodities was distinguished by the court in a citation.

It is possible to conclude from Blacker that the Third District, for purposes of Florida blue sky law, has limited Continental Commodities to its own facts. Blacker may legitimately be distinguished from Continental Commodities on the basis of the differences between the underlying transactions in the cases. In Continental Commodities, the promoter was brokering naked options on commodities futures. In Blacker, however, the broker merely acted as an agent in purchasing existing commodities futures contracts in the form of straddles. Where, as in Continental Commodities, the common agent places his own solvency at risk by brokering naked options, the broker's ability to satisfy the subsequent claims of other investors is in jeopardy. Where a broker acts

81. 403 F. Supp. at 722.
83. 358 So. 2d 1147 (Fla. 3d DCA 1978).
84. A commodities straddle is the purchase of an option to buy commodities at a price prevailing on a particular commodities market at a future date and the purchase of an option to sell commodities on a different market on the same date. A straddle thus involves the purchase of two futures contracts issued by a party other than the broker of the discretionary account. A double option, however, may constitute a security. See SEC v. Commodity Options Int'l, Inc., 553 F.2d 628, 632-33 (9th Cir. 1977).
85. See id. at 1148-49.
86. Id. at 1149.
merely as an agent in purchasing commodities straddles for an investor, however, the broker has put nothing at risk which would dampen the prospects of other investors. Under this reading of Blacker, it may be that the Third District will adhere to Continental Commodities in appropriate instances.

The District Court of Appeal, Fourth District, cast a similar doubt upon the viability of the Continental Commodities standard under the Florida blue sky laws in Brown v. Rairigh. In Brown, an owner of race horses sold a single investor a ten percent interest in the horses. The investor was obligated to pay ten percent of all bills and stake fees in connection with racing the horses and was to receive ten percent of any winnings. The seller retained custody and control of the horses. The Fourth District held that the seller did not violate the blue sky laws because the presence of only one investor failed to satisfy the common enterprise requirement of the Howey test.

On its facts, the decision does nothing more than adopt the holding of Sunshine Kitchens v. Alanthus Corp. The curious reasoning of Brown, however, has broader ramifications for the common enterprise requirement of the Howey test as applied by Florida courts. The Fourth District identified three distinct lines of cases dealing with the definition of “common enterprise.” First, the court noted the standard of Milnarik and Blacker which “requires some kind of joint participation or dependency between investors.” Next, the court considered the Koscot commonality standard, which is satisfied by the mutual dependence of the investors upon the promoter in securing additional investors. Finally, the court noted the Huberman standard, which is satisfied by a showing that a single investor and promoter shared a common risk. By evaluating these standards, the Fourth District established the following two-pronged test:

[W]e adopt the view that not only should there be more than one investor, but there should be some form of interaction between investors, or, in the alternative, if there is no such interaction between the investors then the success of the enterprise should be dependent upon obtaining a number of investors.

88. 363 So. 2d 590 (Fla. 4th DCA 1978).
89. Id. at 593.
91. 363 So. 2d at 592 (citing Milnarik v. M-S Commodities, 457 F.2d 274 (7th Cir. 1972); Blacker v. Shearson Haydon Stone, Inc., 368 So. 2d 1147 (Fla. 3d DCA 1978)).
92. 363 So. 2d at 593.
Thus, the Fourth District defined a continuum stretching from *Huberman* to *Koscot to Milnarik* and held that only transactions involving elements found on the *Koscot-Milnarik* end of the spectrum possessed the requisite commonality. If *Continental Commodities* were placed along that continuum, however, it probably would be positioned between *Huberman* and *Koscot*. Thus, one possible interpretation of *Brown* is that the *Continental Commodities* standard will not be controlling on Florida’s investment contract test. Another view of *Brown*, however, is that the Fourth District considered the *Continental Commodities* standard as being so similar to the *Koscot* approach that both tests come within the second prong of the *Brown* test. This interpretation explains the court’s failure to mention *Continental Commodities*.

The ambiguity in *Brown* was not dispelled by the Fourth District in the subsequent case of *LeChateau Royal Corp. v. Pantaleo*. In *LeChateau Royal*, the selling agent of a condominium developer entered into a secret agreement with a purchaser of three units to resell the units on behalf of the purchaser prior to the closing date. The Fourth District held that there was no sale of securities on the basis that only one purchaser was involved in the scheme. As a result, commonality was lacking under the *Brown* rule. The court stated that “the common enterprise envisioned in an investment contract requires more than one investor, and some interaction between the investors or a showing that the success of the enterprise would be dependent upon obtaining a number of investors.” The court thus seems to ignore or disapprove of *Continental Commodities*.

2. THE ECONOMIC REALITY TEST

In *Howey*, the Supreme Court established that the substance of a transaction, rather than its form, governs the question of whether securities have been sold. The Court in *Howey* praised those state courts which had construed the term “security” so that “form was disregarded for substance and emphasis was placed upon economic reality.” Thus, the Court held that the land sales in *Howey* were incidental to the investment objective set forth in the service contracts. The economic reality test has since occupied an
important role in determining what is or is not a security. In some contexts application of the test has brought transactions within the regulatory scheme, while in others its application has resulted in a finding that units, such as common stock, should be deemed outside the definition of securities.

a. Beneficial Interests in Trusts

During the survey period, the District Court of Appeal, Third District, held that some purported investment contracts were not securities under the economic reality test. In *Wiener v. Brown*, a real estate broker executed a purchase of unimproved real estate on behalf of twenty-five other persons. Instead of a commission, the broker received a 4.77% interest in a trust into which the land was placed. The purchasers named the broker as trustee and authorized the broker to negotiate a favorable resale of the property on behalf of the purchaser-beneficiaries. The beneficiaries, however, retained the right to reject a proposed resale if one third of them objected.

Under a literal reading of *Howey* this transaction can be held to involve a sale of securities. The beneficiaries had invested in the land with an expectation of profits to be derived solely through the efforts of the broker to negotiate favorable resale. Although the form of the transaction thus satisfied the *Howey* criteria, the purchasers retained substantive managerial control over the resale of the property. The purchasers were not merely passive investors who lacked

fined. The respondent companies are offering something more than fee simple interests in land, something different from a farm or orchard coupled with management services. They are offering this opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents. They are offering this opportunity to persons who reside in distant localities and who lack the equipment and experience requisite to the cultivation, harvesting and marketing of the citrus products. Such persons have no desire to occupy the land or to develop it themselves; they are attracted solely by the prospects of a return on their investment. Indeed, individual development of the plots of land that are offered and sold would seldom be economically feasible due to their small size. Such tracts gain utility as citrus groves only when cultivated and developed as component parts of a large area. A common enterprise managed by respondents or third parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investments. Their respective shares in this enterprise are evidenced by land sales contracts and warranty deeds, which serve as a convenient method of determining the investors' allocable shares of the profits. The resulting transfer of rights in land is purely incidental.

*Id.* at 299-300.

99. 356 So. 2d 1302 (Fla. 3d DCA 1978).
a voice in the disposition of the underlying property, but were the masters of their own destinies.

The Third District held that the trust arrangement did not involve securities in view of the substance of the transaction. The court relied heavily upon the affidavit of a law professor who had analyzed the transaction under both state and federal precedent. The affiant had noted that, “the intention of the parties was to purchase certain real estate, and the fact that they did so by taking title in the name of trustees instead of taking title in the names of all the purchasers was to simplify the purchase and the subsequent sale thereof.” Although the court did not cite SEC v. Royal Hawaiian Management Corp. as its authority, the Third District in effect adopted the Royal Hawaiian rule.

Wiener should be contrasted with the earlier decision of the Third District in Levine v. I.R.E. Properties, Inc. In Levine, a purchaser of an apartment complex was induced by the seller to enter into a contract whereby the seller would manage the property subsequent to the sale. The service agreement was cancellable upon thirty days notice by the purchaser. The seller persuaded the trial court that the termination provision vested such control in the purchaser that he could not be held to have relied solely on the efforts of the seller. The Third District reversed, holding that the cancellation provision was not conclusive as to the economic realities which underlay the transaction.

A conclusion which may tentatively be drawn from a comparison of Wiener and Levine is that it is the degree of control rather than the exclusivity of control which is the essence of the economic reality test. Under the literal language of Howey, profits were in fact to be generated solely by the promoters’ efforts in both Wiener and Levine. The purchasers in both cases were not perceived as active participants in resale or maintenance of the respective properties. The crucial distinction between the cases is that Wiener involved an arrangement whereby investors were in a position to monitor each important decision made by the promoter. The investors in Wiener could overrule a particular decision of the promoter yet continue to enjoy his services, whereas the investors in Levine could only act to cancel the management contract. Apparently, it is not a sufficient indicium of control that investors may remove management, but rather that investors must be in a position to reject the

100. Id. at 1305.
102. 344 So. 2d 938 (Fla. 3d DCA 1977).
management decisions of the promoter while still retaining the promoter's services.

b. Promissory Notes

The status of promissory notes as securities has been determined by a test similar to the economic realities test. The United States Court of Appeal for the Fifth Circuit has consistently held that the status of promissory notes as securities depends upon whether or not the notes were issued for commercial or investment purposes. In a series of cases, the court has advanced a set of criteria which act to distinguish commercial notes from investments. These criteria demonstrate that the investment-commercial test is actually an inquiry into the economic reality of the transaction rather than a mechanistic application of formal definitions.

In State v. Fried, the District Court of Appeal, Third District, upheld the dismissal of a criminal indictment handed down for both antifraud violations and failure to register two promissory notes, on the grounds that the notes were not securities under the statutory definition. The notes had been issued by a corporation which secured the obligation with a mortgage on real property. No facts concerning the circumstances underlying the issuance of the notes were stated in the opinion of the Third District. Rather, both the trial court and the Third District examined the resale of the note and concluded that the resale arose out of a commercial loan because the defendant's sale was an isolated transaction.

Although the language of the opinion is couched in the economic realities test of United Housing Foundation, Inc. v. Forman, the realities of the underlying transaction were largely ignored. The court clearly attempted to determine whether the note


104. 357 So. 2d 211 (Fla. 3d DCA 1978).

was a security at the level of secondary distribution without regard to the context surrounding the issuance of the note. The fact that the sale by the note holder was isolated was of controlling significance.

The investment-commercial test, however, should not be determined by reference to secondary distributions. An investment note should not be deemed to acquire the attributes of a commercial note merely because it finds its way into the hands of an individual who has never previously held commercial paper. Although that individual's resale of the note may qualify for exemption under the isolated sale exemption, the note continues to be a security, and the individual will be liable for antifraud violations if he makes material misstatements to the purchaser of the note. The fact that a sale of notes by an issuer is an isolated occurrence may bear on the question of whether a note is a security, but the isolated nature of sales by holders of the note are only relevant in regard to the applicability of a particular exemption from registration for the resale of the security. The confusion of these two concepts in Fried has been criticized by a member of the Department of Banking and Finance.

B. Registration Procedures

The Florida Securities Act retains section 517.07 of the Florida Statutes in much the same form as it existed under the Sale of Securities Law. Thus, the familiar principle that all securities must be registered before they are offered and sold unless they are exempt securities or are offered in an exempt transaction is still the governing principle. It is the procedures for registration which have been changed.

Under prior law, there were three available registration procedures: registration by announcement, coordination, and qualification. Registration by announcement applied only to secondary dis-

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106. See Fla. Stat. § 517.061(3) (Supp. 1978), discussed in section III(D)(2) infra.
107. The antifraud provisions of the blue sky law apply to all transactions regardless of whether the securities being sold are exempt from registration.
108. See 1 BLUE SKY L. REF. (CCH) ¶ 13,691.
109. Fla. Stat. § 517.07 (Supp. 1978). It should be noted that a similar principle exists under federal law. Thus, in all offerings in which the facilities of interstate commerce are employed, securities must be registered prior to offer or sale unless a federal exemption applies. Failure to register with the federal authorities will not be excused by virtue of the fact that an exemption from registration exists under state law. Conversely, registration under state law is not excused merely because a federal exemption applies to a sale. An issuer can be criminally convicted and is liable for civil penalties even for an innocent failure to register securities which he has sold. See State v. Houghtaling, 181 So. 2d 636 (Fla. 1966).
tributions of the securities of large successful public firms by persons other than issuers, underwriters or controlling persons.\textsuperscript{110} Registration by coordination was only provided for the initial offerings of such firms.\textsuperscript{111} Neither procedure is available under the Florida Securities Act. Not only are the procedures rarely used, but sections of the Florida Securities Act provide exemptions from registration for almost all the offerings to which these procedures would have applied.\textsuperscript{112}

The sole remaining registration procedure is registration by qualification.\textsuperscript{113} New section 517.081 of the Florida Statutes (Supp. 1978), adopts almost verbatim the former section covering this procedure. Section 517.081(7) provides that the Department of Banking and Finance shall only record the registration of those securities when the sale would be fair, just and equitable, would not be fraudulent and when the enterprise of the issuer is based upon sound business principles. Thus, the full panoply of merit regulation is carried forward to all those offerings which must be registered in Florida. Yet, the great expansion of the scope of the registration exemptions will enable most sales of securities to escape the perils of merit regulation.

C. Exempt Securities

"Exempt securities" are statutorily defined classes of securities which are exempt from registration regardless of the form of the transaction in which they are offered and sold.\textsuperscript{114} Many classes of exempt securities under prior law are retained intact by the Florida Securities Act.\textsuperscript{115} Others, however, have been dramatically changed.

\begin{itemize}
  \item 111. Id. § 517.08.
  \item 112. Registration by announcement was not very helpful since secondary distributions through brokers were practically constrained by SEC rule 144, 17 C.F.R. § 230.144 (1978). The rules promulgated under the new isolated sale exemption, \textit{Fla. Stat.} § 517.061(3) (Supp. 1978), provide that transactions which satisfy the requirements of rule 144 will be lawful in Florida. See rule 3 E-5.02(A)(ii), 1 \textit{Blue Sky L. Rep.} ¶ 13,642. Similarly, no one will mourn the absence of the coordination procedures because new \textit{Fla. Stat.} § 517.061(19) (Supp. 1978) exempts from registration all of those securities which in the past would have been subject to the coordination procedures. See text accompanying notes 246-249 infra.
  \item 113. Because only one procedure exists now, \textit{Fla. Stat.} § 517.081 (Supp. 1978) is simply captioned "Registration Procedure."
  \item 114. Although such securities are exempt from the registration provisions of the Florida Securities Act, offerors or sellers of such securities are still liable for violations of the antifraud provisions which they commit in connection with offers or sales of exempt securities. Additionally, offerors or sellers must either register such securities with federal authorities prior to an offer or sale, or couple the Florida exemption with the federal exemption when interstate commerce facilities are employed.
  \item 115. The exemptions for domestic government securities have not been materially al-
SECURITIES ACT OF 1978

1. EXCHANGE LISTED SECURITIES

Two of the categories of exempt securities under prior law were comprised of exchange listed securities. Repealed section 517.05(6) of the Florida Statutes (1977) classified securities listed on the exchange of any city with more than one million inhabitants, the New York Stock Exchange, the American Stock Exchange, and the Chicago Board of Trade, as exempt as long as all classes of the securities of the issuer remained listed. A separate exemption was provided for securities listed on any other "recognized and responsible" exchange which had been approved by the Department of Banking and Finance.

If applied to initial offerings, the exemption could be abused by unscrupulous issuers. By distributing their stock on unregulated local exchanges, the issuers would avoid both disclosure requirements and regulatory scrutiny. Unlike privately placed securities, which traditionally have been deemed beyond regulation due to the nonpublic nature of the offering, and unlike the securities of heavily regulated industries, which have been scrutinized by other government officials, listed securities were neither philosophically outside the regulatory field nor already subject to extensive regulation. Under the Florida Securities Act, issuers, underwriters and controlling persons must register such securities unless another exemption from registration applies.

Secondary trading in securities listed on an exchange registered under the Securities Exchange Act of 1934 is an exempt transaction under the Florida Securities Act in certain circumstances. First, the transaction must be made by or on behalf of persons other than an issuer, underwriter, controlling person or dealer selling part

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116. The Department of Banking and Financing had been authorized to deny the exemption to securities of a particular issuer by publishing an order to that effect. Id. § 517.05(b) (1977) (repealed 1978). The effectiveness of this restraint, however, was limited since the Department rarely could detect intended frauds prior to the initial offering. Thus, this weapon was aimed principally at secondary trading. Unscrupulous issuers could usually obtain the full benefit of the exemption.

117. Id. § 517.05(7).

118. See id. § 517.061(18)(b) (Supp. 1978).
of an unsold allotment. 119 Second, securities and rights to the securities of the issuer must be listed on such an exchange. Third, the Department must not have published an order denying the exemption for the security involved. 120

2. BANKING INSTITUTIONS

The new exemption for securities issued by banking institutions was expected to greatly expand a similar exemption provided by the Sale of Securities Law. 121 Repealed section 517.05(8) of the Florida Statutes (1977) exempted only those securities which represented an interest in or a direct obligation of state banks, trust companies, savings institutions, and building or savings and loan associations organized in and subject to the examination, supervision and control of the State of Florida. There was no exemption provided for initial equity subscriptions issued by such institutions. 122

Although no statutory exemption for initial equity subscriptions existed, a rule promulgated by the Department of Banking and Finance has effectively extended the exemption to such securities. 123 These securities were to be deemed exempt under section 517.05(8) when the organizing directors filed notice prior to sales. The required information in the notice included such substantive disclosures as: (1) biographical descriptions of the directors; (2) the proposed capital structure; and (3) the intended use of the proceeds. Additionally, the Division of Securities was empowered to exact on an ad hoc basis such information as it might deem necessary.

An exemption for the initial equity subscription of domestic and foreign banks, trust companies, savings institutions, and building or savings and loan associations is specifically provided in new section 517.051(5). 124 The sole requirement of the exemption is the

119. Id.
120. See text accompanying notes 257-270 infra.
121. The exemption for banking institutions, other than national banking institutions, which existed under the Sale of Securities Law provided exemption for any security issued by and representing an interest in or a direct obligation of any state bank, trust company, or savings institution incorporated under the laws of and subject to the examination, supervision, and control of this state; or issued by any building and loan association of this state under like supervision.
122. COMMERCE COMM. REPORT ON FLA. H.B. No. 2118, at 4 (May 9, 1978) [hereinafter cited as "REPORT"].
123. See Rule 3E-20.22, 1 BLUE SKY L. REP. (CCH) ¶ 13,689B.
124. Id.
filing of proper notice prior to sales as specified by the rules of the Department. The elements of proper notice under the new section include the same substantive disclosures as those previously re-
quired. 125

In the process of expanding the exemption of initial equity sub-
scriptions, however, the exemption of securities issued by building
or savings and loan associations was limited by the division of sec-
tion 517.051(5) into two parts. The first part relates to all securities
other than initial equity subscriptions; the second covers initial
equity subscriptions only. The subsection was structured in this
manner so that a notice requirement could be placed upon the ex-
emption of initial equity subscriptions without limiting the excep-
tion of other types of securities. The difficulty is that building or
savings and loan associations are listed among the issuers whose
securities are exempt only in the second part. Thus, it would appear
that only the initial equity subscriptions of building or savings and
loan associations are exempt under section 517.051(5) of the Florida
Statutes (Supp. 1978).

No apparent policy supports this construction of the exemp-
tion. There has been no suggestion that the operations of building
or savings and loan associations are different from those of other
banking and savings institutions. Nor can it have been the intention
of the legislature to provide an exemption for the riskiest of securi-
ties (promotional stock) of such issuers and deny exemption to all
other securities of such issuers. A reform of new section 517.051(5)
would be desirable.

The manner in which new section 517.051(5) was drafted also
calls into question the extent of the exemption. The statute appears
to extend the exemption to all domestic and foreign banks subject
to Florida authority regardless of their place of incorporation. Thus,
the phrase, “any domestic or foreign bank,” 127 was substituted for
“any state bank . . . incorporated under the laws of . . . this
state.” 128 It is clear that securities issued by international banking

125. Any security issued by and representing an interest in or a direct obliga-
tion of any domestic or foreign bank, trust company, or savings institution subject
to the examination, supervision, and control of this state; or the initial subscrip-
tion for equity securities in such bank, trust company, savings institution, or
building or savings and loan association of this state under like supervision;
except that the foregoing subscription exemption shall not be available unless and
until proper notice is filed as required by the rules of the department.

126. See Rule 3E-20.22.1 BLUE SKY L. REP. (CCH) ¶ 13,684B.
128. Id. § 517.05(8) (1977) (repealed 1978).
agencies which have been authorized to maintain facilities in Florida since January 1, 1978, are exempt under the new statute.\textsuperscript{129} The status of securities issued by banks organized in other states, however, has not been changed by the Florida Securities Act.

The purported exemption of securities issued by any domestic bank is a trap for the unwary. Section 517.051(5) conditions the applicability of this exemption to banks which are subject to the examination, supervision and control of the State of Florida. Banking corporations operating facilities in other states, however, are prohibited from conducting a general banking business in Florida.\textsuperscript{130} Such banks may only undertake certain activities in this state which are incidental to the business of banking and which are not peculiar to banking corporations.\textsuperscript{131} Because these banks are not permitted to do a general business in Florida, they are not regulated in their capacity as banking corporations by the Department.\textsuperscript{132} The securities of domestic banks located in other states are, therefore, not exempt. Prior to the last legislative session, international banking agencies located in other states were permitted to maintain offices in Florida. Such agencies may now operate either in Florida or in another state.\textsuperscript{133} Thus, foreign banks will enjoy no greater exemption for sales of securities than do domestic banks.

3. RELIGIOUS AND ELEEMOSYNARY CORPORATIONS

Traditionally, the securities laws have provided competitive advantages in capital markets to charitable and religious organizations. In recent years, however, the Division of Securities became


\textsuperscript{130} See [1959-60] Fla. ATT'Y GEN. BIENNIAL REP. 456.

\textsuperscript{131} "Foreign banks," including all banks located in other states, may do the following: (1) contract with a lender to acquire a portion of the interest or the security; (2) enter mortgage servicing contracts with persons authorized to transact business in this state; (3) exercise the rights of a mortgagee with regard to property held by the bank as security. Fla. STAT. § 659.57 (1977).

\textsuperscript{132} The statutory provisions for the examination, supervision and control are contained in Fla. STAT. §§ 658.05-11 (1977). The operant terms in the Banking Code governing the class of banking corporations subject to regulatory scrutiny by Florida authorities are "bank," "state bank," and "commercial bank," id. § 658.02(1), (2), (3), none of which refer to domestic banks located in other states. See [1959-60] Fla. ATT'Y GEN. BIENNIAL REP. 456.

alarmed that these issuers were using the exemption as a means of defrauding the public.

For instance, the case of In re Skekinah Cloister Christian Church, Inc. illustrates the type of fraudulent practices common under the exemption. There, Reverend Walker obtained over $700,000 through the sale of securities on behalf of the Beaches Chapel Christian Church. The offering circular did not mention prior outstanding debts against Walker, nor the fact that his ordination had been revoked. Furthermore, the addition in the circular was incorrect and profit figures were misrepresented, as were the figures for the church’s weekly attendance and the valuation of recently acquired property. The net result was to give the church a positive net worth and cash flow when the opposite was true.

As a result of these and other abuses the Comptroller was able to find that Walker had failed to perfect his claim to an exemption, and a cease and desist order issued. The fact that it took this kind of gross abuse to take the case out of the statutory exemption indicates why the exemption has been greatly contracted by the Florida Securities Act.

Under prior law, the securities of religious or charitable corporations were exempt during both the initial offering and secondary trading as long as the issuer provided the offerees with written reports concerning the feasibility of the project and the method of financing. No further attention to the registration provisions of the blue sky laws was required by the issuer or the shareholders trading their stock.

The amendment of this exemption in the Florida Securities Act changes a class of exempt securities into a class of exempt transactions. New section 517.051(8) of the Florida Statutes (Supp. 1978) only provides exempt status to securities issued by religious or charitable corporations when all offers or sales are made exclusively by an offering circular containing full and fair disclosure, as prescribed by rules of the Department of Banking and Finance. Since each

134. 1 BLUE SKY L. REP. (CCH) ¶ 71,405 (Order of the Florida Comptroller).
135. Id. at 68,313.
136. Id. at 68,314.
137. The exemption from registration under the Sale of Securities Law extended to any security issued by a corporation organized exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes and not for pecuniary profit, and no part of the net earnings of which inures to the benefit of any private stockholder or individual, and provided that each offeree receives a written report as to the feasibility of the project and the full disclosure of the method of financing.

FLA. STAT. § 517.05(5) (1977) (repealed 1978).
person must communicate offers only through an offering circular, persons other than the issuer must prepare disclosure documents before secondary trading in such securities occurs. Because ordinary shareholders usually will not be in a position to obtain all the information in a form necessary to prepare a document containing full and fair disclosure, this exemption probably will be successfully utilized only by issuers and controlling persons.

Under the new rules promulgated by the Department there are different requirements for offerings exceeding $250,000. The disclosure requirements for offerings involving less than $250,000 are extremely limited. They do, however, appear to be more extensive than the disclosure requirements which existed under the Sale of Securities Law.138 The requirements for offerings exceeding $250,000 are both numerous and vague.139

The manner in which sales by persons other than issuers will be integrated is unclear. Thus, whether any particular offering involves less than $250,000 raises a perplexing problem. The only integration standards which have been officially adopted under the new blue sky law pertain to exempt transactions under section 517.061(11)(d) of the Florida Statutes (Supp. 1978).140 Until standards applicable to the offerings of the securities of eleemosynary corporations are adopted, the only relief available to persons intending to offer such securities is to petition the Department for a declaratory statement.141

D. Exempt Transactions

The most remarkable feature of the Florida Securities Act is the improvement of the provisions for exempt transactions.142 Through both the legislative amendment and administrative rulemaking processes Florida authorities have greatly developed the law of exempt transactions during the survey period.

138. Compare id. (written feasibility report and disclosure of the method of financing) with Rule 3E-4.01, BLUE SKY L. REP. (CCH) ¶ 13,631.

139. Rule 3E-4.01 provides extremely truncated descriptions of the categories of information required. It has been observed by others that the reason for such brief descriptions was that the Division of Securities was seeking to avoid the formalistic practice of securities disclosure prevalent in connection with the federal requirements. These rules, however, may force practitioners to rely upon previously approved documents more than is necessary under the federal guidelines.

140. Rule 3E-5.01, BLUE SKY L. REP. (CCH) ¶ 13,641.

141. FLA. STAT. § 120.565 (1977).

142. "Exempt transactions" are statutorily defined circumstances under which securities are exempt from registration due to the form of the transaction in which they are being offered or sold.
The disarmingly simple character of the blue sky law revisions is exemplified by the recently adopted integration rule. The rule states that no exempt transaction will be integrated with any other exempt transaction except as specified in the new private placement exemption. Attorneys unfamiliar with the vague integration standards may be led to disregard the impact of integration unless they are representing an issuer in a private placement. For example, a tax attorney may counsel a corporate employer to fund a pension plan with the stock of the corporation without considering the effect of such sales on the subsequent ability of the corporation to raise capital through a private placement. Since the rules prescribe that private placements will only be integrated with sales occurring during the 365-day period ending on the date of the last sale of privately placed stock, the attorney should have considered privately placing the stock before funding the pension plan.

1. PRIVATE PLACEMENTS

The exemption most commonly relied upon by issuers, under both state and federal law, is the private placement exemption. The confusion generated by the Florida exemption was a source of

143. "Integration" is a principle by which two separate transactions are considered as one. Under the Sale of Securities Law, most exempt transactions which occurred within 12 months of a post-organization private placement have been automatically integrated. FLA. STAT. § 517.06(11) (1977) (repealed 1978). The Florida Securities Act appeared to perpetuate this system, id. § 517.051(11)(d) (Supp. 1978), but relief has been provided through the interplay of the Department's rules. See Rule 3E-5.01, 1 BLUE SKY L. REP. (CCH) ¶ 13,641; Rule 3E-5.04, 1 BLUE SKY L. REP. (CCH) ¶ 13,644.

144. Rule 3E-5.01, 1 BLUE SKY L. REP. (CCH) ¶ 13,641.

145. See Rule 3E-5.04, 1 BLUE SKY L. REP. (CCH) ¶ 13,644.

146. Practitioners should also consider the impact of federal integration rules and safe harbors when advising an issuer of securities. For example, if the facilities of interstate commerce were used by the employer funding the pension plan with its stock, those securities must be registered with the SEC unless exempt under federal law. Should the issuer rely upon either rule 146 or rule 147, the permissible timing of other offerings will differ from an offering made under the Florida integration rules. Both rules 146 and 147 provide safe harbors from integration for all offerings made more than six months prior to the first sale and six months after the last sale of any offering undertaken pursuant to the rule. Thus, if an issuer relies upon the Florida private placement exemption and rule 146 or 147, he would generally enjoy a safe harbor from integration only for sales which occurred before the 365-day period prior to the last sale in the private placement and after the six-month period following the last sale in the private placement. See text accompanying notes 160-167 infra.

147. Under federal law, an exemption from the registration provision of § 5 of the Securities Act of 1933 provides: "The provisions of § 5 shall not apply to . . . (2) transactions by an issuer not involving any public offering." 15 U.S.C. § 77d (1976). The reason for such an exemption from registration is that the federal securities laws were only intended to compel full disclosure when issuers entered public capital markets, but not when issuers sold to a small number of investors. See H.R. REP. No. 152, 73d Cong., 1st Sess. 25 (1976).
much dissatisfaction to issuers and their attorneys. The history of the reform of this blue sky exemption closely parallels its federal analogue, section 4(2) of the Securities Act of 1933. In both cases, a vague statute was enacted, subjected to differing administrative interpretations at various times, and examined by a commissioned study which recommended reform. The confusion surrounding the Florida exemption which necessitated this reform stemmed from three basic flaws.

First, the Florida private placement exemption was not in harmony with the federal exemption. Under the Sale of Securities Law, the private placement exemption was divided into one exemption for pre-organization subscriptions and another for offerings by organized firms. Taken together, these two exemptions permitted sales to twenty-five persons while the firm was in the promotional stage and sales to twenty persons in any twelve-month period after the firm was organized. If sales in the pre-organization period occurred within twelve months of the post-organization offering, the earlier sales were counted toward the twenty-person limitation on the subsequent offering. By contrast, the SEC's rule 146 permitted thirty-five sales within any twelve-month period. This disparity was troublesome because issuers relying upon both the state and

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148. 15 U.S.C. § 77d(4) (1976). For many years practitioners struggled with the vague language of § 4(2) of the Securities Act of 1933, which referred to "any public offering." Rather than simply employ a standard based upon the numbers of investors, the courts have subjected the language of the exemption to elaborate constructions in order to promote their perception of the policies underlying the Securities Act of 1933. For example, the Supreme Court of the United States has held that the number of investors solicited is not the sole criterion, but that the exemption will only apply when the particular investors are "able to fend for themselves." SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953). In the meantime, the SEC was busy issuing releases and no-action letters which raised more questions than they answered. See 2 S. GOLDBERG, PRIVATE PLACEMENTS AND RESTRICTED SECURITIES §§ 2.2a, 2.3b, 2.3e, 2.4b, 2.4d(1), 2.5d(1), 3.6b(1), 2.8a & 2.9a (1978).

To solve these problems, a study of this and other exemptions was commissioned. A product of this study was the famous Wheat Report. The Wheat Report proposed a rule which was further amended and eventually adopted by the SEC as rule 146. See 17 C.F.R. § 230.146 (1978).

149. Fla. Stat. §§ 517.06(10), (11) (1977) (repealed 1978). As originally enacted, however, the Sale of Securities Law provided a private placement exemption solely for "[s]ubscriptions for the shares of the capital stock of a corporation prior to the incorporation thereof under the laws of this State, when no expense is incurred, or no commission, compensation or remuneration is paid for or in connection with the sale or disposition of such securities." 1931 Fla. Laws ch. 14899, § 5. Thus, the exemption was only extended to Florida corporations in their promotional stage. Two years later a post-incorporation exemption was provided for Florida corporations. See 1935 Fla. Laws ch. 17253, § 5. It was not until 1959 that the private placement exemption was extended to sales of partnership and trust interests. See 1959 Fla. Laws ch. 59-170, § 1.

150. See Robinton & Sowards, supra note 6, at 533.

151. 17 C.F.R. § 230.146(b)(1), (g) (1978).
federal private placement rules could sell only to the lesser number of persons.

Second, the Florida exemption made it extremely difficult for practitioners to determine the number of sales which could lawfully be made absent registration. The problem existed for two reasons. The first of these was the manner in which the term "sale" was defined in the Sale of Securities Law. Since all offers to sell were included within the definition of sale, the blue sky law prohibited, at least through the *in terrorem* effect of the definition, unregistered sales of securities if verbal or written offers had been made to more than twenty-five subscribers or to more than twenty offerees of the securities of an organized firm. This was a serious problem because an offering usually would be spoiled if the first few persons who rejected an offer were counted toward the limitation of twenty or twenty-five persons. The uncertainty under the Sale of Securities Law with respect to the identity of persons deemed subscribers or purchasers also made it difficult to determine the number of sales allowable. For example, the status of promoters as subscribers was unclear. Thus, if five businessmen participated equally in the formation of a corporation, only twenty other subscribers could be enlisted in order to avoid a possible violation of the law. The federal exemption contained provisions better defining the identity of purchasers. Under rule 146, persons making bona fide purchases of more than $150,000 need not be counted toward the limitation of thirty-five purchasers. Furthermore, when a purchaser caused relatives living in his household to hold some of the privately placed securities in their names, only the principal purchaser was to be counted.

A third problem with both private placement exemptions of the Sale of Securities Law was the absolute ban on compensation and commissions to anyone other than registered Florida securities dealers. As a practical matter, in most private placements accountants or other service professionals intervened between issuers and investors. Rule 146 permitted such "offeree representatives" to receive commissions from the issuer as long as all such remuneration was

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152. Practitioners have frequently commented that Florida authorities have sometimes told them that the limitation applied to offers and at other times said that only ultimate sales were regulated.


156. Id. § 230.146(g)(2)(i)(a)-(c).
disclosed to the offeree prior to a sale. The blue sky ban on such compensation, however, either acted to reduce the number of private placements or encouraged violations of the registration provisions.

These three major problems inherent in the private placement exemptions of the Sale of Securities Law have been solved by the Florida Securities Act and the regulations promulgated thereunder. The practitioner should be cautioned, however, that the applicability of the exemption hinges upon strict compliance with all of the requirements of the new exemption. A discussion of these requirements follows.

a. Thirty-five Purchasers

New section 517.061(11) of the Florida Statutes (Supp. 1978) exempts sales to thirty-five or fewer purchasers in a consecutive twelve-month period. Thus, the number of offers which may be made is unlimited; only ultimate sales are limited to thirty-five purchasers. The statute also defines “offer” and “sale” separately. The term “sale,” but not the term “offer,” is included within the private placement exemption. Thus, the Florida blue sky law now permits sales to as many as thirty-five purchasers, without regard to the number of offers made by the issuer. In addition, the new blue sky exemption has eliminated the distinction between pre-organization and post-organization offerings. As a result of these

157. Id. § 230.146(a)(1)(iv).
158. The Florida Securities Act provides: “Offer to sell,” “offer for sale,” or “offer” means any attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.” FLA. STAT. § 517.021(10) (Supp. 1978).
159. The Florida Securities Act provides: “Sale” or “sell” means any contract of sale or disposition of a security or interest in a security, for value. The term defined in this subsection shall not include preliminary negotiations or agreements between an issuer or any person on whose behalf an offering is to be made and any underwriter or among underwriters who are or are to be in privity of contract with an issuer. Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing shall be conclusively presumed to constitute a part of the subject of such purchase and to have been offered and sold for value. The issue or transfer of a right or privilege, when originally issued or transferred with a security, giving the holder of such security the right to convert such security into another security of the same issuer or of another person or giving a right to subscribe to another security of the same issuer or of another person, which right cannot be exercised until some future date, shall not be deemed to be an offer or sale of such other security; but the issue or transfer of such other security upon the exercise of such right of conversion or subscription shall be deemed a sale of such other security.

Id. § 517.021(12).
changes the Florida exemption now closely parallels its federal counterpart.

For the first time the status of parties as purchasers has been defined. The statute explicitly excludes from the computation the number of purchasers making a bona fide investment of $100,000 or more. Furthermore, according to a rule of the Department of Banking and Finance, promoters are no longer to be counted in reaching the limitation of thirty-five purchasers. Pursuant to this rule, general partners in a limited partnership will not be counted regardless of the interests they receive in the partnership. Also excluded from the computation are certain relatives, related business organizations, and related trusts and estates. Thus, offerings to more than thirty-five persons may qualify as private placements provided only thirty-five persons who are deemed purchasers are involved.

The new private placement exemption adopts a twelve-month period for integration with other exempt transactions. During a consecutive twelve-month period, therefore, sales of securities in most other exempt transactions will be eligible for integration into the limitation of thirty-five purchasers for the private placement exemption. Rules promulgated during the survey period establish standards regarding the integration of sales and offers. Rule 3E-5.04 provides that only sales made during the 365-day period ending on the date on which the last sale in the private placement is made will be subject to integration. Exempt transactions other than private placements which are made at least a day after a private placement will not be integrated with the private placement offering. Furthermore, only those offers and sales made within the relevant 365-day period will be integrated if they collectively are a single offering. Thus, the new private placement exemption involves both more certainty and flexibility than did prior law.

160. Id. § 517.061(11)(b).
161. Rule 3E-5.04(2)(d), 1 BLUE SKY L. REP. (CCH) ¶ 13,644. The term “promoter” is not defined in this rule. It is, however, broadly defined in rule 3E-2.02, 1 BLUE SKY L. REP. (CCH) ¶ 13,612, for the purpose of determining who is an “issuer.” Whether this definition of promoter will apply to rule 3E-5.04 is as yet undetermined.
162. Another important change in the rules governing the computation of purchasers is that a corporation or other business association which was not formed specifically for the purpose of acquiring the securities of the issuer will be counted as one purchaser. See rule 3E-5.04(3), 1 BLUE SKY L. REP. (CCH) ¶ 13,614.
163. Exempt sales by an issuer to a bank or other qualified institutional investor, FLA. STAT. § 517.061(7) (Supp. 1978), will not be integrated with sales in a private placement. Id. § 517.061(11)(d) (Supp. 1978).
164. Rule 3E-5.04, 1 BLUE SKY L. REP. (CCH) ¶ 13,644.
165. Rule 3E-5.01, 1 BLUE SKY L. REP. (CCH) ¶ 13,641.
Since issuers frequently will rely on section 517.061(11) in conjunction with rule 146 or rule 147, attention should be given to the differing provisions for safe harbors from integration in the state and federal rules. Under rules 146 and 147 a danger zone exists within six months prior to the first offer or sale made pursuant to the rule and within six months after the last offer or sale.\footnote{166. 17 C.F.R. §§ 230.146(b)(1), .147(b)(2) (1978).} Other offers or sales made within the danger zone will be integrated if they are part of the same offering as the offers and sales made pursuant to the rule. Thus, the federal integration standards will be applied to all offers and sales made six months before and after the offering, and Florida's integration standards will be applied to offers and sales made twelve months before the last sale in the offering.

b. 

\textit{Commissions}

The new exemption perpetuates the requirement that no commissions or compensation be paid in connection with a private placement to anyone other than a registered Florida securities dealer.\footnote{167. FLA. STAT. § 517.061(11)(a)(3) (Supp. 1978).} A degree of relief from this requirement, however, has been provided by a rule of the Department of Banking and Finance. Pursuant to rule 3E-5.06 fees paid by issuers to attorneys, accountants or evaluators of securities are not deemed compensation for purposes of the statutory prohibition, if the amount of such fees and whether they are contingent on pay scale is disclosed to the offeree prior to the sale.\footnote{168. Rule 3E-5.06(C), 1 BLUE SKY L. REP. (CCH) ¶ 13,646.} Furthermore, compensation may be paid regardless of whether disclosure of such payment has been made if sales are made outside the State of Florida.\footnote{169. Rule 3E-5.06(A), 1 BLUE SKY L. REP. (CCH) ¶ 13,646.} Persons receiving such commission, however, should determine whether they are subject to registration as brokers or dealers under local law.

Further reform of this requirement is desirable if Florida citizens are to experience the benefits of an optimum level of private placements in Florida. In order for issuers to fully utilize this exemption they must be able to provide incentives to those persons in close contact with sophisticated investors. As a result of restricting access to these individuals by effectively limiting issuers to communication through dealers, part of the available market for venture capital will be cut off. This situation can be remedied and investors can be protected by allowing commissions to be paid to anyone, provided that such payment is disclosed to the purchaser.
c. Disclosure

Under the Sale of Securities Law, the pre-organization exemption did not impose any disclosure requirement, but the post-organization exemption required the delivery of information concerning "the true financial condition of the issuer, its business operations, and the use of the proceeds of the sale." The Florida Securities Act, however, provides that offering circulars containing full and fair disclosure must be furnished to all offerees if securities are to be sold to more than five persons.

The rules for computing the number of persons, for purposes of the disclosure requirements, are the same as the rules for the computation of the persons deemed purchasers. Thus, where sales are made to ten promoters, no offering circular need be provided by the issuer because securities will be deemed to have been sold to five or less persons for purposes of the statute.

The exemption provides that when less than five persons receive securities no disclosure is necessary. Prudent issuers and their attorneys, however, may often choose to provide disclosure in offerings to five or less investors. First, disclosure material should be provided because the antifraud provisions of the blue sky laws apply to the offering even though it is an exempt transaction. Although section 517.07 of the Florida Statutes (Supp. 1978) may be satisfied without disclosure, the issuer and counsel aiding and abetting him are exposed to the same penalties as those for violating section 517.07 for violations of the antifraud provisions through nondisclosure of material information.

173. The great expansion of federal antifraud liability has forced an entire class of exempt issuers dealing in the municipal bond market to provide increasingly expanded disclosure. See generally, Casey & Smith, A New Look at Municipal Bonds—Disclosure Responsibilities in the Municipal Bond Market, 50 St. John's L. Rev. 639 (1976). Florida law has kept pace with, if not exceeded, the development of federal antifraud liability. It is likely, therefore, that the securities bar in Florida will encourage their clients to make disclosures which are not required under the offering circular rules but which may be needed to avoid antifraud liability. On rare occasions no disclosure may be necessary pursuant to the antifraud provisions where there is a sale to blood relatives. See Brown v. Rairigh, 363 So. 2d 590, 593-94 (Fla. 4th DCA 1978).
174. Fla. Stat. § 517.211 (Supp. 1978). Beside aider and abettor liability, counsel for the issuer may be liable as a principal if its representation of the issuer was disclosed. See Black & Co. v. Nova-Tech, Inc., 33 F. Supp. 468, 472 (D. Or. 1971). Although Nova-Tech has been severely criticized, the rationale of that case will present difficulties for attorneys if it is adopted by Florida courts. Counsel for the issuer would be placed in a precarious position due to the overlap between the Nova-Tech rule and rule 3E-5.06, 1 Blue Sky L. Rep. (CCH) ¶ 13,646. Rule 5.06(C) provides that attorneys who advise purchasers must disclose any...
Second, the disclosure may still be required regardless of the Florida exemption if the facilities of interstate commerce are used in connection with the offering. When an issuer seeks to avoid registration at both the federal and state levels and relies upon the federal private placement exemption in conjunction with the Florida exemption, delivery of offering circulars will generally be required.\(^7\) When the issuer relies upon the intrastate exemption or rule 147, only the disclosure requirements of the federal antifraud provisions will be imposed.\(^7\)

In light of the overlapping disclosure requirements of the state and federal securities laws, it is common practice to determine the most demanding of all standards relevant to a particular offering and to comply with all of them in a single document. For example, in an offering of less than $500,000, an issuer should distribute an offering circular which meets the requirements of rule 146 to the six or more Florida resident purchasers, assuming there are also nonresident purchasers, subject to the few modifications in that document required by Florida law.\(^7\) In that way maximum protection from antifraud liability under Florida law is provided at the least cost.

Where the issuer sells securities to more than five persons, it must furnish all offerees with an offering circular containing full and fair disclosure pursuant to section 517.061(11)(a)(1) of the Florida Statutes (Supp. 1978). The new rules provide for a two-tiered system of disclosure. According to the rules, only limited information must be furnished if the offering involves $500,000 or less.\(^7\) Disclosure compensation they have received from the issuer and whether the fees were contingent upon sales. For example, the law firm of \(X & Y\) represents issuer \(A\) in its private placement of securities. The law firm agrees to perform its services to \(A\) for compensation based on the number of subscriptions which \(A\) receives. \(B\), one of \(X\)'s clients, is a high-income investor who asks \(X\) if he knows of any sound investments. Because \(X\) had great confidence in \(A\)'s abilities, he responds that \(A\)'s offering seems to be rather attractive. Under these facts \(X\) should disclose to \(B\) his fee arrangements with \(A\). This disclosure should be documented and memorialized in the offering circular. See Carney, \textit{The Perils of Rule 146}, 8 U. Tol. L. Rev. 343, 351 (1977). When the name of the firm is placed on the offering circular, however, the partners would be exposed to liability as principals if the Nova-Tech doctrine applied.

\(^{175}\) Under the § 4(2) exemption of the Securities Act of 1933, courts will generally require the actual delivery of disclosure information to the offeree. See Lawler v. Gilliam, 569 F.2d 1283 (4th Cir. 1978). Under rule 146, delivery of disclosure information is necessary unless the offeree possesses either an economic bargaining position or a family relationship that provides him with access to all information which would be disclosed in a registration statement. 17 C.F.R. § 230.146(e) (1978).

\(^{176}\) Rule 3E-505(B), 1 \textit{Blue Sky L. Rep.} (CCH) ¶ 13,645.

\(^{177}\) The issuer only would be required to add to the rule 146 offering circular a clear statement that the sale may be voided at the election of the purchaser within three days of the making of a purchase and to provide a copy of the escrow agreement. \textit{Fla. Stat.} § 517.061(11)(c), (e) (Supp. 1978).

\(^{178}\) Disclosures.
sure of most items found on Schedule A of the Securities Act of 1933 is required if the offering involves more than $500,000. To determine whether an offering involves more than $500,000, both the offering price and any recourse indebtedness assumed by the purchasers should be included in the computation.

Issuers relying on the small offering disclosure rules should consider the costs of litigation attendant to the use of an abbreviated document. Private parties suing the issuer may argue that courts should not view this two-tiered system as satisfying the conditions of the private placement exemption because the Department of Banking and Finance failed to implement the full disclosure standard allowed by the statute. Such an argument suffers from several infirmities. First, the argument assumes that the marginal benefits of increased disclosure outweigh the social costs of decreased economic activity within the State of Florida. Second, the argument ignores the clear delegation to the Department of rulemaking authority over disclosure standards. Since the Department has fashioned its standards in accordance with the overall regulatory philosophy of the Florida Securities Act, and it acts to promote a healthy business environment, those standards should withstand attacks made on the basis that higher levels of "investor protection" would have been achieved by more costly and demanding disclosure standards. It was the Florida Legislature that favored an expanding economy over the marginal social benefits of increased regula-

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180. Rule 3E-5.05(E), 1 Blue Sky L. Rep. (CCH) ¶ 13,645. The rule specifically states that nonrecourse indebtedness assumed by the purchasers will not be computed in determining the size of the offering. Id.


182. See text accompanying notes 32-33 supra. If the costs of extensive disclosures were imposed upon all offerings regardless of their size, many of the smaller offerings would not be feasible. For the same reason, the SEC has established a higher standard of disclosure under rule 146 for offerings exceeding $1.5 million and a lesser standard for smaller offerings. SEC Release No. 33-5975, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,708 (Sept. 8, 1978).


184. See text accompanying notes 51-54 supra. In order to create a healthy business environment it was necessary to remove the restrictive burdens on the access of promotional firms to sources of capital. See Casey, supra note 23, at 572-73. To adopt the nearly uniform disclosure requirements which rule 146 had previously imposed would have provided large firms with competitive advantages. Should Schedule A disclosures be required of all firms, the larger firms would be the only ones able to place securities privately. "Reporting companies ordinarily can afford the costs of full registration. The economic burden of rule 146 disclosure thus falls most heavily on smaller issues. Newly formed companies will have the highest proportional burden . . . ." Kessler, Private Placement Rules 146 and 240—Safe Harbor?, 44 Fordham L. Rev. 37, 54 (1975).
tion in these situations. That the benefits of such regulation would be slight is attested to by the fact that the disclosures required by Schedule A are generally not information deemed significant by sophisticated investors in private placements.\textsuperscript{185}

d. Voidability of Sales

An exemption provides that all sales of privately placed securities are voidable by the purchaser within three days of the making of a purchase.\textsuperscript{186} The power to void the sale must be clearly communicated to offerees in offering circulars. It appears that this information must also be communicated in disclosure documents which are gratuitously provided by the issuer as well as in those offering circulars required by section 517.061(11)(a)(1) of the Florida Statutes (Supp. 1978).

e. Escrow Agreements

The private placement exemption does not apply to a transaction in which an "offering seeks to or does receive subscription from more than five persons,"\textsuperscript{187} unless the issuer complies with the statutory requirements for the escrowing of invested funds. Although the term "subscriptions" is not defined in the Florida Securities Act, it, as well as the entire escrow requirement, was borrowed from the preorganization exemption of the Sale of Securities Law where its meaning was clear.\textsuperscript{188} Whether an offering seeks to attract more than five subscribers is problematic. It is not entirely clear whether the intent of the promoters, a document purporting to be a plan of offering or the minutes of organizing directors' meetings should be the controlling evidence as to what was sought by an offering.

If an offering involves more than five subscribers, the issuer or its agents must establish a bona fide escrow account with a bank, a trust company or an attorney.\textsuperscript{189} The agreement must state the price of the securities, the total number of securities which will be issued, the minimum funds necessary to satisfy the terms of the offering and the day on which the same will be concluded.\textsuperscript{190} A copy of this

\textsuperscript{185} "The kind of information that experienced investors demand and get in a private placement is quite different than that normally found in a prospectus." Casey, \textit{supra} note 23, at 576.

\textsuperscript{186} FLA. STAT. § 517.061(11)(e) (Supp. 1978).

\textsuperscript{187} Id. § 517.061(11)(c) (emphasis added).

\textsuperscript{188} FLA. STAT. § 517.06(10) (1977) (repealed 1978).

\textsuperscript{189} Id. § 517.061(11)(c) (Supp. 1978).

\textsuperscript{190} The agreement must not provide that the offering may remain open for more than six months. Id.
agreement must be delivered to each subscriber before his funds are accepted in order for the transaction to be deemed a private placement. If the escrow agent collects at least the minimum funds stated in the agreement, the agent must pay those funds to the organized firm. Otherwise, the funds must be returned to the investors.

The escrow requirement is a vestige of the Sale of Securities Law and burdens issuers without providing substantial corresponding benefits to investors. The requirement is annoying to an issuer contemplating sales to five or fewer persons who actually sells to a greater number. In such cases, the issuer might not have established an account or may have refrained from distributing copies of the escrow agreement to offerees. When the decision to sell to more than five persons is made, the issuer then becomes responsible to return all of the funds previously invested and begin the offering process anew. Further criticism of the escrow requirement is based upon its imposition of an arbitrary six-month limitation on offerings. For these reasons the escrow requirement should have been eliminated in the Florida Securities Act.

f. Advertising

The private placement exemption only extends to transactions which involve no advertising or public solicitation. Thus, neither an issuer nor any person acting on the issuer's behalf may publish any article, notice or other communication in printed media or broadcast advertisement of an offering over radio or television. If such advertising is accomplished in another state where it is lawful, the exempt status of the offering will not be affected.

g. Legended Certificates

Issuers must imprint the documents evidencing securities with a "restrictive legend" indicating that the security has not been registered under the Florida Securities Act. "Restrictive legend" is not a defined term in the Florida Securities Act. The restrictive legend device, however, has been utilized in connection with the federal private placement exemption for many years. The purpose

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191. See Brown, supra note 179, at 3.17.
193. Rule 3E-5.07(B), 1 Blue Sky L. Rep. (CCH) ¶ 13,647. Pictures are a form of advertisement according to the rules of the Department of Banking and Finance. Rule 3E-2.01, 1 Blue Sky L. Rep. (CCH) ¶ 13,611.
194. See Rule 3E-5.07, 1 Blue Sky L. Rep. (CCH) ¶ 13,647.
of the legend is to ensure that a private placement of securities will actually remain a nonpublic offering.\textsuperscript{196} The restrictive legend now required in Florida private placements is similar to those which have commonly been used in securities practice under the federal law.\textsuperscript{197} A respected commentator, however, has argued that the legend need only contain a statement that the securities have not been registered under the Florida Securities Act.\textsuperscript{198}

h. Improvements on Rule 146

Section 517.061(11) of the Florida Statutes (Supp. 1978) was created after securities practitioners had gained practical experience with rule 146. Although the Florida exemption parallels the SEC rule in many important respects, the section deviates from the rule in a significant fashion.

Both exemptions limit the number of ultimate purchasers in a private placement to thirty-five. Both provide similar definitional exemptions from the term "purchaser" so that when more than thirty-five persons can participate in private placement under one law, the other law probably will allow almost the same amount of flexibility.\textsuperscript{199} A common problem with these numerical limitations lies in the vague integration standards now common to the blue sky and federal rules.\textsuperscript{200} To unravel the mystery of integration, counsel will be forced to request interpretive letters from the SEC and to petition the Division of Securities for a declaratory statement.

Another problem is that both rule 146 and the blue sky exemption permit the payment of compensation to offeree representatives or evaluators, but neither the SEC nor the Department adequately

\textsuperscript{196} See 2 S. GOLDBERG, supra note 148, at 2-96.

\textsuperscript{197} A form of the legend which has been recommended for use in the offering of federal private placements is as follows:

\begin{quote}
THE SECURITIES REPRESENTED BY THIS CERTIFICATE HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933. THESE SECURITIES MAY NOT BE OFFERED, SOLD, TRANSFERRED, PLEDGED OR HYPOTHECATED IN THE ABSENCE OF REGISTRATION, OR THE AVAILABILITY OF AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT OF 1933. FURTHERMORE, NO OFFER, SALE, TRANSFER, PLEDGE OR HYPOTHECATION IS TO TAKE PLACE WITHOUT THE PRIOR WRITTEN APPROVAL OF COUNSEL OF THE ISSUER BEING AFFIXED TO THIS CERTIFICATE.
\end{quote}

\textsuperscript{198} Brown, supra note 179, at 3.17.

\textsuperscript{199} Compare 17 C.F.R. § 230.146(g)(2) (1978) \textit{with} rule 3E-5.04, 1 BLUE SKY L. REP. (CCH) ¶ 13,644.

\textsuperscript{200} 17 C.F.R. § 230.146 (preliminary Note 3) (1978); rule 3E-5.01, 1 BLUE SKY L. REP. (CCH) ¶ 13,641.
protects those persons from inadvertently becoming broker-dealers or investment advisers.201 The SEC raised the problem in such a vague manner that persons who assist the offeree cannot be certain whether they will be deemed investment advisers or broker-dealers. The business environment in Florida would be greatly improved by the adoption of a statute or rule which protected these evaluators from the requirement of a registration as a professional in the securities industry.

The most dramatic area in which the two standards for private placements differ lies in the disclosure requirements. Under rule 146, issuers must deliver offering circulars to all offerees unless the offerees have "access to the kinds of information a prospectus would have provided." Problems exist for the issuer under rule 146 whether he relies on access or delivery to satisfy the disclosure requirement.

While the elements of access are uncertain, it is commonly believed that the courts and the SEC will not find "access" unless there is a special relationship between the issuer and the investors or the investors have close ties to the officers of a firm.203 The access exception to the offering circular requirement of rule 146 is thus a trap for the unwary. Furthermore, there are significant legal expenses associated with supplying access, so little is gained by relying on the access provisions.204

A problem exists with delivery of disclosure information under rule 146 as to the type and extent of disclosure required. The rule

201. The suggestion is made by the SEC that: "Persons acting as offeree representatives should consider the applicability of the registration and anti-fraud provisions relating to brokers and dealers under the Securities Exchange Act of 1934 and relating to investment advisers under the Investment Advisers Act of 1940." 17 C.F.R. § 230.146(a)(1) (Note 1) (1978). One commentator has attempted to alert offeree representatives to the fact that Florida's registration requirements may apply as well. Brown, supra note 179, at 3.15.

202. 17 C.F.R. § 230.146(e) (1978). Access is defined as follows: "Access can only exist by reason of the offeree's position with respect to the issuer. Position means an employment or family relationship or economic bargaining power that enables the offeree to obtain information from the issuer in order to evaluate the merits and risks of the prospective investment." Id. § 203.146(e) (Note). The courts have come to overlay the judicial construction of § 4(2) of the Securities Act of 1933 with both an access and delivery requirement. See, e.g., Lawler v. Gilliam, 569 F.2d 1283 (4th Cir. 1978).

203. See SEC Release No. 33-5487, 1 FED. SEC. L. REP. (CCH) ¶ 2710 (Apr. 23, 1974). At one point in time the SEC espoused the view that access existed only where the offerees' relationship to the issuer approximated that of an insider's. See SEC v. Continental Tobacco Co., 463 F.2d 1283 (5th Cir. 1972).

204. In a recent article a commentator has indicated that the legal expenses associated with supplying offerees with access to relevant information involved at least $10,000 to $20,000. See Campbell, supra note 27, at 1146. He concluded that "[t]he cost of supplying access may well be prohibitive." Id.
provides that an offeree must be furnished with a document containing all the information which would have been included in a registration statement unless the issuer is a reporting company under the Securities Exchange Act of 1934. Much of that information, however, is generally considered worthless by sophisticated investors. Yet a failure to disclose complete information on any particular item provides an excuse for investors to rescind the transaction.

The Florida exemption alleviates these problems. First, the type of access implicitly involved in the Florida Securities Act is based upon the notion of reasonable access. Second, the regulatory scheme permits issuers to provide those disclosures which are desired by the investors without burdening them with excess costs, unless there are more than six purchasers investing more than $500,000. In the latter situation the offering circular requirements resemble those of Schedule A of the Securities Act of 1933. If the Department and the courts do not demand the same precision in full disclosure as under the federal standard then "the sword of recission-by-technicality from man-to-man dealings between small groups" will have been lifted from the necks of issuers seeking private investors.

The Florida exemption improves rule 146 since there is no suitability requirement for offerees. They need be neither sophisticated nor financially able to bear the risk of the investment. Most of the voluminous criticism of SEC rule 146 has centered upon the problems created by its suitability requirements.


206. "The registration process was not designed to provide the kind of information needed to evaluate new ventures and unseasoned businesses. . . . The kind of information that experienced investors demand and get in a private placement is quite different than that normally found in a prospectus." Casey, supra note 23, at 576.

207. For an analytical comparison of the standards determining whether violations of the registration or antifraud provisions have occurred, see Note, The Defective Private Offering: A Comparison of Purchasers’ Remedies, 62 IOWA L. REV. 236 (1976).

208. See, e.g., Brown v. Rairigh, 363 So. 2d 690, 593-94 (Fla. 4th DCA 1978).

209. "[O]nly a summary of the Schedule A items was used in an attempt to provide a less intricately structured system of formal disclosure." Brown, supra note 179, at 3.11. By changing the formal system of disclosure, however, the Division has deprived attorneys of the measure of certainty which had come to surround the formulation of disclosures under Schedule A. The Division should thus not insist upon anything more than a competent attempt at compliance.


211. See, e.g., Carney, supra note 174, at 352-77, passim; Hevman, Is SEC Rule 146
2. ISOLATED SALES

The new private placement exemption restricts the secondary trading of the securities sold.\textsuperscript{212} An opinion of counsel in the form of a restrictive legend stating that the proposed transfer will not violate the Florida Securities Act may be a prerequisite to such a transaction.\textsuperscript{213} Unless the securities are registered by the issuer at the time of resale, counsel must find an applicable secondary trading exemption in order safely to aid his client. The Florida Securities Act, however, provides few such exemptions. The securities of most small unlisted companies must be sold pursuant to the isolated sale exemption unless they are registered.\textsuperscript{214} This exemption must have a broad sweep in order for the private placement mechanism to be effectively employed.\textsuperscript{215}

Under both prior and current law, isolated sales of the securities of a seller not the issuer or the underwriter thereof are exempt if the sale is not made pursuant to a scheme to violate chapter 517 of the Florida Statutes.\textsuperscript{216} There had been little judicial interpretation of the isolated sale exemption under the Sale of Securities Law.\textsuperscript{217} The

\begin{footnotesize}
\begin{enumerate}
  \item See text accompanying notes 195-198 supra. "Restricted \textsuperscript{1}securities\textsuperscript{2}\textsuperscript{3}\textsuperscript{4}" are securities upon which restrictions on transferability have been imposed. Securities which are privately placed under the Florida Securities Act constitute one variety of restricted securities. Thus, the documents evidencing such securities must be imprinted with a restrictive legend pursuant to Fla. Stat. \textsection 517.061(11)(f) (Supp. 1978).
  \item See note 197 supra.
  \item The Florida Securities Act provides several exemptions for secondary trading in securities. First, securities listed on major exchanges or securities of firms registered under \textsection 12(g) of the Securities Exchange Act of 1934, 15 U.S.C. \textsection 78l(g) (1976), are exempt if sold at the market price through a registered Florida dealer. Fla. Stat. \textsection 517.061(18) (Supp. 1978). This exemption, however, is limited to sales by other than controlling persons. Second, an exemption is provided for resales of securities issued in connection with certain transactions in property. Id. \textsection 517.061(2). The scope of this exemption is extremely narrow. See text accompanying notes 271-279 infra. Third, a resale of securities not exempted under the first two exemptions may be sold absent registration only if they are sold pursuant to the isolated sale exemption. Id. \textsection 517.061(3).
  \item When the resale provisions are too burdensome, as are the conditions of SEC rule 144, the private placement mechanism will be viewed as unattractive due to the increased pressure for control from investors. See Casey, supra note 23, at 577.
  \item Fla. Stat. \textsection 517.063(3) (1977) (current version at id. \textsection 517.061(3) (Supp. 1978)).
  \item There was no opinion which carefully described the requirements of the exemption. See [1957-58] Fla. ATT'Y GEN. BURENIAL REP. 77,78 [hereinafter cited as ATTORNEY GEN. OP.]. Out of the three cases interpreting the exemption, two concern the elements of a sale by an "issuer or underwriter," Brown v. Rairigh, 363 So. 2d 590, 592 n.2 (Fla. 4th DCA 1978); Dokken v. Minnesota-Ohio Oil Corp., 232 So. 2d 200, 203-04 (Fla. 2d DCA 1970), and the third analyzes whether a particular transaction was conducted for the benefit of an issuer. Cain v. Solomon, 213 So. 2d 35, 38 (Fla. 3d DCA 1968).
\end{enumerate}
\end{footnotesize}
Attorney General attempted to fill the void by borrowing from the case law of states with a similar exemption. A dichotomy was thus established between isolated and repeated sales. Successive, recurring or repeated sales were dispositions pursuant to a single plan, while isolated sales were considered haphazard events prompted by unrelated circumstances:

The act explicitly permits an owner to make more than a single sale of his stock, and he may safely dispose of it piecemeal on occasion, for profit, from convenience or other legitimate motive. But where the sales by an unregistered owner, though detached and separate, recur within such reasonable time as to indicate an association of acts under one general purpose, such sales are not ‘isolated’ . . . .

The Attorney General noted that the length of time between sales would be a significant factor in many cases, but he also stated that such variables as the value of the securities and the number of shares sold were of equal importance. Thus, there was no clear method for bringing sales within the exemption.

Confusion also existed as to the class of persons who could rely upon the exemption. The exemption specifically denied protection to issuers and underwriters. Problems arose because the meaning of those terms was unclear. The term “issuer” included all promoters of the issuer but no definition of “promoter” was provided in the Sale of Securities Law or the regulations thereunder.221


220. Id. at 77-78.

221. Fla. Stat. § 517.02(5) (1977) (current version at id. § 517.021(a) (Supp. 1978)). The range of possible definitions was large. One construction might have been the definition chosen by the SEC:

The term “promoter” includes:

(1) Any person who, acting alone or in conjunction with one or more other persons, directly or indirectly takes initiative in founding and organizing the business or enterprise of an issuer;

(2) Any person who, in connection with the founding and organizing of the business or enterprise of an issuer, directly or indirectly receives in consideration of services or property, or both services and property, 10 percent or more of any class of securities of the issuer or 10 percent or more of the proceeds from the sale of any class of securities. However, a person who receives such securities or proceeds either solely as underwriting commissions or solely in consideration of property shall not be deemed a promoter within the meaning of this paragraph if such person does not otherwise take part in founding and organizing the enterprise.

SEC rule 405(q), 17 C.F.R. § 230.405(q) (1978). According to this definition, an attorney who
During the survey period the Department of Banking and Finance has promulgated regulations which explain the operation of the isolated sales exemption. These rules define the class of persons who will be permitted to use the exemption and the characteristics of transactions which will be deemed isolated sales. Through the definition of major terms, the rules harmonize with the legislative overhaul of this exemption.

Section 517.021(16) of the Florida Statutes (Supp. 1978) provides a new definition of “underwriter.” Persons who will not be permitted to rely on the isolated sales exemption are those who: (1) purchase from an issuer or an affiliate of the issuer with a view to distribution; (2) sell or offer to sell securities on behalf of an issuer or an affiliate; and (3) participate directly or indirectly in any such undertaking. The statute, however, specifically provides that a

had received 11% of the stock for his services in the organization of a firm might be deemed a promoter even though he became a passive investor in later years.

222. Fla. Stat. § 517.021(16) (Supp. 1978). The term issuer continues to mean “any person who proposed to issue, has issued, or shall hereafter issue any security . . . [and] any person who acts as a promoter.” Id. § 517.021(9). The term promoter is defined, for the first time in the Florida blue sky laws, as:

(a) Any person who, acting along or in conjunction with one or more other persons, directly or indirectly initiates the founding or organizing of the business or enterprise of an issuer; or

(b) Any person who, in connection with the founding and organizing of the business or enterprise of an issuer, directly or indirectly receives in consideration of services, or a combination of services and property, ten percent (10%) or more of any class of securities of the issuer or ten percent (10%) or more of the proceeds from the sale of any class of securities of the issuer; provided that any person who receives securities or proceeds from the sale of securities either solely as underwriting commissions or solely in consideration of property shall not be deemed a promoter if such person does not otherwise take part in founding and organizing the enterprise of the issuer.

Rule 3E-2.02, 1 Blue Sky L. Rep. (CCH) ¶ 13,612. Under the new regulatory scheme, therefore, the persons who will be deemed issuers are those actual or would-be issuers of securities and those persons who have within one year participated in organizing the enterprise. Persons selling securities on behalf of such persons are underwriters and may not rely upon the isolated sale exemption. Rule 3E-5.02, 1 Blue Sky L. Rep. (CCH) ¶ 13,642.

Underwriters may also be those persons who deal with affiliates of the issuer. “Affiliates” include those persons who “directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with [an issuer].” Fla. Stat. § 517.021(1) (Supp. 1978). Control is defined in the following manner: “‘Control,’ including the terms ‘controlling,’ ‘controlled by,’ and ‘under common control with,’ means the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract, or otherwise.” Id. § 517.021(5). Thus, underwriters are the persons who purchase, sell, or otherwise participate in a distribution by or for a person: (1) who can direct the management of the issue; (2) whose management is directed by the issuer; or (3) whose management is subject to the direction of a person who is also able to direct the management of the issuer. If one purchases securities from these persons, he will not be permitted to resell through reliance upon the isolated sale exemption unless rule 3E-5.02, 1 Blue Sky L. Rep. (CCH) ¶ 13,642, applies.
person who has beneficially owned stock for one year will not be deemed an underwriter.\textsuperscript{223} Tacking of holding periods will be permitted where the holder acquired his security upon conversion when he has paid no additional consideration for the security. Furthermore, dealers will not be deemed underwriters of securities other than part of an unsold allotment to or subscription by the dealer acting as a participant in a distribution.

New rule 3E-5.02\textsuperscript{224} provides a nonexclusive definition of isolated sales made by or on behalf of persons other than issuers or underwriters. A transaction will be deemed an isolated sale within section 517.061(3) of the Florida Statutes (Supp. 1978) if it satisfies the requirements of either SEC rule 144 or 237 as those rules were in effect on November 1, 1978. Furthermore, transactions by nonissuers which conform to the criteria elaborated in the private placement exemption provided in sections 517.061(11)(a) and (b) of the Florida Statutes will be considered isolated sales.

SEC rule 144 implements the exemption from registration for certain secondary transactions provided by section 4(1) of the Securities Act of 1933.\textsuperscript{225} The rule defines the circumstances under which a person will not be deemed an underwriter of securities and thus able to sell without registration. Conditions are imposed upon: (1) the amount of securities which may be sold; (2) the manner of sale; (3) the availability of current public information concerning the issuer; and (4) the holding period of the seller of the securities.\textsuperscript{226} Once every three months, and subject to certain qualifications, sales may be made of the greater of one percent of the total outstanding class of securities or the average weekly trading volume of that class of the issuer’s securities for the four weeks preceding the sale. A detailed analysis of rule 144 is beyond the scope of this article and has been adequately presented elsewhere.\textsuperscript{227}

\textsuperscript{223} FLA. STAT. § 517.021(16) (Supp. 1978). Furthermore, the rules clearly state that promoters and affiliates of the issuer will not be deemed underwriters of securities which they have beneficially owned for at least one year. Rule 3E-5.02(B), 1 BLUE SKY L. REP. (CCH) ¶ 13,842.
\textsuperscript{224} 1 BLUE SKY L. REP. (CCH) ¶ 13,842.
An important question of interpretation arises as to whether the SEC's administrative gloss on rule 144 will control the interpretation of rule 3E-5.02. An analysis of the purpose and function of such pronouncements leads to the conclusion that sellers relying on rule 3E-5.02, disgruntled purchasers and the Department should not be bound by SEC no-action letters. No-action letters and other interpretative rulings are not binding on the SEC since they are not considered formal acts of the Commission. Ordinarily, they may not be reviewed by a court absent interested parties other than the party seeking the administrative ruling. Thus, commentators have criticized many of these releases as exercises of bureaucratic trial ballooning.

An alternative exists to the wholesale incorporation of the informal opinions of the SEC into the isolated sales exemption via rule 3E-5.02. Rule 3E-5.02 should be interpreted to adopt rule 144 as promulgated through the formal rulemaking procedures as of November 1, 1978. The scope and application of rule 3E-5.02 can then

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228. The staff of the Division of Corporation Finance of the SEC has informally interpreted the provisions of rule 144 in both no-action letters and other interpretative releases. For a recent discussion of some of these pronouncements, see Barron, Control and Restricted Securities, 6 SEC. REG. L.J. 261 (1978).

229. The Chief Counsel of the Division of Corporation Finance of the SEC stated:

The Division acts in an advisory capacity to the Commission, and recommendations of the Division may or may not be accepted by the Commission. A "no-action" letter merely represents the recommendation the Division would make to the Commission on the basis of the facts presented; it is not a formal administrative act of the Commission.


be defined by the Department through the administrative procedures of Florida law. These procedures are preferable to the no-action process because petitioners for declaratory statements have an absolute right to a reply.\(^{232}\) Furthermore, such statements are deemed final orders of the agency and are thus subject to judicial review.\(^{233}\) Florida's administrative procedures provide a framework which requires a careful construction of the parameters of the exemption.

A seller can rely on the isolated sale exemption if he satisfies the requirements of sections 517.061(11)(a) and (b) of the Florida Statutes (Supp. 1978).\(^{234}\) The seller, therefore, will be required to furnish an offering circular containing full and fair disclosure if he sells to more than five persons in any consecutive twelve-month period.\(^{235}\) Because of this requirement, it is assumed that sellers will generally limit their sales to five or fewer persons. The seller or those acting in his behalf must refrain from public solicitation and advertising and must not pay a commission or other remuneration to anyone other than a registered Florida securities dealer.

Some confusion may arise as to whether the rules promulgated under the private placement exemption apply regardless of the fact that the seller is not an issuer of the securities.\(^{236}\) The rules relating to integration of purchasers, offering circular requirements and advertising are not by their terms limited in application to the acts of issuers.\(^{237}\) Because the Department fashioned those rules at the same time as the rule implementing the isolated sale exemption, an integrated approach to the rules is appropriate. The rule regarding compensation, however, specifically applies to sales by issuers.\(^{238}\) Because sellers may wish to avail themselves of attorneys' and accountants' services this rule should be amended, or another promulgated, so as to include within the exemption sellers other than issuers.

\(^{232}\) FLA. STAT. § 120.565 (1977). The SEC, however, cannot be compelled to respond to a request for a no-action letter. See Kixmiller v. SEC, 492 F.2d 641 (D.C. Cir. 1974).


\(^{234}\) Rule 3E-5.02(A)(i), 1 BLUE SKY L. REP. (CCH) ¶ 13,642. The provisions of the private placement exemption, FLA. STAT. § 517.061(11) (Supp. 1978), have been discussed in detail above. See text accompanying notes 147 - 211 supra.


\(^{236}\) Issuers cannot rely on the isolated sale exemption. Id. § 517.061(3); Brown v. Rai-righ, 363 So. 2d 590, n. 1 (Fla. 4th DCA 1978).

\(^{237}\) Rule 3E-5.01, .04, .05 & .07, 1 BLUE SKY L. REP. (CCH) ¶¶ 13,641, 13, 644-45, 13,647.

\(^{238}\) Rule 3E-5.06, 1 BLUE SKY L. REP. (CCH) ¶ 13,646.
3. THE DEALER’S EXEMPTION FOR ISOLATED SALES

Sales by dealers who effected sale of stock for secondary traders relying upon rule 144 are exempted from registration by section 4(4) of the Securities Act of 1933 as implemented by rule 144(g). 239 According to rule 144(g), brokers who neither solicit on behalf of the customer nor receive more than the customary broker’s commission need not register the securities they sell as agents pursuant to rule 144. The Sale of Securities Law contained a provision which somewhat resembled section 4(4). 240 This exemption was criticized because its application to isolated sales was uncertain. 241 When this exemption was carried verbatim into the Florida Securities Act, a commentator called for a clarifying rule that would provide an exemption for dealers in keeping with the new rules for isolated sales. 242

Rule 3E-5.08 243 accomplishes most of the objectives sought by the Bar. The rule establishes that all sales in transactions conforming to rule 144 as it existed on November 1, 1978 will be deemed an unsolicited purchase or sale of securities on order of and as agent for another pursuant to section 517.061(13) of the Florida Statutes (Supp. 1978). This rule reaffirms the position taken in rule 3E-5.02 that promoters or affiliates of an issuer, or participants in a distribution for the issuer, will not be deemed underwriters with respect to those securities which they have beneficially owned for at least one year. 244

4. FEDERALLY REGISTERED OFFERINGS

The Florida Securities Act provides an exemption from registration in Florida for the sale of securities pursuant to a registration statement which has become effective under the Securities Act of 1933. 245 Under the Sale of Securities Law, registration had been required for offerings by issuers or other sellers of securities even if the securities were registered under federal law. 246 Now, issuers, dealers and other sellers of securities can entirely avoid merit scru-
tiny of the securities by registering their offering with the SEC. Reliance upon this exemption is conditioned upon four factors. First, the seller must execute and deliver to the Department of Banking and Finance a notice of intention to sell which contains the names and addresses of the seller and issuer and the title of the securities. Second, a copy of the initial registration statement and the prospectus filed with the SEC must be sent to the Department. The Department also requires amendments arising through SEC staff comments to be filed with the Division of Securities. Third, a nonreturnable filing fee of one percent of the aggregate sales price of not less than $25 nor more than $750 and an irrevocable consent to service must accompany the prospectus. Fourth, all other information which the Department may require by rule must be provided by the seller.

This new exemption furthers the major legislative policies underlying the Florida Securities Act. Costs to issuers, underwriters and investors will be reduced by removing wasteful and duplicative regulatory burdens. Thus, more capital will be available for investment in the production of useful products. Furthermore, the exemption will greatly contract the scope of merit regulation.

According to a literal interpretation of the statute, only sales, and not offers, are exempt. This problem arises because the earliest time at which sales of securities are permitted under the Securities Act of 1933 is when the registration statement becomes effective. Hence, the phrase "sales pursuant to an effective registration statement" is a term of art under the federal securities laws. The new exemption under the Florida Securities Act will lose its usefulness, however, if offers and sales are not exempt even after notice is filed with the Department. The courts, therefore, should interpret this provision in a manner consistent with the legislative purpose underlying the exemption.

Even so, the scope of the new exemption is too narrow. Although section 517.061(19) of the Florida Statutes (Supp. 1978) will provide relief in the case of large offerings, the welfare of smaller issuers has not been improved. Because the fixed costs of registered offerings under the Securities Act of 1933 have disproportionately adverse effects on small offerings, large firms gained an unfair competitive advantage over small firms with the enactment of the Florida Securities Acts. This disparity can be remedied under state law.

247. Id. § 517.061(19) (Supp. 1978).
248. Id. §§ 517.061(19)(c), 101; Rule 3E-5.09, 1 BLUE SKY L. REP. (CCH) ¶ 13,649.
249. See text accompanying notes 14-28 supra.
as it has been remedied in the federal system.

Regulation A of the SEC has established streamlined procedures for small offerings without sacrificing the important elements of disclosure. If an offering involves $1.5 million or less the issuer may file a Form 1-A with a Regional Office of the SEC. Although the issuer must amend his original form in accordance with the staff's comments and must wait until the Commission, in effect, makes the Regulation A filing effective by determining that the small offering exemption is applicable, the process is generally believed to be quicker and less expensive than the ordinary registration process. Because the financial statement required in a Form 1-A need not be certified, large savings in accountants' fees are realized. Similarly, costs are reduced because both the filings with the Regional Offices and the offering circulars distributed to purchasers may be typewritten rather than printed. The fact that small issuers depend upon Regulation A should be considered by the Florida Legislature.

If section 517.061(19) of the Florida Statutes (Supp. 1978) is expanded to exempt Regulation A offerings from registration in Florida, the gross disparity between the treatment of large and small issuers would be corrected. The public would benefit from such a legislative amendment because they would receive almost as much disclosure but at reduced cost. Nor would Florida be the first to extend an exemption for registered securities to Regulation A offerings. Rather, it would be joining most of the other states which presently provide exemptions for federally registered securities. Because of the blue sky exemption, issuers in those states have considered Regulation A to be a meaningful alternative to registration.

250. Regulation A is a series of rules promulgated by the SEC, 17 C.F.R. §§ 230.251-263 (1978), which implement the exemption provided by § 3(b) of the Securities Act of 1933. 15 U.S.C. § 77c(b) (1976). This exemption is the only one which is not self-determinable by an offeror and which requires prior notice to and the acquiescence of the SEC. Glavin & Purcell, Securities Offerings and Regulation A—Requirements and Risks, 13 BUS. LAW, 303, 304 (1958).


254. Id. at 51, 58.


256. Cole, supra note 252, at 36. The major obstacle to the use of Regulation A in the
5. SALES BY DEALERS AT THE MARKET PRICE

Under the Sale of Securities Law there existed a transactional exemption for two types of sales by registered dealers selling as principals or agents at or near the market price.\(^{257}\) First, dealers selling the securities of a reporting company under section 12(g) of the Securities Exchange Act of 1934\(^{258}\) were exempt as long as the issuer was current in meeting its reporting requirements. Second, the exemption extended to sales of securities of a firm whose financial statements had recently been published in reports by either Moody's Investors Service, Inc. or Standard and Poor's Corp.\(^{259}\) These exemptions were not applicable to sales by issuers, controlling persons or dealers disposing of all or part of their unsold allotment as underwriters.

Section 517.05(6) of the Florida Statutes (1977) provided that securities listed on any exchange in a large city were exempt securities. This exemption applied to sales by issuers, underwriters and controlling persons. Because certain local exchanges did not require registration or disclosure of any kind, it was possible for issuers to publicly offer their securities for sale on an intrastate basis. These sales could be made without registration under federal or Florida law, because the distribution was made through a securities exchange.

The Florida Securities Act modifies the exemption for exchange listed securities and the exemption for securities described in published financial reports in section 517.061(18)(a) of the Florida Statutes (Supp. 1978). Section 517.06(18)(a)(2) provides that sales of securities issued by companies listed on national exchanges will be exempt if all senior securities, evidences of indebtedness and subscription rights issued by the firm are also listed.\(^{260}\) In other words, sales of securities of companies registered pursuant to section 12(a) of the Securities Exchange Act of 1934 are exempt if all of the issuer's securities are listed. Because the exemption does not apply to sales for the direct or indirect benefit of issuers and controlling

\(^{257}\) FLA. STAT. § 517.06(16) (1977) (repealed 1978).
\(^{259}\) Rule 3E-20.21, 1 BLUE SKY L. REP. (CCH) ¶ 13,689(A).
\(^{260}\) The following national exchanges are registered with the Securities and Exchange Commission: American Stock Exchange; Boston Stock Exchange; Chicago Board of Trade; Cincinnati Stock Exchange; Detroit Stock Exchange; Midwest Stock Exchange (Chicago); National Stock Exchange (New York); New York Stock Exchange; Pacific Stock Exchange; Philadelphia Stock Exchange; Pittsburgh Stock Exchange; Salt Lake Stock Exchange; and Spokane Stock Exchange. See 1 BLUE SKY L. REP. (CCH) 861.
persons, there now exists only a secondary trading exemption. Furthermore, since the securities of firms listed on a national exchange must be registered under the Securities Act of 1934, the potential for abuse has been eliminated.

Section 517.061(18)(c) provides the Department of Banking and Finance with authority to deny the exemption with reference to any particular security by order published in a manner deemed proper by the Department. This portion of the statute may be constitutionally infirm in several respects. First, the grant of absolute power to deny the exemption with regard to any particular security may constitute an unconstitutional grant of legislative authority to an agency. This conclusion is supported by the fact that the statute does not provide any criteria to guide the agency in its exercise of the power. Thus, the grant is potentially one of unbridled discretion.

The Supreme Court of Florida has repeatedly held that the legislature must incorporate guidelines into every statutory grant of administrative authority. In *Lewis v. Bank of Pasco County*, the authority of the Department to release bank records to public media was stricken as unconstitutional because there were "no restrictions, limitations, or guidelines provided in the statute to limit or regulate the action of the department in granting [or] withholding consent to the news media inspecting, copying and publishing any information in a bank's records." Because section 517.061(18)(c) provides no guidelines which the Department should apply in ruling on the exemption, the Department would be acting within the grant no matter what its reason for denial. Such a grant seems too broad. The power to terminate effectively the secondary market

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261. See, e.g., Florida Home Builders Ass'n v. Division of Labor, 367 So. 2d 219 (Fla. 1979); Harrington & Co. v. Tampa Port Auth., 358 So. 2d 168 (Fla. 1978); High Ridge Mgt. Corp. v. State, 354 So. 2d 377 (Fla. 1977).

262. 346 So. 2d 53 (Fla. 1977), discussed in Baena & Romanchuck, supra note 129, at 774-75.

263. 346 So. 2d at 55. The court went on to state:

The legal principal guiding the Circuit Judge in this case and which is dispositive of the issue under consideration is so well known as to be deemed "hornbook" law. This Court had held in a long and unvaried line of cases that statutes granting power to administrative agencies must clearly announce adequate standards to guide the agencies in the execution of the powers delegated. The statute must so clearly define the power delegated that the administrative agency is precluded from acting through whim, showing favoritism, or exercising unbridled discretion.

Id. at 55-56 (citations omitted).

264. For a comparison of a valid and an invalid delegation in statutes regulating the same subject matter, see Flesch v. Metropolitan Dade County, 240 So. 2d 504 (Fla. 3d DCA 1970).
in an issuer's securities should not be granted without limitation. The Florida Legislature should amend this statute and impose standards and limitations upon the agency.

Supporters of the legislation might argue that the avowed purpose of the legislation, whether it be to prevent fraud or to protect orderly markets, should be sufficient to overcome a constitutional challenge. In the words of the supreme court, however: "No matter how laudable a piece of legislation may be in the minds of its sponsors, objective guidelines and standards should appear expressly in the act or be within the realm of reasonable inference from the language of the act where a delegation of power is involved." The nondelegation doctrine acts to protect a constitutional right and, therefore, cannot be set aside on the strength of policy considerations.

A second potential constitutional infirmity inherent in section 517.061(18)(c) is its failure to require a type of notice reasonably calculated to ensure an opportunity to be heard. Publication of an order in a manner deemed proper by the Department may not always satisfy that standard. For example, suppose that the Department publishes an order in the Florida Administrative Weekly denying an exemption previously extended to the securities of X Corporation. Whether or not the publication in the Florida Administrative Weekly would constitute proper notice to shareholders as potential secondary traders, such notice would not be proper as against

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265. No suggestion is made that the Department is predisposed to wield § 517.061(18)(c) as a weapon to coerce certain behavior from issuers. Still, the legislature should act within its constitutional constraints.


267. Administrative agencies must act in a manner which comports with procedural due process. See, e.g., State Road Dep't v. Cone Bros. Contracting Co., 207 So. 2d 489, 491 (Fla. 1st DCA 1968); Florida Beach Orchards, Inc. v. State, 190 So. 2d 796, 798 (Fla. 1st DCA 1966). Thus, the notice of an order by an agency must guarantee an adequate opportunity for a hearing prior to action upon the order by the agency. See Wilson v. Pest Control Comm., 199 So. 2d 77 (Fla. 4th DCA 1967).

268. The type of periodical in which notice is published must be one which a shareholder and potential secondary trader might read, although it need not be a trade publication. See Culclasure v. Consolidated Bond & Mfg. Co., 94 Fla. 764, 114 So. 540 (1927). The Department recognizes that publication in the Florida Administrative Weekly will not always provide adequate notice:

Service and notice of initial pleadings and orders and notices shall be effected upon members of the general public by publication in the Florida Administrative Weekly. The department may require any applicant to publish additional notices in newspapers of general circulation in the area affected, or to give notice by mail, as may be deemed reasonably necessary by the department to afford adequate notice.

the issuer, whose address would be prominently featured upon all disclosure documents required by the Securities Exchange Act of 1934. It is suggested that prior to undertaking any action which affects the substantial rights of any party the Division of Securities must provide the best notice practicable despite the lax standard of section 517.061(18)(c).

Even if the statute is held to be constitutional, the Florida Administrative Procedure Act (“APA”) imposes certain requirements which must be met prior to the making of orders based upon section 517.061(18)(c). Orders may only be made according to rules adopted pursuant to the procedures provided for in the APA. Because no standards have been articulated in section 517.061(18)(c), the content of the rule is currently indeterminable.

6. DEBTS SECURED BY REAL PROPERTY

The Sale of Securities Law contained exemptions for certain transactions in real property. These exemptions provided a basis for certain practices which were labelled the “14% racket.” The Comptroller undertook a statewide investigation of the “mammoth securities and mortgage fraud,” which culminated in numerous trials beginning in 1975. The 1976 House Select Committee on Mortgage Frauds proposed, and the legislature adopted, amendments to the Mortgage Brokerage Act and the Florida Uniform Land Sales Practices Law which effectively terminated the practices involved in the fourteen percent racket. The Florida Legislature completed this reform by eliminating the exemption from blue sky registration.

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269. See State v. Stevens, 344 So. 2d 290, 296 (Fla. 1st DCA 1977). But see McDonald v. Department of Banking & Fin., 346 So. 2d 569 (Fla. 1st DCA 1977) (when governing rules are in existence, additional statements of policy can be set forth in final orders without violating rulemaking procedures). Substantially affected persons can petition the Department to make rules implementing § 517.061(18)(c). FLA. ADMIN. CODE § 3-501 (1975). Denial of this petition can be appealed. FLA. STAT. § 120.68 (1977).

270. Should rules be adopted pursuant to § 517.061(18)(c), they could immediately be attacked by a substantially affected person at an administrative level as an unconstitutional delegation. FLA. STAT. § 120.54(4)(a) (1977); FLA. ADMIN. CODE 3-6.01 to .03 (1975). Such a person might alternatively bring an action for a declaratory judgment based upon the unconstitutional delegation in a circuit court. FLA. STAT. §§ 86.011-.111 (1977).


272. REPORT, supra note 122, at 6.


274. 1977 Fla. Laws ch. 77-397 (codified at FLA. STAT. §§ 494.01-.11 (1977)).

275. 1976 Fla. Laws ch. 76-262 (codified at FLA. STAT. §§ 478.011-.34 (1977)).

276. REPORT, supra note 122, at 6.
The exemption in the Florida Securities Act for notes secured by mortgages is narrow. The exemption extends only to notes or bonds issued by a purchaser to a seller to finance an acquisition of real property or a renewal of the obligation when the debt is secured by all or part of the property.77 "Renewals" is a term of art defined as the issuance of additional debt by the landowner if secured by the real property itself.78 The proceeds of the renewals need not be applied toward the retirement of the notes or bonds originally issued upon acquisition of the property. When the proceeds are not so applied, however, disclosure must be made to those who lend for investment purposes, unless the provisions of the Mortgage Brokerage Act cover the transaction.79

7. SALES TO INSTITUTIONS

The exemption for sales to institutional investors rested on the theory that sophisticated investors can compel the required information from an issuer.280 The exemption in the Sale of Securities Law extended to all banks, savings institutions, trust companies, insurance corporations, pension plans and broker-dealers.281 The inclusion of all corporations among the select group of institutional investors was criticized by commentators as archaic.282 Even sales of securities to a "Ma and Pa" candy store, if incorporated, were exempted. The potential for abuse of this exemption was staggering.

The institutional exemption of the Florida Securities Act in section 517.061(7) of the Florida Statutes (Supp. 1978) does not extend to corporations. Regulated investment companies, however, remain within the exemption. The statute also contracts the scope of the former exemption by excepting sales to pension or profit-sharing plans with assets of less than $500,000. An intent clause was added to the statute to prevent abuses which might arise if potential purchasers were to organize sham institutions for the purpose of evading the registration provisions.

277. FLA. STAT. § 517.061(9) (Supp. 1978).
278. Rule 3E-5.03(1), 1 BLUE SKY L. REP. (CCH) ¶ 13,643.
279. Rule 3E-5.03, 1 BLUE SKY L. REP. (CCH) ¶ 13,643.
280. In fact, such institutions usually want information which is different than the items which are provided in a prospectus. See Casey, supra note 23, at 576.
IV. PROFESSIONALS IN THE SECURITIES INDUSTRY

The Reporter to the Law Revision Council advocated partial or total elimination of blue sky regulation of broker-dealers, salesmen and investment advisers since the federal laws and industry self-regulation provided ample protection. This recommendation was not adopted. As a result, the policies which underlay the other portions of the Florida Securities Act conflict with the apparent proliferation of regulation in this area. Some of the changes will increase the operating costs of professionals: increases which will be passed on to the investor.

A. Who are the Professionals?

The scope of regulation can be broadened or narrowed by changing the definition of the class of persons subject to the substantive regulatory controls. The definitional section of the Florida Securities Act, which contains the definitions of the professionals, was taken almost verbatim from the draft of the Reporter to the Law Revision Council. This aspect of the regulation of professionals is, therefore, more in keeping with the regulatory philosophy of other portions of the Florida Securities Act.

1. DEALERS

The definition of "dealer" and, therefore, of "broker," remains much the same under the Florida Securities Act as under the Sale of Securities Law. As under prior law a broker-dealer is one who engages, for at least part of his time, in the business of trading in securities as an agent or principal. Issuer-dealers are included within this definition. Under the Sale of Securities Law issuers of securities are defined as "issuers," and issuers of securities are defined as "persons..." Therefore, the term "issuer-dealer" is not used under federal law.

283. Mofsky, supra note 6, at 32-33.
284. According to Fla. Stat. § 517.021(4) (Supp. 1978), a broker is a dealer as defined in § 517.021(6). The Florida blue sky law does not distinguish between brokers and dealers as does the Securities Exchange Act of 1934. 15 U.S.C. § 78c(a)(4) & (5) (1976). To avoid difficulties in the discussion of both the federal and blue sky definitions, the term "broker-dealer" will be used to indicate Florida "dealers."
286. Id. The concept of issuer-dealers is not new to Florida law. It was present in the earliest blue sky law, 1913 Fla. Laws ch. 6422, § 6, and was later incorporated into the Sale of Securities Law by the Florida Legislature four years after it adopted the uniform act. 1935 Fla. Laws ch. 17253, § 6. The concept of an issuer-dealer exists to a lesser extent under the Securities Exchange Act of 1934. Pursuant to the federal law, the concepts of issuer and dealer are mutually exclusive when the issuer is engaged in the sale of its own securities. See Augustine & Fass, Broker-Dealer Licensing in the Field of Real Estate Syndication, 29 Bus. Law. 369, 370 (1974). The relevant question under the federal standard is whether the persons selling the securities of the issuer have the type of relationship with the issuer which will bring
exempt securities were not considered dealers, but no such limitation is placed upon the definition of dealer in section 517.021(6) of the Florida Statutes (Supp. 1978). Some limitations on the definition do exist by virtue of sections 517.12(2) and (3) of the Florida Statutes (Supp. 1978). The only significant change here is the removal of options traders from the class of regulated persons. Thus, if the activities of a professional in Florida consist exclusively of writing, selling or purchasing options as an agent or principal, he will not be considered a broker-dealer.

2. INVESTMENT ADVISERS

Under the Sale of Securities Law all of those persons within the definition of "investment advisers" were deemed "dealers." The terms are given separate definitions in the Florida Securities Act, the distinction being based upon their different functions and expertise. New section 517.021(8) of the Florida Statutes (Supp. 1978) provides that any person who makes a business of advising others about the value of or desirability of buying and selling securities is, subject to certain exceptions, an investment adviser. Several classes of persons have been specifically exempted from regulation as investment advisers because there is no need for additional regulation as to them. First, licensed attorneys or certified public accountants are not investment advisers if their services are offered in the regular practice of their profession. Second, an exemption applies to persons who advise less than fifteen clients in twelve consecutive months. Third, banks or trust companies are not regulated as investment advisers if they render their services in a fiduciary capacity in accordance with their trust powers. Fourth, investment advisers who service only insurance and investment companies are exempted. Fifth, dealers will not be treated as investment advisers if they are treated within the federal issuer-dealer exemption. Id. at 370-74. Thus, proposed rule 3a4-1(2), 2 Fed. Sec. L. Rep. (CCH) ¶ 21,152, appears to test whether the issuer's agent is an ordinary employee or a hired securities professional. For a comparative analysis of the issuer-dealer concept in federal and Florida law, see Leisner, Perils and Pitfalls for Unregistered Securities Brokers, 51 Fla. B.J. 683 (1977).


288. "The most important distinction is the clarification between 'dealer' and 'investment adviser'. A 'dealer' is actively engaged in selling securities while an 'investment adviser' provides advice concerning securities and is not involved in the actual sale of securities." REPORT, supra note 122, at 2.

289. This exemption parallels that of the Investment Advisers Act of 1940. 15 U.S.C. § 80b-3(b)(3) (1976). A significant difference between the two exemptions is that the federal exemption is inapplicable if advice were rendered to a registered investment company.
render the advice only incidentally to their performance as dealers and without additional compensation.

3. SALES MEN

New section 517.021(13) of the Florida Statutes (Supp. 1978) does not alter the definition of "salesman." Salesmen are persons who are employed, appointed, or authorized by a dealer or an issuer to sell securities in any manner, or who act as investment advisers. The partners of a partnership and the executive officers of a corporation or other association regulated as a dealer are not salesmen within the meaning of this definition.

B. Registration of Professionals

The general rule of section 517.12 of the Florida Statutes (Supp. 1978) is that no professional may engage in his business until he is registered to perform the function of investment adviser, salesman or dealer. The procedures and conditions of this registration have been altered dramatically. This panoply of new controls acts to create new barriers to entry into the securities industry.

In general, the disclosure requirements of the application imposed by the statute are much more detailed than those which had previously existed. Commentators, however, do not anticipate a change in practice because many of the specifications were drawn from rules of the Department of Banking and Finance which existed prior to the amendment of section 517.12.290 Among the technical changes is a new provision for waiver of the Florida Securities Law Examination and the Florida Securities General Knowledge Examination on condition that the applicant pass the tests administered pursuant to section 15(b)(7) of the Securities Exchange Act of 1934.291

The major change in the registration process is the inclusion of a net capital rule. Section 517.12(8) of the Florida Statutes (Supp. 1978) provides for the establishment of rule 3E-6.031,292 which sets the standard for the rule. The rule parallels the SEC's net capital rule but does not contain many of its ameliorative or alternative methods of computation. The latter rule, which is extremely complex, provides that a broker-dealer who clears through another

290. See Lowy, Broker-Dealer, Salesman and Investment Advisor Regulation, in The Florida Securities Act, supra note 47 at 6.5.
292. 1 Blue Sky L. Rep. (CCH) ¶ 13,664.
broker-dealer must have minimum net capital of $5,000. These
broker-dealers who conduct a general securities business are re-
quired to have a minimum net capital of $25,000. Broker-dealers
who act as market makers are required to have minimum net capital
of between $25,000 and $100,000 depending upon the number of
securities in which they make markets and the price of the securities
involved. In addition, established broker-dealers are required to
maintain a ratio of fifteen to one in aggregate indebtedness to net
capital, and young firms must have a ratio of eight to one. The rule
also provides that if the broker-dealer is a member of NASD, or any
national securities exchange, the net capital computation will be
made in accordance with the rules of that organization.293

Unfortunately, promotional firms seeking equity capital must
ordinarily rely upon the services of underwriters who are not yet
established and are, therefore, adversely affected by the net capital
rule.294 Because funds will be unavailable to the more speculative
enterprises, such as Edison, Inc.,295 innovation and the creation of
new products will be discouraged. The public will also be harmed
by the net capital rule when brokers are forced to charge more for a
decreased quality of service.

Some relief from the net capital rule is afforded to issuer-
dealers. There is no requirement for the maintenance of a ratio of
aggregate indebtedness to net capital. Issuer-dealers selling securi-
ties in an amount less than $250,000 must maintain an excess of
$5,000 of total assets over total liabilities, the assets being valued
at cost.296 If the offering is to raise more than $250,000, the issuer
must maintain a net capital of $25,000. This rule, in effect, imposes

293. 17 C.F.R. § 240.15c3-1 (1978).
294. See Mofsky, SEC Financial Requirements for Broker-Dealers: Economic Implica-
295. See text accompanying notes 21-33 supra. The loss of such firms as Edison, Inc.
and the products they would produce is a significant factor to be considered when the impact
of the regulation upon the public is concerned:

The small business attempting to raise public capital necessarily relies on the
investment banking services of small securities firms, since large New York Stock
Exchange members do not generally underwrite securities offerings by speculative
companies of firms lacking a strong earnings history. In the long run, the most
significant loss to society occasioned by a reduction in the number of small securi-
ties firms may not be the loss of the small securities firms themselves. Indeed,
the more significant loss may well be all the small businesses that could only be
capitalized with funds raised through the efforts of the small securities firm.
Mofsky, supra note 294, at 238 (footnotes omitted). Whether the net capital rule could survive
an attack based upon the cost/benefit criteria of Fla. Stat. § 120.54(2)(a) (Supp. 1978) is
unclear.
a merit standard upon promotional firms because the promoters will be required to fund the firm with either $5,000 or $25,000 depending upon the size of the offering.

C. Exemptions

Under the Sale of Securities Law persons who acted as professionals with respect to exempt transactions were not regulated as professionals. Dealers in exempt securities were regulated unless they engaged solely in exempt transactions. Thus, bond dealers who sold only to institutions, or investment advisers who advised only investment companies, were not required to register under the Sale of Securities Law. Issuer-dealers were exempted from registration when they sold securities solely through exempt transactions.297

Under the Florida Securities Act, an exemption is provided for issuer-dealers of all exempt securities other than those issued by religious or charitable institutions. Issuer-dealers also continue to be exempt from regulation if they issue their securities in certain exempt transactions. The general exemption for professionals with respect to exempt transactions does not extend to options traders, dealers selling securities at or near the market price or professionals involved in sales pursuant to a registration statement which has become effective under the Securities Act of 1933.

D. Revocation, Denial or Suspension of Registration

Section 517.161 of the Florida Statutes (Supp. 1978) provides the grounds for and the procedure through which a professional will lose the right to practice. Violation of the Florida Securities Act or any lawful rule thereunder will constitute adequate grounds to halt the activities of a professional.298 Similarly, a violation of the rights of his clients will be grounds for the Department of Banking and Finance to prohibit a professional from operating.299 The scope of some of the other grounds is less clear.

Section 517.16(1)(k) of the Florida Statutes (Supp. 1978) states that the Department may prohibit a professional from operating if the professional is of "bad business repute." This term is not defined in the Florida Securities Act. The Florida Legislature may have delegated too much authority to the Department when it failed to limit the scope of this grant of power.300 A similar problem exists

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298. Id. §§ 517.161(1)(a)-(d), (g) & (j) (Supp. 1978).
299. Id. §§ 517.161(o), (e) & (f).
300. For a discussion of the constitutional proscription against delegation of legislative
with respect to the provision which allows action where a professional "has demonstrated his unworthiness to transact the business of dealer, investment adviser, or salesman." Although the Department has promulgated a rule to help determine what shall constitute prima facie evidence of unworthiness, the remaining uncertainty inherent in the vague statutory language may leave the latter subject to constitutional attack on due process grounds.  

An additional problem with section 517.061 involves the procedure for revocation of a registration under subsection (3). The statute provides that the Department upon its own determination may enter a final order revoking a license. There is no statutory requirement that the professional be given prior notice or an opportunity to be heard. Subsection (3) appears to be derived from identical language in subsection (6) of repealed section 517.16 of the Florida Statutes (1977). Under the repealed statute, subsection (6) followed other subsections which specifically provided for prior notice and hearing. The term "determination" in subsection (6) meant a determination based upon a hearing which included the full panoply of procedural protections. The new statute contains no such supplemental language. Section 517.161 should be amended to specify the applicable procedure.

E. Security Guarantee Fund

A new and significant provision of the Florida Securities Act concerns the establishment of a Security Guarantee Fund and the elimination of the bonding requirement for broker-dealers which had existed under the Sale of Securities Law. The cost of membership in the fund is small when compared to the premium for a $50,000 bond, which had been required under the prior law. The fund is created by assessing each registered broker-dealer or investment adviser twenty-five dollars per year, plus five dollars per salesman and twenty-five dollars for each branch office. These assessments continue until the fund exceeds $250,000 at the end of a license year. From that time forward no additional fees are imposed unless the fund is reduced below $150,000.  

In order to recover from the Security Guarantee Fund, a person

authority to an administrative body, see text accompanying notes 261-66 supra. When the grant of power does not include clear standards for the exercise of authority, but can be fairly interpreted in a manner which provides the agency with complete discretion, the statute may be held unconstitutional. See, e.g., Lewis v. Bank of Pasco County, 346 So. 2d 53 (Fla. 1977).

must have suffered monetary damages as a result of acts committed by a registered professional and a court determines that the damage resulted from a violation of the securities registration provisions and/or the antifraud provisions. To obtain a payment, the person seeking damages must establish that the judgment debtor lacks sufficient assets to satisfy the judgment. No recovery from the fund may be based upon a wrongful act occurring prior to January 1, 1979.

Section 517.141 of the Florida Statutes (Supp. 1978) provides that claimants may apply to the Department of Banking and Finance for payment from the Security Guarantee Fund for the amount equal to the unsatisfied portion of the judgment or $10,000, whichever is less, but only to the extent of actual or compensatory damages. No more than $100,000 is to be paid out of the fund with respect to the wrongs of a particular professional regardless of the number of persons injured by the professional. In cases of multiple claims, the $100,000 will be pro rated among the number of claimants.

Under prior law, victims of broker-dealers had recourse against a bond worth $50,000. Under the Florida Securities Act, such persons may only obtain damages of $10,000 where the professional has no assets. The reform seems to have placed investors in a worsened position. In order for the fund to provide an adequate remedy each claimant should be able to receive a maximum of $50,000, subject to the $100,000 limitation in cases of multiple claims. Amendment of this statute, therefore, is suggested.

V. ENFORCEMENT

The Florida Securities Act places an increased emphasis upon the enforcement of the antifraud provisions. Because it is generally not possible to prevent securities fraud through the proliferation of costly filing and registration requirements, it is absolutely essential to identify and arrest fraudulent activities if the citizens of the State of Florida are to benefit from the existence of the blue sky laws. Thus, the antifraud provisions and the enforcement powers conferred upon the Department of Banking and Finance are the crux of the Florida Securities Act.

A. Antifraud

Section 517.301 of the Florida Statutes (1977) establishes a rule of antifraud liability for deception through misstatements, omissions or practices which operate as frauds. That provision contains
further prohibitions against the knowing and willful use of falsified documents and the concealment of material facts through coverups or similar means. The only amendment to this statute was the rewording of the introductory language from "in the sale or purchase" to "in connection with the offer, sale or purchase." This revision was occasioned by the separate definition of the terms "offer" and "sale" in the Florida Securities Act. Under the Sale of Securities Law the term "sale" comprehended both offers and sales. Thus, the scope of activities which will give rise to liability under section 517.301 are precisely the same as under the prior law.

A separate variety of frauds is identified in section 517.311 of the Florida Statutes (1977). This section prohibits representations that an agency or officer of the federal government or the State of Florida has sanctioned the security or the professional unless: the statements are required by the Florida Securities Act or by the rules of the Department of Banking and Finance; the statement is true in fact and does not have the effect of a misrepresentation. Practitioners have discovered certain problems with respect to the breadth of this section. For example, if the Metropolitan Dade County Industrial Revenue Authority should issue bonds stating that the Metropolitan Dade County Industrial Revenue Council has approved of the issuance of the bonds, that declaration may be prohibited by section 517.311 despite the truth of the statement because neither the Florida Securities Act nor any rule of the Department requires that the statement be made. For this reason the section should be amended to permit representations that a governmental agency or official has sanctioned the security.

B. Injunctions

The principal antifraud enforcement method is the power conferred by section 517.191 of the Florida Statutes (Supp. 1978) to allow the Department of Banking and Finance to bring injunctive actions against certain violations of the Florida Securities Act. Although the language of sections 517.191(1) and (2) was simplified by the recent amendment, the broad grant of injunctive power to the Department still allows it to enjoin all violations of the Florida Securities Act.

304. Id. § 517.301(1) (1977).
305. Id. § 517.301.
306. Id. (Supp. 1978).
307. Id. § 517.021.
308. Id. § 517.02 (1977).
309. Id. § 517.311(1), (3).
Although the Florida courts have not examined the criteria for granting injunctions for some time, the United States Court of Appeals for the Fifth Circuit has recently addressed that issue. In SEC v. Blatt, the law firm of Blatt & Udell represented a company, a majority of whose stock had been acquired by another corporation. After Blatt learned through inside information of the intention of the parent company to acquire additional shares of the subsidiary he caused a long-time client, Pullman, to acquire the requisite number of shares without disclosing this inside information to the sixteen sellers of the shares. Pullman made a huge profit on the resale after holding the stock for a few months. Sometime thereafter, the parent company announced its intention to merge with the subsidiary. Blatt and Udell then placed the subsidiary stock which they owned into the hands of a trustee to conceal their ownership. The law firm, which had continued to represent the subsidiary, did not counsel the rejection of the plan of merger nor did Blatt disclose any unsatisfactory aspects of the exchange offer. Nonetheless, he ordered his trustee to seek dissenters' appraisal rights. Blatt and Udell were held liable under SEC rule 10b-5 for nondisclosure to the surviving corporation, and Blatt and Pullman were held liable under rule 10b-5 for nondisclosure of material facts to the sixteen shareholders who had sold them the subsidiary's stock.

The trial court granted injunctions against Blatt, Udell and Pullman. In reviewing the propriety of the injunctions, the Fifth Circuit articulated the following standard:

The trial court should consider several factors in deciding whether to issue an injunction in light of past violations. The critical question in issuing the injunction and also the ultimate test on review is whether defendant's past conduct indicates that there is a reasonable likelihood of further violations in the future. To obtain injunctive relief the Commission must offer positive proof of the likelihood that the wrongdoing will recur. The Commission needs to go beyond the mere fact of past violations. Thus, the government must establish that there is a likelihood of recurring violations. Applying this test, the Fifth Circuit upheld the injunctions against Blatt and Pullman but vacated the injunction against Udell. Because Blatt had been the "mastermind" of at least two frauds in the past, there was reason to believe he would commit securities frauds in the future. An injunction against Pullman was considered proper because he had engaged in a serious fraud and

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310. 583 F.2d 1325 (5th Cir. 1978).
311. Id. at 1334 (citations and footnotes omitted).
because he would continue to engage in many investment opportunities. Udell's involvement had been minor and he had committed only one infraction; nothing suggested that Udell would participate in frauds in the future.

Although the Florida courts are not bound by the standard adopted by the Fifth Circuit, the test appears to be rooted in the considerations underlying the injunction remedy. Because these considerations are common both to the power of the SEC and to the power of the Department as established in section 517.191, the Florida courts may ultimately adopt the rule of Blatt.

A second unresolved issue in Florida law concerning injunctions is whether the Department must establish scienter in past violations in order to obtain injunctions against future violations. One Florida court has spoken on the issue of whether scienter is a necessary element of a private antifraud action. In Merrill Lynch, Pierce, Fenner & Smith v. Byrne, the District Court of Appeal, Third District, held that scienter was not an element of the plaintiff's case based on the court's analysis of then existent federal precedent: "We think the better Federal decisions and the clear weight of authority is that scienter is not necessary to recovery."313

After Byrne was decided, the Supreme Court of the United States handed down its decision in Ernst & Ernst v. Hochfelder, holding that scienter is a necessary element of the plaintiff's case in a private action under the federal antifraud provisions. This result was based upon the language of the provisions banning deceptions, manipulations and acts which otherwise defraud. The United States Court of Appeals for the Fifth Circuit has recently held that the rule of Ernst & Ernst will govern the determination of whether the SEC should be granted an injunction which it is seeking. Thus, a demonstration of intentional misconduct is a prerequisite to the granting of an injunction. This requirement is in harmony with the reasoning that injunctions should not be granted unless there is a reasonable likelihood of future wrongdoing. Only when the defendant has intentionally committed past frauds is

312. 320 So. 2d 436 (Fla. 3d DCA 1975).
313. Id. at 440 (footnote omitted).
315. "When a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances—the commonly understood terminology of intentional wrongdoing—and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct." Id. at 214.

Currently it is unclear whether the Florida courts will adhere to \textit{Ernst \& Ernst} and \textit{Blatt}. Certainly, they are not bound to do so.\footnote{318. See \textit{Report, supra} note 122, at 1.} \textit{Blatt}, however, appears to be a well-reasoned construction of anti-fraud provisions which are similar to those of the Florida Securities Act.\footnote{319. See Sporkin, \textit{SEC Developments in Litigation and the Molding of Remedies}, 29 Bus. Law. 121, 123-24 (1974).} \textit{Byrne} was decided as it was specifically because the existing federal cases were inconclusive, although the weight of the federal authority favored the result.

\section*{C. Receiverships}

Section 517.191(2) of the Florida Statutes (Supp. 1978) confers authority upon the Department of Banking and Finance to apply for and to obtain receiverships. Experience with the acceleration of destructive effects upon an entity that accompanies certain full receiverships has led the SEC to seek the appointment of some or all directors by a court.\footnote{320. 301 So. 2d 101 (Fla. 3d DCA 1974).} In cases where the immediate liquidation of the entity is not expected, Florida courts should consider a flexible approach to the receivership remedy.

\section*{D. Disgorgement}

Under the Sale of Securities Law the Department of Banking and Finance was not authorized to seek disgorgement or other forms of restitution. In \textit{Wee Mac Corp. v. State ex rel. Dickenson},\footnote{321. \textit{Id.} at 102.} the District Court of Appeal, Third District, stated: "Nothing in the Statute authorizes the State to seek recovery on behalf of private purchasers. The wisdom of this decision of the legislature is evident since the private purchasers are not parties to this suit and therefore have not been heard upon the business decision involved."\footnote{322. \textit{Id.} at 102.} Thus, the court refused to apply the remedy of restitution because the shareholders may have approved the business decision, although it subsequently proved to be incorrect.

Under amended section 517.191 of the Florida Statutes (Supp. 1978), the Department is given permissive authority “to apply to the
court hearing [the] matter for an order of restitution," if it establishes that money was obtained through a violation of the Florida Securities Act. The courts, at their discretion, may refuse to grant a disgorgement request by the Department. Furthermore, defenses to the request may exist for the person against whom disgorgement is sought. Since the proceeding is essentially in the form of a parens patriae action, defenses against the Department include those defenses which would have existed against the persons on whose behalf restitution is sought. Thus, the fact that the shareholder has approved of or consented to the acts of the defendant would be a defense to the Department's claims. Therefore, the rationale of Wee Mac will continue to occupy a place of some importance in disgorgement actions.

Additional limitations should be placed upon the application of this rather drastic remedy. Commentators have criticized the mushrooming use of disgorgement by the SEC and have argued that courts should not impose restitution as a penalty. Recently, the courts have responded by establishing more restrictive tests. Thus, the Fifth Circuit recently held:

The purpose of disgorgement is not to compensate the victims of fraud, but to deprive the wrongdoer of his ill-gotten gain. . . . Disgorgement is remedial and not punitive. The court's power to order disgorgement extends only to the amount with interest by which the defendant profited from his wrongdoing. Any further sum would constitute a penalty assessment.

E. Cease and Desist Orders

The power to issue cease and desist orders is conferred upon the Department of Banking and Finance by new section 517.221 of the Florida Statutes (Supp. 1978). Such an order may be issued if the Department has reason to believe the recipient of the order has violated or is about to violate the Florida Securities Act or the rules thereunder. The procedure for the order is governed by the Administrative Procedure Act. Accordingly, the Department must serve notice of the order and hearing (essentially an order to show cause) upon the person charged with the violation. The cease and desist order does not become final until the recommendation after the

hearing and the issuance of a final order. The fine of $1,000 can only be imposed after the final cease and desist order is in effect.\footnote{326}

F. Criminal Prosecutions

Pursuant to section 517.302 of the Florida Statutes (Supp. 1978), any violation of chapter 517 is a felony in the third degree. Because criminal actions must be brought by the state's attorney, the Department refers all criminal matters to the state's attorney for prosecution.\footnote{327} A five-year statute of limitations is provided by section 517.302.

Section 517.07 of the Florida Statutes (1977) requires the party seeking the benefit of an exemption from registration to establish the existence of its right to that exemption. In \emph{State v. Buchman}\footnote{328} the Supreme Court of Florida held that this rule applied to criminal prosecutions involving the sale of unregistered securities. There, the prosecutor was excused from proving that an exemption did not exist because the legislative intent did not indicate that the lack of an exemption was an element of the offense.\footnote{329}

A standard for proving scienter in criminal actions was established in \emph{State v. Houghtaling}.\footnote{330} In \emph{Houghtaling}, the Supreme Court of Florida held that scienter was not an element necessary to a violation of the provisions for registration of securities or professionals. Whether scienter is required in a prosecution for antifraud violations remains an open question under Florida law.\footnote{331}

VI. Addendum

Prior to the publication of this article, the Florida legislature

\footnote{326. Aggrieved recipients of final orders may petition for the appropriate district court of appeal for review of the final order. In all cases in which the Department's order has the effect of suspending or revoking a license, enforcement will be stayed or superseded as will be granted as a matter of right. \textsc{Fla. Stat.} § 120.68(3) (1977).}

\footnote{327. In Yarbrough v. Pfeiffer, 1979 \textsc{Fla. L. Weekly} 359, (Fla. 4th DCA Feb. 14) (No. 78-1559), a securities broker was charged with the sale of unregistered securities. In its investigation, the Department of Banking and Finance was assisted by the Department of Criminal Law Enforcement, which obtained and executed a search warrant for business records. The court refused to grant immunity to the broker under the self-incrimination rule provided by \textsc{Fla. Stat.} § 914.04 (1975) because the broker had not been personally compelled to produce the records. Thus, the Department can utilize the powers of other government agencies even in administrative proceedings and thereby extend its own reach to those powers provided under the criminal statutes.}

\footnote{328. 361 So. 2d 692 (Fla. 1978).}

\footnote{329. \emph{Id.} at 695.}

\footnote{330. 181 So. 2d 636 (Fla. 1966).}

\footnote{331. See Snyderburn, \emph{Enforcement Under Chapter 517}, in \textsc{The Florida Securities Act, supra} note 47, at 7.10.}
amended the Florida Securities Act in several respects. Furthermore, the Florida Division of Securities promulgated emergency regulations, effective September 1, 1979, which significantly change practice under the Florida Securities Act. Although these revisions will be discussed in the next survey of the Florida blue sky law, several of the changes should be mentioned in connection with this article.

The Florida private placement exemption has been changed significantly. First, according to an emergency rule of the Division of Securities, effective September 1, 1979, issuers may not pay commissions or compensation to an offeree representative unless the offeree representative is registered as a dealer under the Florida Securities Act. Second, there is no longer an exemption from the disclosure requirements for offerings involving less than five purchasers. Third, the two-tiered disclosure system provided in the rules has been abolished. Fourth, specific conditions for the satisfaction of "access" have been established. Fifth, the three-day rescission option has been modified: purchasers may rescind their sale three days after the first tender of consideration to the issuer or its escrow agent or three days after this right is communicated by the issuer to the purchasers, whichever is later.