THE NEW GEORGIA SECURITIES ACT

By GEORGE S. PARTHEMOS*

INTRODUCTION

The states, as well as the Federal government through the Securities Exchange Commission, regulate the sale of corporate securities to the general public. Since Congress has no express power on the subject, it controls the sale of securities through the exercise of its specifically delegated powers over interstate commerce and the mails. Congress might, if it wishes, exempt from the operation of state laws securities subject to registration with the Federal Securities and Exchange Commission, but it has not done so. And as early as 1917, the United States Supreme Court held that state securities legislation may constitutionally apply to securities coming from other states even though the securities have not yet lost their interstate character.[1]

In point of fact, the enactment of the Federal Securities Act of 1933, and subsequent federal legislation on the subject, with the exception of the Investment Advisers Act, expressly preserves the jurisdiction of state regulatory agencies.[2] State agencies, however, confine their activities largely to the relatively smaller issues of securities, for the issuance of which registration with the Federal Securities and Exchange Commission is not a condition precedent to sale. In most instances though compliance with the federal statutes more than complies with state enactments. But this does not mean that there is little for the state agencies to do. Congress has far from preempted the field of securities regulation, and in the area of relatively small capitalizations, there is a vast field for state activity.

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1. Hall v. Geiger-Jones Co., 242 U.S. 539, 37 S.Ct. 217, 61 L.Ed. 480 (1917), Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559, 37 S.Ct. 224, 61 L.Ed. 493 (1917); Merrick v. N. W. Halsey & Co., 242 U.S. 568, 37 S.Ct. 227, 61 L.Ed. 498 (1917) (Blue Sky Law Cases).

2. There are seven statutes under which the Federal Securities Exchange Commission operates. With the exception of the Investment Advisers Act, enacted in 1940, they all contain provisions preserving the jurisdiction of state regulatory agencies even where the mails or facilities of interstate commerce are used. The absence of any provision preserving state jurisdiction in the Investment Advisers Act is usually explained by the fact that there are so few state statutes which seek to regulate so-called "investment advisers" and there were even fewer in 1940. See LOSS, SECURITIES REGULATIONS, pp. 19, 88, 103-104, and 480-481 (1951).

While it is frequently said that Kansas was the first state to pioneer the field of securities regulation in the year 1911, a law regulating the sale of certain types of securities was enacted by the Georgia General Assembly as early as 1904.[3] The Georgia law required companies selling "investment securities of any kind on the partial payment, installment or any other plan of payment, and providing for the redemption and retiring of the same, or any part thereof", to deposit in a trust company at least $25,000 or not less than 75 per cent of the amount collected in payment. A financial statement containing information of the company's assets and liabilities together with its annual income was also to be filed with the Comptroller General of the state. Hence, seven years before the date usually given for the enactment of the first state "Blue Sky Law", Georgia moved to protect certain types of investors and to deal with the problem of security regulation. It thus seems that Georgia may well claim credit for the first legislation in the field of securities regulation. The Georgia law, however, was not a comprehensive regulatory measure and did not require registration of securities or dealers. Kansas was the first state to enact a general registration and licensing act requiring the filing of certain information with state authorities and obtaining their approval before undertaking to sell securities to the investing public.[4]

It was the Kansas law which served as the pattern for similar laws subsequently passed by states in all parts of the country, with certain few exemptions. During the debate over the Kansas bill a member of the Kansas legislature contended that dishonest promoters would sell shares "in the bright blue sky itself". State statutes take their name from this illustration, and the terminology has been adopted by the United States Supreme Court. Within five years of the enactment of the Kansas statute, most states followed suit. Today, every one of the states, with the exception of Nevada and Delaware, have some form of "Blue Sky Laws,[5] which, unless carefully complied with, present potential technical pitfalls for companies intending to distribute their securities.

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3. Ga. Laws 1904, p. 74.
4. Kan. Sess. Laws 1911, c. 133.
5. Delaware in 1931 adopted a one paragraph simple fraud statute which merely authorized the chancellor, at the instance of the attorney general, to enjoin the "fraudulent sale or exchange of . . . securities". It did not provide for investigation or criminal prosecution and there were no reported instances of its use. In 1953 it was dropped from the Delaware code. Del. Laws 1931, c. 260, DEL. REV. CODE § 4369 (1935). Also see Loss, *op. cit.* pp. 20-21, and Loss, SECURITIES REGULATION (1955 Supp.).

The specific type of securities legislation varies considerably from state to state. There are, however, three fairly well recognized types in existence today. Some states require the registration and approval of the security issue as a condition precedent to sale. Other states control the dealer and his salesmen exclusively and require that they be licensed as a condition precedent to sale. These are the two most common types of state statutes. Ordinarily these are used in conjunction, but some states rely on only one. A small number of states have the "fraud type" of statute which provides civil and criminal penalties for the perpetration of frauds in the sale of securities.

The first comprehensive Georgia law relating to the sale of securities in the state was passed by the General Assembly in 1913 and was known as the "Georgia Blue Sky Law".[6] This act was repealed and superceded by an act of 1920 known as "The Georgia Securities Law".[7] The 1920 act was subsequently amended several times,[8] and in 1953 a comprehensive new statute repealing in their entirety previous provisions was enacted.[9]

The 1953 act basically provided that unless the security was exempt under one of the seven subparagraphs of Section 5 of the Act, or unless the sale of securities was an exempt transaction under one of nine subparagraphs of Section 6, no dealer, salesman, or issuer could lawfully sell or offer for sale any security within the state until the dealer or the issuer filed with the Secretary of State, acting as Commissioner of Securities, the following items: (1) a notice of intention to sell such securities containing detailed information required by the statute, (2) a prospectus meeting the requirements of the act, and (3) the payment of a filing fee. Then, as provided by the act, the Secretary of State could "make such investigation of any securities described in a notice of intention to sell filed with him as he may deem advisable to enable him to determine whether the sale of such securities would work or tend to work a fraud on purchasers thereof". If the Secretary of State found that the securities offered for sale would work a fraud upon the purchasers, he could issue an order forbidding the further sale of such securities in the state.[10]

The 1953 act was the controlling act until the enactment of still another new comprehensive measure by the recent 1957 General As-

6. Ga. Laws 1913, p. 117.
7. Ga. Laws 1920, p. 250, GA. CODE ANN. § 97-101.
8. Ga. Laws 1922, p. 163; Ga. Laws 1933, p. 263; and Ga. Laws 1937, p. 787.
9. Ga. Laws 1953, p. 423; GA. CODE ANN. § 97-101.
10. Ga. Laws 1953, p. 429; GA. CODE ANN. § 97-103 (1933).

sembly which repeals the 1953 act.[11] The new Georgia Securities Act is essentially a revision of the 1953 statute, although it clarifies and rearranges several sections and makes a number of other important changes.

Perhaps the most significant change made by the new 1957 act is to be found in the division of securities into two general classes. One class of securities may be registered by a relatively easy, simplified procedure generally known as "notification" and the other class by a more detailed and somewhat more complex procedure generally referred to as "qualification". Registration by "notification" is usually reserved for securities of established companies, while registration by "qualification" is usually required for securities of new companies or of companies engaged in an activity more "speculative" in nature. Registration of securities is usually effected by one of these two methods, or by both, with numerous variations in the particular registration schemes.

Georgia formerly divided securities for purposes of regulation into Classes A, B, C, and D.[12] Classes A and B designated certain exempt securities and exempt transactions respectively. Class C securities were securities of corporations which had operated continuously for two years and which met a specified minimum earning standards. Class D securities included all securities other than those falling within the first three classes. Different procedures were applicable for the registration of Class C and Class D securities with the requirements for the registration of the latter class being much more complete than for the former.[13]

The Securities Act of 1953 dropped this earlier classification of securities and put all non-exempt securities on the same basis. Under that statute, all securities, not specifically exempt, were subjected to the same type of registration procedure, rather than having two or more classes of securities with a particular procedure for each class. Under the 1953 act, established businesses with good earning records were required to file the same application with the requisite accompanying information in detail as was required of new or more speculative enterprises. To many persons this seemed to contradict a basic purpose of securities regulation—to protect the public from fraud and misrepresentation by purveyors of worthless or questionable securities, or securities based upon unsound corporate or business structures.

11. Ga. Laws 1957, p. 134.
12. Ga. Laws 1920, pp. 252, 258; Ga. Laws 1933, pp. 265-266.
13. Ga. Laws 1920, pp. 255-258.

II

REGISTRATION UNDER THE NEW ACT

Section 3 of the new Georgia Securities Act permits registration by the more simplified notification procedure of securities of companies which have been in continuous operation for at least five years, provided the company meets the following conditions: (1) there has been no default in the payment of principal, interest, or dividends on any security of the company with a specified maturity or a specified interest or dividend rate during the firm's current fiscal year nor within the three preceding fiscal years, (2) the company has shown annual net earnings during the past three years, determined in accordance with generally accepted accounting practices, of at least five per cent of the amount of securities without a specified maturity or a specified interest or dividend rate outstanding at the date the registration statement is filed. The amount of securities is measured by the maximum offering price or the market price, whichever is higher, on a day selected by the registrant within thirty days before the date of filing the registration statement. If there is neither a readily determinable market price nor an offering price, then book value on a day selected by the registrant within ninety days of the date of filing the registration statement may be used to determine amount for the purpose of qualifying under the five per cent average net earnings provisions. If the company has not had any securities without a specified maturity or fixed interest or dividend provision outstanding for three years, then it must have average net earnings equal to at least five percent of the amount of such securities which will be outstanding if all the securities being offered or proposed to be offered are issued.[14]

The securities of companies qualifying under the "registration by notification" provisions of the new act may be registered by filing with the Secretary of State a short form registration statement containing information concerning the character and location of the business, title and total amount of securities to be offered and the amount to be offered within the State of Georgia, the price at which the securities are to be offered for sale to the public, and all commissions to be paid in connection with the sale of securities. A copy of the prospectus to be used with the public sales and a financial statement demonstrating eligibility for registration by notification must

14. Ga. Laws 1957, p. 138.

be filed also.[15] Registration by notification under the new law automatically becomes effective when the registration statement together with the other required documents plus the payment of a filing fee have been filed with the Secretary of State. No action is required by the Secretary of State; he may take action, as we shall see, but in the absence of action on his part, the security is registered with the filing of the required documents and the payment of the filing fee.[16] There is no stipulated waiting or "cooling off" period, between the filing of the statement and the offering of the security for sale. Federal legislation and many state statutes provide that registration shall become effective only after the elapse of a stipulated interval of time.

The new Georgia Securities Act also provides that "any security may be registered by qualification."[17] Those securities, however, which are not eligible for exemption or for registration by notification must be registered by qualification (or "application" as it is sometimes called). The requirements of the registration statements for this procedure are much more complete than notification, calling for detailed disclosure of information concerning the undertaking and its promoters. Full information must be given of the character and scope of the business, the purpose of incorporation (if incorporated), and the specific purpose in detail for which the funds raised are to be used. A balance sheet as of a date not more than ninety days prior to the filing of the statement is required, and a certified profit and loss statement for the three years preceding the date of the most recent balance sheet must be included. A statement of the capitalization of the issuer must be shown. The Secretary of State must also be informed of the title and total amount of securities to be offered and the amount to be offered in Georgia, the price at which the securities are to be offered for sale to the public, all commissions or other forms of remuneration to be paid in respect to the sale, and the names and addresses of directors, trustees, and officers. A copy of any offering circular or prospectus and a detailed statement showing the items of cash, property, services, patents, and any other consideration for which any of the securities have been within two years or are to be issued in payment must also be included. The registration must in addition show if a statement for such securities has been filed under the Federal Securities Act of 1933.[18] Objection

15. Ga. Laws 1957, p. 139.
16. *Ibid.*
17. *Ibid.*
18. Ga. Laws 1957, pp. 140-141.

is frequently made that the information exacted by state securities laws is too detailed. It must be remembered, however, that the registration statement is of basic importance, both as a source of information to the prospective investor, and as a foundation for civil and criminal liability should the information therein given be fraudulent or misleading. It would seem that such detailed information is indispensable especially in the registration of securities of new enterprises. On the other hand, the more simplified registration by notification procedure seems practicable and desirable for securities of established companies. It must also be remembered that for securities requiring registration with the Federal Securities Exchange Commission, fulfillment of federal requirements usually fulfills state requirements. The Georgia act of 1953 permitted the filing of federal registration statement or prospectus in lieu of the information otherwise required.[19] The new 1957 Act also accepts the federal prospectus in lieu of certain statutory requirements, provided that a registration statement for the securities has been filed with the Securities Exchange Commission within sixty days prior to filing under state law.[20].

Unlike registration by notification, which becomes effective when necessary documents are filed with the Secretary of State, registration by qualification under the new law does not become effective until the Secretary of State so orders. Under notification, as has been pointed out, the filing of the required documents and the payment of the fee, is in the absence of any action by the Secretary of State, all that is required. Such is not the case with registration by qualification. Specific action is necessary to admit the security to registration in the latter instance, and apparently there is no time limit upon the Secretary taking action.[21] In both types of registration a filing fee in the amount of 1/20th of one per cent of the aggregate offering price of the securities to be offered for sale in the state is levied, but in no case may the filing fee be less than twenty-five dollars.[22]

As in the case of the 1953 Act, the Secretary of State may make an investigation of any securities registered with him. If he finds that the registration is defective and that the securities offered for sale will work a fraud upon the purchasers, he is empowered to prevent the further sale of such securities by a "stop order" or a court injunc-

19. GA. CODE ANN. § 97-103 (1933).
20. Ga. Laws 1957, pp. 141-142.
21. Ga. Laws 1957, p. 142.
22. *Ibid.*

tion.[23] This type of administrative action has generally proven to be a very effective sanction. This act, however, also provides that criminal penalties may be invoked against those who willfully violate its provisions,[24] and also accords a civil remedy to all purchasers. According to the act, every sale made in violation of its provisions is "voidable at the election of the purchaser" who is entitled to recover from the seller in a civil action the full amount paid by him together with court costs and attorney's fees. All actions for civil liability are barred, however, unless brought within two years after the date of sale.[25]

III

Exempt Securities and Exempt Transactions

As in previous legislation on the subject, and in common with federal and state legislation, the new Georgia Securities Act lists a number of categories of securities which are exempt from the regulatory provisions of the act. These exemptions include domestic governmental or governmental-owned agency or corporations securities, issues of building and loan associations, securities issued for religious, educational, benevolent, or charitable purposes and not for pecuniary profit, commercial paper maturing in not more than twelve months, securities issued by national banks, or banks or credit associations organized under federal law and supervised by a federal agency, securities issued by a state bank, trust company, or savings institution incorporated under state law and supervised by a state agency, securities issued by a railroad or public utility subject to the jurisdiction of a state or federal agency, and securities fully listed on the New York, Midwest, and American Stock Exchanges, or any other stock exchange approved by the Secretary of State as provided in the Act, and all securities senior or equal in rank to any securities so listed.[26] Exemptions of principal stock exchange listings is done on the theory that the exchanges will prevent fraudulent operations in all listed securities. These exempt provisions are essentially the same as were provided in the 1953 act. The only important change

23. Ga. Laws 1957, pp. 142-143 and pp. 159-160. The issuer or dealer adversely affected by a "stop order" may request a hearing under the provisions of section 8 of the act. An appeal may be taken from any decision of the Secretary of State to the Superior Court of Fulton County.
24. Ga. Laws 1957, pp. 161-162. Violation of the statute is made a misdemeanor, and carries a fine of $500 for the first offense, and a fine of not more than $5000 or one year in prison, or both, for subsequent violations.
25. Ga. Laws 1957, p. 161.
26. Ga. Laws 1957, pp. 149-150.

is the deletion of the exemption for securities issued by insurance companies.[27]

Most state securities laws contain similar provisions for exempt securities. Some states have broadened their exempt provisions to include certain other types of security issues like, for example, securities issued by credit unions approved and supervised by some state agency, securities issued under some "employee-security-purchase plans", or some "employee profit-sharing trusts or plans" or "employee pension trusts plans", under certain conditions.[28] Advocates of exemptions relating to employee security purchase plans stress the fact that employee security ownership tends to reduce labor strife, and that issuers desiring to sell their securities to their employees through one of several plans generally issue the securities on quite favorable terms. They also argue that since these plans are usually subject to revenue laws, additional requirements of registration are not necessary for the protection of the employee-investor. Some states exempt securities of insurance companies and foreign governments. Some exempt securities of domestic Rural Electric Cooperative Corporations. A number of states variously grant exemptions to securities issued by domestic corporations.[29]

In addition to exemptions based on the type of security, Georgia securities regulations provide for a number of exemptions based on the type of transaction. Section 6 of the new Georgia Securities Act lists ten types of transaction that are exempt from the regulatory provisions of the act. These exempt transactions, with one exception, are the same as were provided in the act of 1953.[30] The important new exempt transaction relates to the sale of securities, not involving an underwriting, to not in excess of twenty-five persons, provided such securities are purchased for investment and not for distribution. Any securities purchased in such an exempt transaction and held by the original purchaser for a period of twelve months after issuance shall prima facie be presumed to have been purchased for investment and not for distribution. In order to qualify for exemption under this provision, however, the issuer of the securities involved must make a written request to the Secretary of State that such sale be exempted and the Secretary must approve the request.[31] This

27. GA. CODE ANN. § 97-105 (1933).
28. See for example the Illinois Securities Law, ILL. ANN. STAT. ch. 121½, § 137.3 and 137.4.
29. Loss, Securities Regulations pp. 43-44 and 47-48 (1951).
30. GA. CODE ANN. § 97-106 (1933).
31. Ga. Laws 1957, pp. 151-152.

new exempt transaction is apparently based on the idea that the number of subscribers and not the amount of money involved is the proper test for an exemption.

IV.

Miscellaneous Revisions

The new Georgia Securities Act makes a number of other miscellaneous revisions, mostly of a clarifying nature, of the former law. Among the more important of these changes from the old law are the following: (1) the new act specifically designates the Secretary of State, "Commissioner of Securities", and authorizes him to appoint an Assistant Commissioner.[32] The 1953 Act referred to the Secretary of State as "acting as Commissioner of Securities".[33] (2) The definition of the term "security" is the same as in the 1953 Act and it embraces most of the instruments that commonly fall in that category in the commercial world. But the new act specifically excludes from the definition "any insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed number of dollars either in a lump sum or periodically for life or some other specified period".[34] (3) The registration of dealers and salesmen of securities is required in much the same manner as in the previous act. But in addition to "dealers" and "salesmen", the new act specifically defines the terms "limited dealer" and "limited salesmen",[35] and the procedure relative to the registration of a "dealer" or "salesmen" is made to apply to the registration of a "limited dealer" and a "limited salesman". An application for registration as a "limited dealer" or "limited salesman" must in addition, however, furnish the Secretary of State with information as to the particular issue or class of securities which are to be offered for sale, and any registration issued to a limited dealer or limited salesman will specify the issue or class of securities which such registration authorizes them to sell.[36] (4) The fee for the registration of dealers has changed so that under the new law the initial registration of a dealer is set at $250, with the annual renewal fee set at $50. The initial registration fee for a limited dealer is set at $100, with a $50 annual renewal fee.. The initial registration fee for each salesman and each limited salesman is set at $10, with a $10 annual renewal

32. *Ibid.*
33. Ga. Code Ann. § 97-102 (1933).
34. Ga. Laws 1957, p. 136.
35. Ga. Laws 1957, pp. 135-136.
36. Ga. Laws 1957, pp. 143-148.

fee.[37] Under the old law the fee for registration and for each annual renewal was for each dealer, $50; for each salesman, $10.[38] (5) Under the new act, the Secretary of State may require as a condition of registration for "salesman" or "limited salesman" that the applicant pass a written examination as evidence of knowledge of the securities business.[39] These and other minor revisions have clarified some and added other provisions to previous securities regulations.

V

CONCLUSION

The new Georgia Securities Act is not perfect. There are no specific provisions regulating the use and publication of advertising materials connected with an issue of securities. The registration of so-called "independent investment advisers" is not required. No provision requiring the bonding of either the issuing corporation or registered dealers is included. But in spite of these and other omissions, the new act seems to go a longer way toward affording greater protection to the investing public of the state, while at the same time eliminating many obstacles which may hamper the operation of legitimate businesses.

37. Ga. Laws 1957, pp. 148-149.
38. GA. CODE ANN. § 97-104 (1933).
39. Ga. Laws 1957, p. 147.

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