

A Century of Investor Protection

1911 – 2011



Introduction

The state and provincial securities regulators who comprise the membership of the North American Securities Administrators Association have protected Main Street investors from fraud for 100 years, longer than any other securities regulator. We have been protecting investors in the United States since the passage of the first blue sky law in Kansas in 1911 and since 1912 in Canada, when Manitoba became the first province to approve securities legislation.

Our primary goal has been and remains to advocate and act for the protection of investors, especially those who lack the expertise, experience and resources to protect their own interests. We are driven by our conviction that every investor deserves protection and an even break, and that the welfare of investors must not be sacrificed in the process of capital formation.

Although Massachusetts required the registration of railroad securities as early as 1852, and other states passed laws relating to securities in the late 1800s and early 1900s, the real push for securities regulation came from the North American heartland.

As we commemorate our first century of investor protection and the evolution of our effective and efficient system of securities regulation, it is enlightening to examine our origins as a progressive proposal built on the principle that holds true today: every investor deserves protection.

Taming the Wildcats

Joseph Dolley had seen enough. A century ago, the Kansas Banking Commissioner took a stand against “wildcat” stock speculators peddling shares of sham companies to unsuspecting investors in his state. Many of the companies that attracted Commissioner Dolley’s wrath targeted local farmers and widows with wild investment schemes promoting nonexistent mines, Central American plantations and irrigation systems.

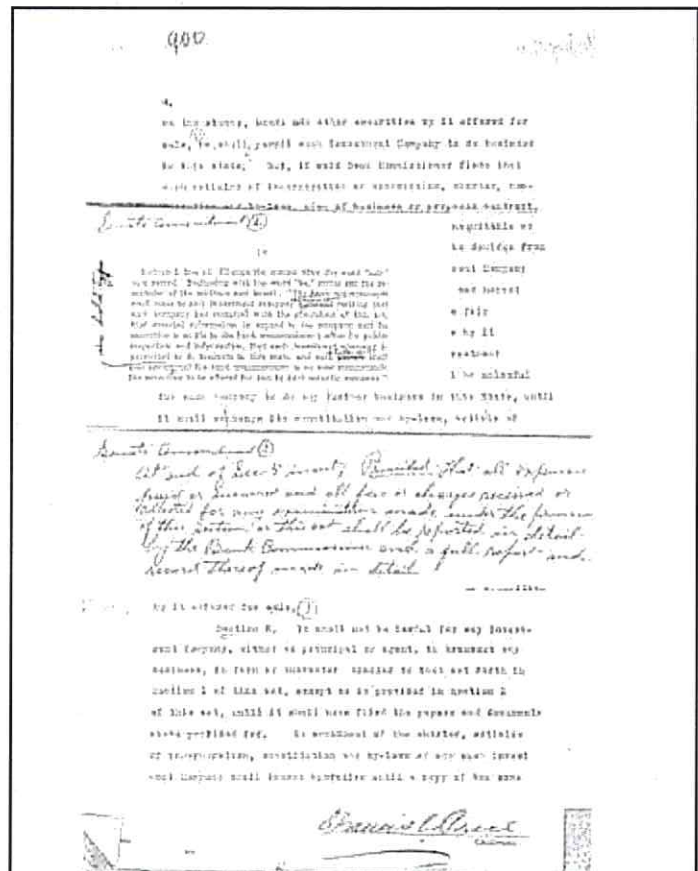
In April 1910, Commissioner Dolley sent a notice to newspapers throughout Kansas announcing the creation of a new agency, the Investment Information Bureau within his agency to, in his words, “protect the people of Kansas from fakers with worthless stock to sell.” The new bureau was formed to provide information about the financial standing of companies offering to sell stock to investors in Kansas.

Inquiries flowed into the bureau about questionable companies. Commissioner Dolley provided information to the public about these companies, but he had no legal authority to require a statement of any kind from the sellers and no power to stop the sale of stock.

In his 1910 report to the state legislature, Commissioner Dolley called attention to the wildcat stock speculators running rampant in Kansas and urged legislators to take action. In addition to asking for an appropriation to carry on the work of his new securities bureau, Dolley made the following suggestion:

“I further recommend that the legislature pass a law compelling all parties who offer stocks and bonds for sale in Kansas to register with some department of state, setting forth in detail their securities, and requiring of them to furnish any other information that said department may demand of them, and to submit to a full examination of their affairs if said department should deem it advisable.”

During the 1911 legislative session, Representative Cliff Matson introduced House Bill 906, “an Act to provide for the regulation and supervision of Investment Companies



Amendments to the original blue sky law

and providing penalties for the violation thereof.”

This “blue sky bill,” which Dolley is credited with writing, was amended by the House of Representatives before it passed with 63 votes – just enough to prevail in a body with 125 members. It then went to the state Senate, where it was further amended and passed 36 to 0. The House concurred in the Senate amendments, and the bill was signed by Governor Stubbs on March 10, 1911. It became effective on March 15, 1911, upon publication in the official state newspaper. And with that, state securities regulation was born.

Dolley was very proud of the new law and immediately moved to implement it. He promoted the law far and

Taming the Wildcats

continued

wide, and he was frequently quoted in the press claiming impressive statistics.

In the 18 months following the enactment of the Kansas law, more than 1,500 companies applied for permission to do business in the state. Of these, 75 percent "were mining, oil, gas and stock selling schemes of a fraudulent nature in which there could be no possible return for the money invested. Of the remaining 25 percent, about half were companies with highly speculative propositions and not at all bona fide investment opportunities," according to noted political scientist Clarence Addison Dykstra.

"All together less than 100 of the companies were given the right to do business in Kansas. Many companies withdrew their applications before having them passed upon and they thus lightened the burden of the bank commissioner. A recent statement of the commissioner declares that this law has already saved to the people of Kansas more money than it took to run the entire state government since the law was passed," Dykstra wrote in the May 1913 edition of *The American Political Science Review*.

The new law helped preserve capital for legitimate investment opportunities. Writing in the October 13, 1911 issue of *The New York Times*, Missouri insurance executive Walter A. La Bar noted that "This law means from four to eight million dollars of additional capital [is] available for bona fide investments. It also gives a legitimate company a better opportunity to secure funds, as heretofore investors found it difficult to separate 'the sheep from the goats'."

The law was aimed not only at preventing fraud but also included the authority to bar the sale of securities of any company whose organization, plan of business or contracts included any provisions that were "unfair, unjust, inequitable or oppressive," or if the investment did not "promise a fair return." The authority to deny sale of securities on these grounds was coined "merit-review" authority.

The attention generated by the law soon caught the attention of other state and foreign legislators. "The wide publicity given to the Kansas law resulted in agitation

**To the people of Kansas
Topeka, April 9, 1910**

The State Banking Department has established a bureau for the purpose of giving information as to the financial standing of companies whose stock is offered for sale to the people of Kansas. If you are offered any stock and want information as to the financial standing of the company offering the same, before investing, please write to this department and I will furnish it.

J.N. Dolley, State Bank Commissioner

for some such legislation in most of our States," political scientist Dykstra wrote. "During this last winter almost every State in the Union has asked for copies of the Kansas law and for information as to its workings from the Kansas bank commissioner."

Dykstra writes that "more than half of the American legislatures are considering bills regulating blue sky sales" within two years of the passage of the Kansas blue sky law. By 1913, blue sky proposals had been adopted by Arizona, California, Florida, Georgia, Idaho, Iowa, Louisiana, Maine, Michigan, Missouri, Montana, Nebraska, North Carolina, North Dakota, Ohio, Oregon, South Dakota, Tennessee, Texas, Vermont, West Virginia and Wisconsin.

The blue sky concept quickly reached beyond U.S. borders. For example, Manitoba, Canada, and New South Wales, Australia, quickly enacted the Kansas law "with practically no variation," Dykstra wrote.

In Canada, Manitoba adopted the Sale of Shares Act in 1912, and Alberta, New Brunswick and Saskatchewan soon followed. Quebec required securities registration in 1924 and Ontario passed the Security Frauds Prevention Act in 1928. This model was followed by Alberta, Prince Edward Island and Saskatchewan a year later. A

"uniform" version of the Act soon was adopted by Alberta, British Columbia, Manitoba, Ontario, Quebec and Saskatchewan following the stock market crash of 1929.

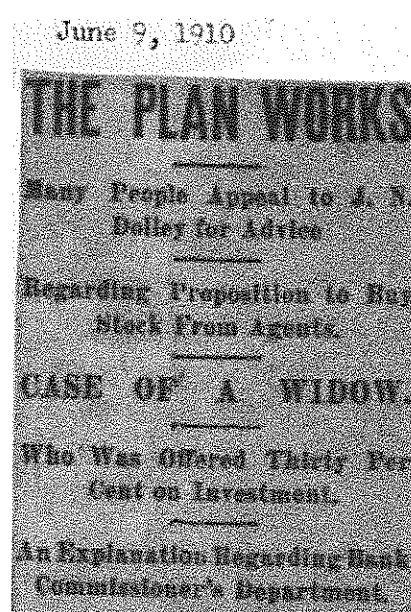
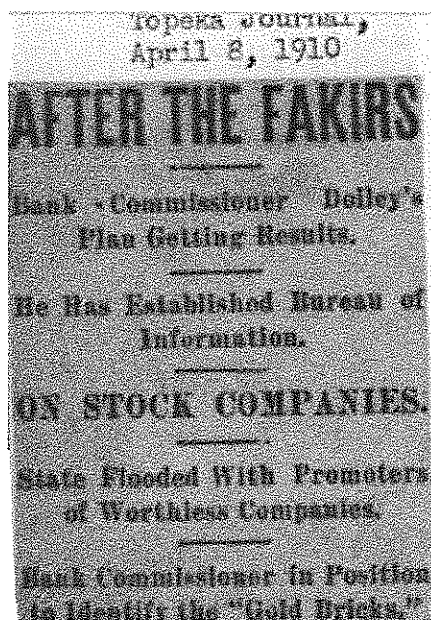
Commissioner Dolley wasn't surprised by the blue sky law's success, telling *Bankers Home Magazine*, "We believe that this is one of the best laws ever placed upon our statute books, and that it has done, and is doing, as much if not more good, than any other statute which has ever been enacted."

Not everyone was as impressed. In November 1912, trainloads of bankers steamed into New York for a convention of the Investment Bankers' Association of America.

"One of the chief topics for discussion by the convention is legislation intended to protect the investor, along the lines of the Kansas 'Blue Sky' law," reported *The New York Times* on November 22, 1912. "There are movements in various states for such legislation; to prevent the peddling of worthless bonds ... The association's Committee on Legislation will make recommendations looking to uniform laws on the subject which will not interfere with their legitimate business."

Association President George B. Caldwell told the *Times*: "My own impression is that the 'Blue Sky law' is not altogether in the interest of the investing public or of the dealers in investment bonds, but legislation can be framed, and will be framed, by our committee, which will accomplish the objects sought in the protection of the public against fraudulent or unsound securities."

The blue sky laws were vigorously challenged on



Topeka Journal News Items, 1910

cases, Justice Joseph McKenna answered the criticism, heard yet today, that the blue sky laws create roadblocks to capital formation:

"We think the [blue-sky] law is within the power of the State. It burdens honest business, it is true, but burdens it only that, under its forms, dishonest business may not be done. This manifestly cannot be accomplished by mere declaration; there must be conditions imposed and provision made for their performance. Expenses may thereby be caused and inconvenience, but to arrest the power of the State by such considerations would make it impotent to discharge its function. It costs something to be governed."

After the Supreme Court's affirmative decision, the blue sky concept gained greater momentum. By 1931 every state had adopted a securities law.

One hundred years after the enactment of the first blue sky law, NASAA members continue to hold true to Commissioner Dolley's mission to protect the citizens of his state from "fakers with worthless stock to sell."

By Rick A. Fleming and Bob Webster

constitutional grounds. The first United States Supreme Court test of the state laws under the federal constitution came in 1917 when the Court upheld the securities laws of Ohio, South Dakota and Michigan in three related cases, referred to as "the Blue Sky cases." In one of these

THE SATURDAY EVENING POST

How Kansas Drove Out A Set Of Thieves



By Will Payne
December 2, 1911
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Not less than a hundred million dollars, in the opinion of those most competent to judge, is stolen from the people in this country every year by the sale of fake and wildcat "securities." The Post-Office Department puts the sum rather higher. Virtually every one of the swindling concerns that prey upon ignorance and credulity to this staggering extent is "duly incorporated" and possesses a charter under the great seal of some sovereign state, qualifying it to go out and rob as many suckers as it can find.

Though nearly every state and territory, with the greatest good nature in the world, will incorporate any sort of rank swindle that comes along, only one state, so far as I know, seriously attempts to protect its citizens from these stock-peddling pirates.

In every state, of course, a purchaser of fake stock may sue for the recovery of his money – which is about as satisfactory as the privilege of suing a pickpocket for the recovery

of your watch. There are also general statutes against obtaining money under false pretenses; but nine times out of ten the fake stock scheme is framed up with sufficient ingenuity to make conviction extremely doubtful, and almost always the victim simply pockets his loss. Generally speaking, it's as safe as taking candy from unprotected infants.

With the exception that I am about to describe, the Post-Office Department is the only effectual barrier between credulous people with money to lose and harpies with wildcat stocks to sell. If the fraud involves use of mails, and a complaint is made to the Post-Office Department, prosecution will follow – and most of the prosecutions end in conviction; but, unless the fraud does involve use of the mails, the Department has no power to intervene; and in any event it cannot intervene until the swindling operation is actually under way – which almost always means not until a great many people have lost their money.

A state official recently remarked: "Of course ninety-nine per cent of the mining companies that go round peddling stock are either rank frauds or mere wildcat prospects in which

the investor is pretty certain to lose his money. Every intelligent person knows that; but if people are foolish enough to buy such stuff I don't see how you are going to keep them from doing it."

That is the prevailing view. It is, of course, exactly equivalent to saying: "Why, if a merchant is silly enough to take a counterfeit bill let him stand the loss. Why should we try to protect him by passing laws to prevent counterfeiting?" If a bank teller doesn't know any better than to pay a forged check why should the state try to save him from the consequences of his own blundering?"

In Kansas they have taken an entirely different view of this fake stock swindle. They have not only done something about it, but have virtually stopped it so far as the limited power of any single state can accomplish that end.

The credit for this Kansas innovation belongs mainly to J.N. Dolley, state bank commissioner. Mr. Dolley stands, I should judge, rather better than six feet and possesses an adequate chest development. His shoulders are as big with his coat off – and it is rather apt to be off in business hours – as with it on. He

has a chin. No person with any skill in reading physiognomy would pick him out as a promising subject with whom to stir up gratuitous trouble.

"Why, I had been in the banking business here in Kansas a good many years before I became bank commissioner," he explained when I asked him about the genesis of the Blue Sky Law. "Every now and then I would hear of one of these swindles – that somebody had lost his money through buying stock in a fake mine, or in a Central America plantation that was nine parts imagination, or in some wonderful investment company that was going to pay forty per cent dividends. Sometimes I knew the man or woman who had been swindled. Of course I thought it was an outrage, but I don't know as it occurred to me then that there was any way to stop it.

"After I was appointed bank commissioner I heard more reports and complaints of fake stock swindles than ever. The banks hear of such cases because usually the victim draws money out of a bank to buy his wildcat mining shares or his stock in a lunar oil company, or whatever it may be. Kansas has been prosperous of late years, you know; the people have accumulated money. If you go back fifteen years you will see that all the state banks in Kansas then held less than fourteen million dollars of the people's deposits. Now they hold ninety millions and the national banks of the state sixty millions. That's fat picking.

"So reports of these stock swindles drifted to me. I received complaints and inquiries direct from people who had been swindled, wanting me to look up the company and see if they couldn't get their money back – after they had parted with the money! An old farmer I used to know came up to Topeka to see me. He'd sold his Kansas farm and had the money in the bank. A couple of smooth gentlemen came along and persuaded him to invest the money in developing a magnificent tract in New Mexico that was just about to be irrigated. He invested; and, after waiting patiently a good many months for the promised returns, he came up to see me. I advised him to invest some more money in a railroad ticket and go down and look at his land personally. He did go down there. He got off at the railroad station that was to be their shipping point and walked half a day through the sagebrush, and then climbed some bare, mountainous hills

until his wind gave out. The land he'd invested in was still higher up. The only way to irrigate it would be from the moon. That was only one instance out of a good many. There was no law to reach the sharks – except, of course, that a man might sue them or prosecute them for getting money under false pretenses; but a man couldn't do either until after he had lost his money. So far as the law went there seemed nothing to do by way of protecting him, from losing his money; but I made up my mind I'd do something."

I may mention here that doing something in this connection was no part of the official duty of the state bank commissioner. So far as law and custom went his duties consisted in supervising the state banks. There are – or were at the date of the last annual report – eight hundred and sixty-two of them scattered throughout the state, holding a hundred and twenty-five million dollars of assets. To supervise them under the law is a fairly full-sized man's job. I may also mention that Kansas does not specially encourage her bank commissioner to go outside of his official duties for the purpose of discovering extra burdens to assume, for she pays him only the very modest salary of twenty-five hundred dollars a year. Mr. Dolley did not touch upon these phases of the situation. Evidently, however, there is a well-defined theory at Topeka that, as regards banking, the grand duty of the state government is to protect depositors rather than merely to make things pleasant for bankers; and the systematic raids by stock-sharks upon the state's fat bank deposits might be considered a matter in which the state bank department could properly interest itself.

"I started an investigation, as best I could, into this fake and wildcat stock-selling," Mr. Dolley continued, "by inquiries from this office and through the bank examiners who visit every town in the state. I concluded that there must be at least five hundred agents in Kansas selling wildcat stocks. A large majority of them seemed to make that their regular business. Some of them had been at it for years. I believe they were getting anywhere from three to five million dollars a year out of the people of this state; and I am certain that at least ninety-five per cent of all the money put in those stocks was irretrievably lost.

"These fellows had become experts at the business. They had a regular system. They watched real-estate transfers; and if a man sold his farm they were right after him. They kept an eye on probate courts; and if anybody that might prove an easy mark inherited money they were on the spot with some gilt-edge investment yielding anywhere from twenty to a hundred per cent per year. They were always on the lookout for farmers with ready money in the bank; but about their best hold was life insurance, especially fraternal life insurance and the smaller policies – one, two, three, or five thousand dollars."

The Wiles of the Agents

A great many men carry such insurance in some lodge or mutual association – farmers, workmen, small tradesmen, and so on. The life-insurance money is enough to tide over the crisis in the family's affairs that is caused by the breadwinner's death; it gives the widow ready cash to meet debts, pay expenses, and support herself and the children for a while. As a rule, the widow has no business experience, has never earned a living, and is more or less bewildered and terrified by the prospect ahead of her; but just about the time the life-insurance money is paid over – and these fellows are so well up in the game they can calculate it to a day – Mr. Agent drops in.

"'You have two thousand dollars,' he says. 'The bank will pay you three per cent interest, or sixty dollars a year. Of course that will do you no good. You will have to live on the principal and in a couple of years it will be gone; but here is a perfectly safe investment that will pay you thirty-five per cent a year. That will give you a sure yearly income of seven hundred dollars. You and the children can live on that quite comfortably!' And in scores and scores of cases he got the money. Do you think the state ought to stand for that?" Mr. Dolley inquired.

The bank commissioner himself didn't think so. On his own initiative he began investigating such stock-peddling concerns as he could hear of. A year ago last April he sent to every newspaper in the state a circular letter as follows:

To the Editor: As you perhaps know, I have established a department in the bank commissioner's office to protect the people of Kansas from fakers with worthless stock to sell. I give you

below a small item concerning the matter, which I hope you may be able to use in your paper. I have no funds for advertising purposes; and the only way I can get this information before the people is through the generosity of the Kansas press. Thanking you for whatever you may do, I am----

The small item read:

*To the people of Kansas
Topeka, April 9, 1910*

The State Banking Department has established a bureau for the purpose of giving information as to the financial standing of companies whose stock is offered for sale to the people of Kansas. If you are offered any stock and want information as to the financial standing of the company offering the same, before investing, please write to this department and I will furnish it.

*J.N. Dolley, State Bank
Commissioner.*

The newspapers very generally printed this item. Many of them supplemented it with advice and warning of their own. Inquiries regarding stock-selling concerns poured into the commissioner's office and the fake stock industry in Kansas thereby suffered some check; but the commissioner had no legal authority whatever to require a statement of any kind from a concern that was selling stock in the state, and no power to stop the sale of the stock, however rotten it might be.

As fast as he got names and addresses of stock-selling concerns he wrote to them, asking for a detailed statement of financial condition, property owned, plan of operation, and so on; concluding by saying that, unless a satisfactory statement were forthcoming within a reasonable time, he should feel obliged to advise all inquirers not, under any circumstances, to buy the concern's stock.

Many companies replied and furnished statements; but they could make the statement in any form they pleased – touching very lightly or entirely ignoring such points as they did not care to have the commissioner scrutinize. Others failed to reply and there was no way of compelling them to do so. In addition to inquiries of the companies themselves, the commissioner wrote to banks, commercial agencies and other sources that seemed likely to be in possession of useful information; but he still stood, so to speak, on a level footing with the fake stock-seller. The law gave him no advantage. If he

could persuade a citizen not to buy a worthless stock, well and good. If an eloquent agent could persuade the citizen to buy it the commissioner was helpless.

In his report for 1910 Commissioner Dolley called attention to the wildcat stock industry and urged the passage of a law to stop it.

The legislature took up the subject as its last session and in March passed the Blue Sky Law – so nicknamed because it is designed to prevent the swindling of people through sales of "securities" that are based mostly upon atmosphere.

State and national banks, trust companies, real-estate mortgage companies, building and loan association and corporations not organized for profit are exempt from this law – as there are other statutes governing them.

Every other corporation or company, whether organized in Kansas or elsewhere, that sells or negotiates for the sale of any stocks, bonds or other securities of any kind – except Government, state or municipal bonds – is brought within the scope of the act. Before offering any stock, bond, or security for sale in Kansas it must file with the bank commissioner a statement in complete detail, in the form prescribed by him, giving an itemized exhibit of its financial condition, assets, liabilities, description of property owned, the plan upon which it proposes to do business, a copy of its charter, by-laws, and all contracts that it proposes to make with its contributors – "and such other information regarding its affairs as said bank commissioner may require" – all to be verified by the oath of a responsible officer of the company.

"And if said bank commissioner shall deem it advisable he shall make or have made a detailed examination of such company's affairs, which examination shall be at the expense of the company. And all such companies shall be subject to examination by the bank commissioner or his deputies at any time the bank commissioner may deem it advisable, in the same manner as now provided in the case of state banks." The company must, moreover, make a detailed statement of its condition to the bank examiner twice a year after being admitted to do business in the state, or oftener if he requires it.

Some Provisions of the Act

Having before him all the

information he requires, and having decided that the company is legitimate, solvent and operating upon a plan that is fair and equitable to all classes of security-holders, the commissioner shall then decide where its operations "in his judgement promise a fair return on the stocks, bonds and other securities by it offered for sale." If his judgment is favorable he then issues to the company a revocable license to sell its securities in Kansas.

The company may then appoint one or more agents to sell its stock or bonds; but the agent also must procure a license from the bank examiner, "subject to revocation at any time by the bank commissioner for cause appearing to him sufficient."

Section XII provides that: "Any person who shall knowingly subscribe to or make or cause to be made any false statement or false entry in any book of such company, or make or publish any false statement of the financial condition of such company or the stocks, bonds or other securities by it offered for sale, shall be deemed guilty of felony; and upon conviction thereof shall be fined not less than two hundred dollars nor more than ten thousand dollars, and shall be imprisoned for not less than one year nor more than ten years in the state penitentiary."

Section XIII says that any agent who attempts to sell the stocks, bonds or other securities of a company that has not complied with the act, or any agent who attempts to sell stock or bonds without having received a license from the bank examiner, shall be fined not more than five hundred dollars or imprisoned in the county jail not more than ninety days, or both.

The Blue Sky Act, in short, is a real law with real teeth in it. As soon as the act was passed, Commissioner Dolley instructed his bank examiners, who are continually traveling about the state, to keep a lookout everywhere for "investment agents." He also requested the eight hundred-and-odd state banks of Kansas to report any stock-peddling operations of which they might learn. "If you hear of anybody offering any stock for sale," he wrote, "find out whether he has a state license. If he hasn't wire me and I will send an officer after him on the first train."

Usually banks do hear of any stock-peddling operations that are going on in their localities, for the cash to pay for the stock comes out of a bank

in one way or another. Naturally no banker likes to see money drawn out of his institution and put into a wildcat investment where neither he nor anybody else thereabout will ever see it again. Consequently the banks form an excellent detective force for the enforcement of the law; and the passage of the act was immediately followed by a great clearing out of wildcat concerns and their stock-peddling agents.

The law, it will be noticed, is very broad, so that perfectly legitimate enterprises fall within its scope. It would include, for example, the offering of stock in a manufacturing concern that was entirely solvent and reputable. The legitimate concern has only to comply with the act – file its detailed statement with the bank commissioner, show who its directors are, and so on – to receive a license.

The law went into effect March 15, 1911; and some idea of the extent of the fraud at which it was aimed may be gathered from the fact that within six months the bank commissioner received more than five hundred applications to sell stocks or bonds in Kansas – and out of about five hundred and fifty applications he approved just forty-four! No doubt the most outrageous schemes simply withdrew from the state without any attempt to get a license; so that the five-hundred-and-odd that did apply and were rejected represent, so to speak, the upper crust or the more plausible of the Blue Sky fraternity.

A Simple Way to Call a Bluff

Bearing that probability in mind, the rejected applications on file in the commissioner's office are really amazing. They show, more graphically than anything else I know of, with what sublime assurance ingenious gentlemen go out after the money of suckers in exchange for stock engravings; in fact, the astonishing tolerance of the law toward this form of fraud has elevated it into a sort of respectability. It has become a kind of vested interest. Apparently some of the people engaged in it think they have an inalienable constitutional right to sell worthless "securities"; and they resent any interference with their operations as an act of tyranny and oppression.

For example, soon after the law was passed two well-dressed, prosperous-looking gentlemen, who made their headquarters at Topeka, waited in person upon the bank commissioner. They were surprised and rather indignant because an application

to sell stock in which they were interested had been peremptorily rejected. They thought the commissioner must be mistaken as to the sort of gentlemen he was dealing with; they had good clothes, jewelry and money in the bank; were well acquainted with various substantial and more or less leading citizens; could furnish references. When they had stated their case the following colloquy occurred:

"How long have you been selling stocks round here?"

"Seven years."

"You must have sold stocks in that time to a good many people."

"Oh, yes; a great many."

"Good!" I'll give you two dollars a head for all the people you will bring to my desk who ever bought stock of any kind from you and got back as much as five per cent of their money."

Whereupon the prosperous agents faded away.

Coming back to the applications, a majority, it is hardly necessary to say, are from mining concerns. Undoubtedly people will fall more readily for a fake or wildcat mining stock than for any other variety. Nothing but bitter experience, it seems, will convince them that any mine, anywhere on earth, which is in such a state of development that large dividends are assured doesn't need to go about peddling its stock at a discount, any more than a man with a pocketful of five-dollar goldpieces needs to stand on a street corner beseeching passers-by to purchase them at four dollars apiece.

Next in number, perhaps, come oil companies – and there is a remarkable assortment of irrigation schemes, plantations in Mexico, Central and South America, transportation enterprises and what not; in fact, the undertakings described in these applications dot the Western Hemisphere from the Equator to the Arctic circle. In running them to earth, Commissioner Dolley has written to every state in the Union, to the State Department at Washington and to foreign Governments. In some cases the accumulated documents make a pile an inch thick.

For example, here is the case of a corporation with a high-sounding title, duly incorporated under the laws of a sovereign state, as a copy of its charter, adorned with the state's great seal, duly attests. Headquarters of the concern for stock-selling purposes, however, are

at Chicago, a thousand miles from the place of incorporation. A beautifully typewritten letter from the president, on fine linen paper, sets forth that the company is engaged in developing and marketing a tract of one hundred and twenty-five thousand acres of fruit land in Central America specially adapted to banana culture. It has a contract on the land from the Central American Government, under which it receives title direct from the Government on payment of two dollars and a half an acre; but similar land, with a little additional improvement, sells readily at twenty dollars an acre. The company is offering five hundred thousand dollars of its treasury stock. With the proceeds it will take title to the land and make judicious improvements. The land may then be sold at twenty dollars an acre or it may be held and cultivated, in which case handsome profits are certain. Any purchaser of the company's stock may turn in his shares and receive a clear title to an equivalent amount of land at the original price of two dollars and a half an acre, plus cost of improvements made by the company; or he may keep the stock as an investment and participate in the company's profits.

Attached to the letter are certified copies of the charter and by-laws; a handsomely engraved stock certificate on bond paper that looks quite like a Government bond; reports as to the character of the land. There are also references and a quite imposing list of directors.

All this looks very plausible. One trouble with it is, it looks too plausible. Why should gentlemen who can buy land for two dollars and a half an acre and very soon sell it for twenty dollars be coming out to Kansas in order to raise the necessary capital in one-hundred-dollar and two-hundred-dollar lots, incidentally paying a large commission to stock-peddling agents? The commissioner begins to investigate. He doesn't get anything in particular "on" the men at the head of the concern. The land is undoubtedly there, and from the best information obtainable it seems to be very good land, quite suitable for fruit culture and capable, under proper management, of returning good profits. The commissioner continues to investigate, however, and discovers that the Central American Government had repudiated the entire contract upon which the scheme is based. At best, the purchaser of stock would be buying a

dubious lawsuit or an equally dubious diplomatic negotiation. He writes "No" upon the application in large, firm letters.

Here is an application from a corporation that proposes to build a railroad through a section of the United States that is now without transportation facilities, but that promises to develop an enormous traffic. My notes, I find, are a bit blurred, so I cannot tell how many ciphers there are in the capitalization; but a few ciphers more or less are immaterial. This, of course, is frankly a "prospect." The corporation doesn't pretend it has any railroad now. So the first question is as to the character of the men behind the undertaking. The commissioner begins inquiring; and it presently appears that one man, though he doesn't figure so prominently on the letterheads as some others, is really the guiding spirit.

Now, fortunately, any man engaged in this stock-vending industry must leave some sort of trail. He can't say: "My name is Smith and I just alighted from the moon." If he is a man of standing, as he claims to be, he must have come from somewhere, and at that somewhere he must have left a record and have told people where he came from before that. So the commissioner patiently followed up the arch-promoter's trail and discovered that, within nine months of the time he launched this imposing transportation project, he had jumped a sixty-dollar board-bill. A little farther back he appeared as the defaulting borrower of small sums. Derogatory letters from the trail showered in upon the commissioner. A country banker in a state far from Kansas, whose experience with the promoter was some four years old, wrote feelingly: "All the common honesty in his composition could be put in the hull of a mustard seed."

This personal trail is one of the chief reliances in running down fake stock schemes. Other standard sources of information are the commercial agencies and the banks; but it is a fact that a great number of banks are scandalously good-natured in lending countenance to stock-selling projects which every banker must know are disreputable. It looks as though the average banker cannot find it in his heart to think ill of a man who deposits money with him. He may not, and probably will not, actually indorse the scheme; but often he will write a letter saying

that Mr. So-and-So has done business with the bank for such and such a length of time, has always met his obligations promptly and the bank's relations with him have been highly satisfactory – or something of that sort, which the average sucker will regard as tantamount to a bank indorsement of the stock project.

It is another melancholy fact that a great number of men who are considered respectable and responsible in the communities where they live will lend their names to wildcat stock schemes. All sorts of mining and other concerns, every one of whose promoters ought to be in jail, come before credulous investors with boards of directors containing names that are considered quite respectable.

How these respectable dummies reconcile their consciences I cannot imagine. It is not, of course, that the schemes which they indorse and tout for are outright swindles. In nearly all cases, no doubt, where the roster contains respectable names, the scheme has some tangible foundation. In some cases, probably, it would be a fair gamble for a man able and willing to take the risk. The question is: "Would you advise a widow whose fortune consists of two thousand dollars of life insurance money to put it into this stock?" Almost every stock-selling campaign by advertisement of the employment of agents draws in more or less money of that kind; and no man who indorses it can escape the moral responsibility.

That question is what Kansas asked herself in passing the Blue Sky Law. Commissioner Dolley's inquiries had shown that millions of dollars were drawn from people of little business experience and limited intelligence, who didn't at all understand that they were going into a gamble but accepted the lying assurances of the agents and the prospectuses that they were certain of getting back their money and of receiving large returns upon it. Out of the five-hundred-and-odd rejected applications on file in the commissioner's office there isn't one that an intelligent and honest man would recommend as a secure investment for persons of small means. Except for the bar interposed by the Blue Sky Law, it is safe to say all of those concerns would now be selling stock in Kansas to persons who thought they were getting a secure investment.

In his annual report for 1910

Commissioner Dolley characterized these stock-peddlers as "fakers – and I wish to say, in a great majority of cases, common thieves." In view of all the circumstances – especially of the helpless class upon which they prey – this characterization seems none too strong; but other states, through cheerfully chartering all manner of wildcat concerns, interpose no effectual bar between them and credulous citizens.

In 1905 Wisconsin passed an act providing that an association or corporation "doing business as a so-called investment company, for the licensing, control and management of which there is no law now in force in this state," and which shall solicit payments to be made to itself, either in a lump sum or on the installment plan, issuing therefor so-called bonds, shares, coupons or other evidences of obligation or agreement, shall be under the control and supervision of the state bank commissioner, must make annual reports to him, and must deposit one hundred thousand dollars with the state as a guaranty fund.

This law, however, is vague and has not been held to apply to wildcat mining, irrigation, plantation and like concerns that offer stock for sale in Wisconsin. Strictly speaking, they are not "investment companies," but mining companies, land companies, and so on. In a few cases wildcat companies that purported to be organized primarily for the investment of money in mortgages and so on, have been called to account; but the law affords no protection to the people of Wisconsin against fake stocks in general.

The Kansas law is effective as far as the power of the state can go. It can and does protect the people against wildcat stocks when offered by agents or by advertisements within the state. There has been a wholesale exodus of fake stock agents since the law went into effect – many of them undoubtedly resuming operations in states that preserve an open door for robbery of this kind.

The Kansas law, however, cannot touch advertisements printed outside the state. The wildcat mine or fake oil concern may still offer its wares to Kansas suckers through the advertising pages of newspapers published beyond the state border. Probably that cannot be stopped until every state takes as intelligent and vigorous action against this form of swindling as Kansas has taken.

What's in a Name?

For 100 years, the exact origin of the term "blue sky law" has been shrouded in mystery. Courts and scholars have theorized about the origin of the label, and early speculation has turned into legend.

A report in December 1911, suggested that the original Kansas law was dubbed the "blue sky law" because it was "designed to prevent the swindling of people through sales of securities that are based mostly upon atmosphere." In 1916, a scholar opined that it was so named because securities promoters were blatant enough to "sell building lots in the blue sky in fee simple." And later, researchers speculated that the term "blue sky" must have already been in popular usage before the original act passed in 1911, referring to various schemes with no more substance than thin air.

The most widely quoted explanation comes from the U.S. Supreme Court in 1917, in an opinion upholding the constitutionality of state securities regulation: "The name that is given to the law indicates the evil at which it is aimed; that is, to use the language of a cited case, 'speculative schemes which have no more basis than so many feet of 'blue sky'."

Unfortunately, none of the authors of these explanations were able to cite any definitive evidence to support their theories. However, while preparing for the centennial celebration of the original blue sky act, the Office of the Kansas Securities Commissioner discovered a newspaper article written by J.N. Dolley, the author of the original blue sky law.

In an article in the Topeka State Journal 24 years after the law's adoption, Dolley explained the story behind the blue sky label:

"...I have been given credit for naming the 'Blue Sky' law. That name goes back to the drouth of the nineties. We had them then, just the same as now, altho they were not so well dramatized and advertised and we had learned less about feeling

Blue Sky Law Named After Drouth

J. N. Dolley, Remembering Failure of Professional Rain-Makers To Bring Moisture to Maple Hill, Thought of Name That Has Been Accepted Nationally—Mr. Dolley Taken for a Prize Fighter When He Arrived in Topeka More Than 50 Years Ago—Exciting Days of Rock Island's Career Thru Topeka, Maple Hill and West—Frank P. MacLennan's Famous Lessons for Teddy Roosevelt.

Topeka Daily State Journal, 1935

sorry for ourselves.

Crops were burning up. Stock water and even water for domestic use was disappearing. It was the day of professional rain makers and some of our people felt we should make every effort to get rain. So we raised the necessary money and contracted with some Chicago slicker to supply us with the necessary quantity of moisture.

They arrived at Maple Hill with two barrels of chemicals, a string of iron pipe and some mysterious mechanical doo-dad. They set up their equipment on a platform within an enclosure to which no one was admitted. Their iron pipe pointed toward the sky. At length it began to emit a light milk colored spray. The machinery was set it (sic) motion.

The milky spray was cast up for four days and four nights. But there was no sign of rain. The fifth day our committee visited the rain makers plant, to discover that the rain makers had disappeared, leaving their equipment behind.

Some of our folks had prepared against overflow damage from rains expected, moving valuables to uper (sic) stories and other property to high grounds. Not only did we have no flood but we saved others from such a fate because the rain making equipment was left with us.

When I appeared before the judiciary committee of the Kansas house and senate with the bill to protect our people against fraudulent stock schemes, one of the senators asked me what to call the law. Remembering our experience with the blue sky artist in trying to make rain, I suggested 'the blue sky law.'"

By Rick A. Fleming

The Man Behind the Law

Joseph Norman Dolley was born in Boston, Massachusetts on April 14, 1860. The son of an Irish sailor, Dolley struck out in search of greater opportunity in his mid-20s and headed west to Kansas, where he established himself as a pioneer merchant, running a trading post and a blacksmith shop.

Dolley got into politics shortly after his arrival in Kansas, serving as a member of both the Kansas House of Representatives and the Kansas Senate. While engaged in politics, Dolley continued to prosper in business, serving as president of a bank, a milling operation, a life insurance firm and an oil and gas company. He served as vice president of a local telephone company and led his local school board.

With the rise of progressivism in Kansas, Dolley's political fortunes improved significantly. He was named chairman of the Republican state central committee in 1908 and Speaker of the House the following year. The Governor appointed Dolley to be the state's Bank Commissioner on March 3, 1909, and he served in that capacity until 1912.

In the midst of his rise to prominence in Kansas politics, Dolley's personal progressive views were well-documented. He was described as a "full-fledged insurgent," and Theodore Roosevelt treated him as a leader of the progressive movement in Kansas.

As a banker, Dolley's progressive tendencies were often expressed as a deep desire to protect the money of Kansas residents, and the blue sky law was only one of his efforts to do so. Dolley was an early and ardent supporter of a bank guaranty law that protected depositors from bank failures, and his implementation of the law demonstrated an extremely conservative banking philosophy. He also led a nationwide lobbying effort to give state banks a strong voice in the discussion of currency reform at the national level. In addition to these public policy initiatives, he led a very successful effort to stamp out bank robberies in Kansas.

Just as Dolley's political ascent tracked the ascent of the broader progressive movement, the decline of the progressives brought Dolley down with it. In May 1913, Dolley resigned as chairman of the state Republican Party and joined the new Progressive Party that was aligned with Theodore Roosevelt's Bull Moose Party. In Kansas as elsewhere, the new party was short-lived.

Dolley went on to serve as president of the National Blue Sky Association and he eventually returned to his roots in the Republican Party. He was serving as chairman of the Shawnee County Republican central committee when he made an unsuccessful run for State Senate in 1924. Dolley died when he was struck by a car on May 6, 1940, at 80 years of age.



Foundation for the Future

In *Blue Sky Law*, Louis Loss and Edward M. Cowett wrote that "by present standards the first blue sky laws seem as crude as the flying machines of the same period."

In 1911, the same year the first blue sky law was adopted, A.K. Longren made the first successful sustained flight into the blue skies of Kansas. And indeed, Longren's biplane looks quite undeveloped when compared to the modern aircrafts produced in Wichita today by Bombardier Learjet, Cessna Aircraft Company, Hawker Beechcraft, Spirit Aerosystems, and Boeing. But, his biplane contained all of the essential elements that are still used today – wings to provide lift, an engine to provide propulsion and landing gear to bring it safely back to earth.

Similarly, the original blue sky law looks strikingly undeveloped by today's standards, but the original act and early amendments created a structure that still exists today.

Modern securities regulation is comprehensive and complex, with volumes of laws and regulations, but most of those laws and rules are built upon a very basic framework.

Distilled to its very core, securities law involves three fundamental elements:

- First, a person cannot sell securities until the securities are registered, unless the securities or method of offering qualify for an exemption from registration.
- Second, the person selling the securities must be registered, unless an exemption applies.
- Finally, the seller cannot commit fraud.

The original blue sky act contained all three of these concepts, and they were further developed with early amendments to the act.

Federal lawmakers took note of the state blue sky laws. Congress passed the Securities Act of 1933 to regulate

interstate sales of securities at the federal level, and the Securities Exchange Act of 1934 to regulate sales of securities in the secondary market and create the U.S. Securities and Exchange Commission to enforce federal securities laws. The '33 Act addressed a system of dual regulation. Congress deferred to the state laws, not only by choosing not to duplicate "merit review" under the jurisdiction of state law, but also by expressly preserving state regulation in the Act. Section 18 of the Act follows:

Nothing in this Subchapter shall affect the jurisdiction of the securities commission of any state or territory of the United States, or the District of Columbia, over any security or any person.

Over the next seven years, Congress passed several more federal acts pertaining to securities regulation, including the Public Utility Holding Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940 and the Investment Advisors Act of 1940.

In 1956, an attempt was made to standardize certain aspects of state securities regulation. In addition to "bringing consistency" to state blue sky law, the Uniform Securities Act of 1956 (USA) sought to integrate the state securities system as much as possible with federal securities laws. Currently, the USA is the mold from which most state securities laws are cast.

The National Securities Markets Improvement Act of 1996 (NSMIA) sought to uniformly regulate certain national securities offerings among states. NSMIA amended section 18 of the '33 Act, preempting state-level registration of securities that qualify for listing on the NYSE, AMEX, Nasdaq, and "securities of the same issuer which are equal in rank or senior to such listed securities," among others. While NSMIA precludes state registration of "covered securities" (those which qualify for the above-listed exchanges), state-level registration of broker-dealer and agent/salesperson of such securities remains a requirement.

In the United States, the role of state regulators

Foundation for the Future

continued

and enforcers in dealing with securities offerings and professionals was significantly impacted by NSMIA. This law preempted many state regulations and transferred significant enforcement responsibilities from the states to the federal government.

Despite the constraints of NSMIA, state securities regulators continue to work closely with their federal counterparts to uncover and prosecute fraudsters. Along the way, state securities regulators emerged as undisputed leaders in criminal prosecutions of securities law violators.

In recent years, ranging from 2004 through 2009, state securities regulators have conducted nearly 14,000 enforcement actions, which led to \$8.4 billion ordered returned to investors. And, state securities regulators worked to secure convictions for securities laws violators resulting in more than 6,000 years in prison. From 2008 to 2010, provincial and territorial regulators in Canada concluded 438 cases, which led to fines and administrative penalties of \$230 million and \$167.3 million ordered returned to investors.

Traditionally, state securities regulators pursue perpetrators at the local level who are trying to defraud "mom and pop" investors, while federal securities regulators focus on fraudulent activities involving the securities market at a national level.

Even so, state regulators have successfully exposed and addressed large issues, such as, the conflicts of interest among Wall Street stock analysts by requiring changed behavior. State securities regulators led all regulators on late trading and market timing in mutual funds and were the first to identify and fight fraud against senior investors by curbing the misleading use of senior designations. Most recently, NASAA members led the nationwide effort to address problems related to the offer and sale of auction rate securities, an effort that has resulted in the largest return of funds to investors in history.

By Rick A. Fleming and Bob Webster

Looking Forward: The Next Century of Investor Protection

In the aftermath of the financial collapse that shook world economies in 2008, Congress recognized that the existing securities regulatory landscape required an overhaul.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in 2010, was crafted to promote stronger investor protection and more effective oversight to help prevent another economic crisis and restore the confidence of Main Street investors.

In several respects, this new law acknowledged the strong role of state securities regulators by expanding state regulatory authority in certain areas.

The Dodd-Frank legislation signaled the beginning of a new era of investor protection and financial market oversight.

Reforms now taking shape at the national level are giving new authority to state securities regulators to address the challenges facing 21st century investors.

Looking forward, the increasing globalization of the world's financial markets demands strong and effective regulation to protect investors and prevent financial harm.

As we enter our second century of investor protection, state and provincial securities regulators throughout North America welcome the opportunity to continue serving at the forefront of investor protection.

A Century of Investor Protection

From modest origins in the American heartland 100 years ago, blue sky laws today provide a foundation of protection for more than 100 million investors throughout North America.

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For more on the history of blue sky law, see Rick Fleming's article, *100 Years of Securities Law: Examining a Foundation Laid in the Kansas Blue Sky*, in the Spring 2011 Washburn Law Journal, Volume 50, No. 3.

NASAA is the oldest international organization devoted to investor protection. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, the provinces and territories of Canada, and Mexico. For more information, visit: www.nasaa.org.