The Securities Industry Standards Act of 1986: Significant Changes In Florida’s Blue Sky Laws

Marilyn B. Cane*
The Securities Industry Standards Act of 1986: Significant Changes In Florida’s Blue Sky Laws

Marilyn B. Cane

Abstract

National attention has often focused on Florida as a base for con-artists.

KEYWORDS: sky, laws, securities
The Securities Industry Standards Act of 1986: Significant Changes In Florida's Blue Sky Laws

Marilyn B. Cane

I. Introduction and Background

National attention has often focused on Florida as a base for con-artists. There are several factors that serve to attract dishonest individuals to Florida. First, the demographic composition of the state includes a significant number of retirees who come to Florida with their life savings. Florida is comprised of a highly mobile population which helps to preserve the anonymity of criminals. Florida’s proximity to off-shore banks provides an opportunity for individuals who wish to make money illicitly and then quickly move the funds outside the jurisdiction of this country. The same climate, cultural and recreational opportunities that serve to attract honest individuals to this state also entice dishonest individuals.

1. Associate Professor of Law, Nova University Center For the Study Of Law. J.D., Boston College, 1974; A.B., Cornell University, 1971. Professor Cane served as a member of the Advisory Committee to the Banking Commissioner of the State Of Connecticut from 1978-1980. The Advisory Committee proposed changes to Connecticut’s Blue Sky Laws.

2. Copyright 1987, Marilyn B. Cane.

1. CONTROLLER’S TASK FORCE REPORT ON SECURITIES REGULATION REPORT, HB 666, 98th Leg., 1st Sess. 13 (1986).
Effective October 1, 1986, Florida has substantially revised its Blue Sky Law. The primary objective of the new legislation is to enhance anti-fraud enforcement of securities and investment transactions. The new law was spurred by recommendations of the Comptroller’s Task Force on Securities Regulation (the “Task Force”), which was formed in June of 1985 “to conduct a comprehensive review of Florida’s regulation of securities and other investment transactions.”

A new statute, the Securities Industries Standards Act of 1986, amends provisions of and creates provisions for the Florida Securities and Investor Protection Act, which is chapter 517 of the Florida Statutes.

2. The term Blue Sky Law is used to describe state securities laws, as contrasted with federal securities laws, which are based on the securities laws in 1911. Indeed, it was in Kansas, apparently, that the term “blue sky law” first came into general use to describe legislation aimed at promoting who “would seek building bows in the blue sky, sky as we.”

3. House Committee on Commerce. Final Staff Analysis CS/HB 644, 9th Leg., 1st Sess. 1986 [hereinafter cited as Final Staff Analysis]. The final legislation evolved from the Task Force recommendations, which may be found in the Comptroller’s Task Force on Securities Regulation Report HB 644, 9th Leg., 1st Sess. 1986 (hereinafter cited as Task Force Report), as well as in other legislative enactments, most notably in CS/HB 644. See House Commerce Committee, Final Staff Analysis CS/HB 644, 9th Leg., 1st Sess 1986 [hereinafter cited as Staff Analysis]. As will be shown, the final legislative package contained many, but by no means all, of the recommendations contained in the Task Force Report, in spirit if not in exact language. Representative Beverly Allen, a member of the Task Force, filed HB 644 on March 5, 1986. The Subcommittee on Banking and Finance, after making nine amendments, recommended it favorably on April 9, 1986, after which it was reported, as amended, to a Committee Substitute. On May 13, 1986, the Appropriations Committee amended the bill once again, and the legislation became Committee Substitute for Committee Substitute for House Bill 644. CS/HB 644 was passed on May 19, 1986. However, its legislative journey was not yet over. The Senate substituted CS/HB 644 for its version of CS/HB 613, and amended it to remove the mandatory option offering American Arbitration services and replace it with a permissive option. The House concurred with this Amendment and, on June 3, 1986, finally passed the bill by a 113-0 vote. The effective date was October 1, 1986.

4.See Chapter 86-85, Committee Substitute for Committee Substitute for House Bill 644, Section 1 (Hereinafter cited as “CS/C/S/HB 644”). This article will also refer to the earlier edition of the bill, Committee Substitute for House Bill 644 [Hereinafter cited as “CS/HB”].


7. See Task Force Report, supra note 3, at 70. Copies of the Task Force Report are available from the Office of the Comptroller, Department of Banking and Finance, Tallahassee, Florida 32301. The Task Force Report is 141 pages long and is invaluable in understanding the motivations behind the enactment of the Florida Standards Act of 1986. The Task Force was chaired by former Florida Governor Reubin Askew, and was composed of 19 members, including representatives from the securities industry, self-regulatory organizations, academia, law enforcement, the Florida Legislative and government agencies.”
Effective October 1, 1986, Florida has substantially revised its Blue Sky Law. The primary objective of the new legislation is enhanced anti-fraud enforcement of securities and investment transactions. The new law was spurred by recommendations of the Comptroller’s Task Force on Securities Regulation (the “Task Force”), which was formed in June of 1983 “to conduct a comprehensive review of Florida’s regulation of securities and other investment transactions.” A new statute, called the Securities Industries Standards Act of 1986, amends provisions of and creates provisions for the Florida Securities and Investor Protection Act, which is chapter 517 of the Florida Statutes.

2. The term Blue Sky Law is used to describe state securities laws, as contrasted with the federal regulation of securities. The colorful term had its origin in connection with the enactment of the Kansas securities law in 1911. "Indeed, it was in Kansas, apparently, that the term "blue sky law" first came into general use to describe legislation aimed at promoters who "would sell building lots in the blue sky in fee simple." L. Low, Fundamentals of SECURITIES REGULATION 8 (1983) (citing Mulvey, Blue Sky Law, 36 CAN. L.J. 37 (1950)).

3. HOUSE COMMITTEE ON COMMERCE, FINAL STAFF ANALYSIS CS/CS/HB 644, 9th Leg., 1st Sess. 1986 [Hereinafter cited as FINAL STAFF ANALYSIS]. The final legislation evolved from the Task Force recommendations, which may be found in the Comptroller’s TASK FORCE ON SECURITIES REGULATION REPORT HB 844 9th Leg., 1st Sess. 1986 [hereinafter cited as TASK FORCE REPORT], as well as in other legislative recommendations, most notably in CS/HB 644. See HOUSE COMM. ON COMMERCE, STAFF ANALYSIS CS/HB 644, 9th Leg., 1st Sess. 1986 [hereinafter cited as STAFF ANALYSIS]. As will be shown, the final legislative package contained many, but by no means all, of the recommendations contained in the Task Force Report, in spirit if not in exact language. Representative Beverly Burnsed, a member of the Task Force, filed HB 644 on March 5, 1986. The Subcommittee on Banking and Finance, after making nine amendments, recommended it favorably on April 9, 1986, after which it was reported, as amended, as a Committee Substitute. On May 13, 1986, the Appropriations Committee amended the bill once again, and the legislation became Committee Substitute for Committee Substitute for House Bill 644. CS/CS/HB 644 was passed on May 19, 1986. However, its legislative journey was not yet over. The Senate substituted CS/CS/HB 644 for its version (CS/CS/SB 613), but amended it to remove the mandatory option offering American Arbitration Association services and replace it with a permissive option. The House concurred with this amendment and, on June 3, 1986, finally passed the bill by a 113-0 vote. The effective date was October 1, 1986.

4. See Chapter 86-85, Committee Substitute for Committee Substitute for House Bill 644, Section 1 [Hereinafter cited as "CS/CS/HB 644"]. This article will also refer to the earlier edition of the bill, Committee Substitute for House Bill 644 [Hereinafter cited as "CS/HB"].


7. See TASK FORCE REPORT, supra note 3, at 70. Copies of the TASK FORCE REPORT are available from the Office of the Comptroller, Department of Banking and Finance, Tallahassee, Florida 32302. The Task Force Report is 141 pages long and is invaluable in understanding the motivations behind the enactment of the Florida Securities Act of 1986. The Task Force was chaired by former Florida Commissioner Askins, and composed of 19 members, including representatives from the “securities industry, self-regulatory organizations, academia, law enforcement, the Florida Legislature and government agencies.” Id. at 5.

8. Id. at 70-71.

9. Id. at 71.


11. Id. § 517.312 (1985).

The Florida Legislature had revised the Blue Sky Law as recently as 1983, with the enactment of the Securities and Investor Protection Act. That Act substituted “notification registration” for the former exemption from state registration for offerings which had been registered federally with the United States Securities and Exchange Commission. According to the Task Force Report, that change was necessitated by problems with federally registered “penny stocks” that had not been issued seven years earlier when the Florida Securities Act was passed.

In addition, as a result of the 1985 legislation, the Department of Banking and Finance’s “Investigative authority was enhanced by providing confidentiality for examination of books and records and strict penalties for non-compliance with investigatory subpoenas.” The Florida Blue Sky Law was materially amended in 1984 with the adoption of the Investor Protection Act of 1984. That Act defined “soror rooms” and prohibited their operation for the commission of investment fraud.

The most significant change in 1984, however, was the expansion of the Department of Banking and Finance’s anti-fraud enforcement authority to offers and sales of “investments.” The purpose of the 1984 legislation was to ensure that the anti-fraud provisions of chapter 517 could be used against investment fraud even where the scheme used had been designed to fall outside the technical definition of a security. A restrictive interpretation of the scope of chapter 517....
had encouraged promoters of fraudulent schemes to locate in Florida where they could argue that their activities did not constitute the sale of "securities."19

Prior to the flurry of legislative activity on the Florida Blue Sky Laws in 1984, 1985 and 1986, the next most recent amendment was in 1978.20 In 1978 the legislature adopted the Florida Sale of Securities Act. "The 1978 Act was characterized by a retreat from the merit review philosophy and an increased emphasis on anti-fraud enforcement. The most significant change in the law was the exemption from merit review of any security registered with the federal government."21 According to the Task Force Report, this change was spurred by proposals from the Florida Law Revision Council in 1975, which asserted that merit review had "arbitrarily inhibited growth of new enterprise and created undesirable competitive advantages for large corporations at the cost of small firms" and was found wanting in a cost/benefit analysis.22

From 1971, when Florida enacted its first Blue Sky Law,23 until 1978, when the Florida Securities Act24 was passed, Florida had been a merit regulation state. The key to merit regulation is that the state regulators have the power to prohibit offerings into the state which are not deemed to be "fair, just and equitable."25 The contrasting philos-

12. TASK FORCE REPORT, supra note 3, at 70. The "restrictive interpretation" referred to in the Task Force Report is doubtless a reference to Yeomans v. State, 452 So. 2d 1011 (Fla. 1984). In Yeomans, the Third District overturned the Comptroller's imposition of cease and desist orders against thirty-two "boiler room" operators selling "selling-service" contracts in connection with the United States Department of Interior's oil and gas lease lottery. The court held that the contracts were not "investment contracts" or any other kind of "security" as defined by the Florida Blue Sky Laws as interpreted by the courts.

14. TASK FORCE REPORT, supra note 3, at 69 (emphasis added).
15. Id. at 69.
16. Id. at 67.


1978 Wis. L. Rev. 79; Huitema, Application of Merit Requirements in State Securities Regulation, 15 WAYNE L. REV. 1417 (1969). Professor James Molsky of the University of Miami Law School, a member of the 1983-86 Task Force, was the reporter to the Florida Law Revision Council whose recommendations "ultimately resulted in the Florida Securities Act of 1978," which, as indicated above, was a retreat from previous merit regulations. See TASK FORCE REPORT, supra note 3. For a discussion of his views see Molsky & Tillison, Demerit in Merit Regulation, 60 MARQ. L. REV. 367 (1977).

19. Id., supra note 2, at 36.
20. Id. (emphasis in original).

Prior to the flurry of legislative activity on the Florida Blue Sky Laws in 1984, 1985 and 1986, the next most recent amendment was in 1978. In 1978 the legislature adopted the Florida Sale of Securities Act. "The 1978 Act was characterized by a retreat from the merit review philosophy and an increased emphasis on anti-fraud enforcement. The most significant change in the law was the exemption from merit review of any security registered with the federal government." According to the Task Force Report, this change was spurred by proposals from the Florida Law Revision Council in 1975, which asserted that merit review had "arbitrarily inhibited growth of new enterprise and created undesirable competitive advantages for large corporations at the cost of small firms" and was found wanting in a cost/benefit analysis.

From 1973, when Florida enacted its first Blue Sky Law, until 1985, when the Florida Securities Act was passed, Florida had been a merit regulation state. The key to merit regulation is that the state regulators have the power to prohibit offerings into the state which are not deemed to be "fair, just and equitable." The contrasting philosophy is the philosophy of "full and fair disclosure." This philosophy, which underlies the federal securities laws, removes the government from its role as in loco parentis.

As the Supreme Court has... put it, the SEC statutes embrace a "fundamental purpose... to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry." In short, Congress did not take away from the citizen his inalienable right to make a fool of himself. It simply attempted to prevent others from making a fool of him. It must not be thought, however, that Disclosure and Merit are two gods that sit on separate but equal thrones. On the one hand [a state blue sky law, in particular, the Uniform Securities Act] has a disclosure component, and most states today require the delivery of a prospectus. On the other hand, the indirect regulatory effect of a policed system of full and fair disclosure should not be underestimated: people who are forced to undress in public will presumably pay attention to their figures. Nevertheless there is a difference..."

II. A Limited Return To Merit Regulation

The long-standing debate over state blue sky merit regulation of securities offerings has assumed a new intensity and practical significance. The new intensity is reflected not only in the increased commentary on the topic but also in the sometimes exaggerated claims of both critics and supporters about merit regulation's value, or lack thereof... While the interest in merit regulation is very high, the terms of the debate have not been well-defined. There is, for example, no universally agreed upon definition of merit regulation, nor is there any comprehensive understanding of its theoretical or functional relation to federal or state disclosure review.
There is a general understanding that a merit regulator has the authority to deny registration to an offering on the ground that it is substantively unfair or presents excessive investment risk to the investor, but there has been little formal inquiry into merit's goals and assumptions.\(^{21}\)

Why then was there a return to merit regulation in the 1986 legislation? In the first place, it is important to understand that the 1986 legislation is not a complete return to merit regulation; it is far from it. Indeed, the vast majority of federally registered offerings may avail themselves of "notification registration." Section 7 of CS/CS/HB 644 rewords section 517.082(1) of the Florida Statutes to provide that

except as provided in subsection (3), securities offered and sold pursuant to a registration statement filed under the [federal] Securities Act of 1933 or the [federal] Investment Company Act of 1940 shall be entitled to registration by notification in the manner provided in subsection (2) provided that prior to the offer or sale the registration statement has become effective.\(^{22}\)

Notification registration pursuant to section 517.082(2) is not merit regulation. It requires an application be filed with the Department of Banking and Finance containing: an application to sell by the issuer, any person on whose behalf the offering is being made, a dealer registered in Florida, and their duly authorized agents; the name and address of the applicant and issuer and the title of the securities to be offered; copies of documents filed with the SEC, as required by the Department by rule; an irrevocable written consent to service of process; and a nonreturnable fee of $1,000 per application.\(^{23}\) Section 517.082(3) contains the exceptions from the notification registration procedures.\(^{24}\) In other words, this provision addresses those situations where notification registration will not apply to federally registered offerings and will, instead, require a full de novo merit review by the State of Florida. Put simply, these situations are (1):

- Securities where the offering price at the time of effectiveness with the securities and Exchange Commission is $5 or less per share or

23. Id. § 517.082(2)(a)-(b).
24. Id. § 517.082(3)(a)-(b).

25. This would include the major national exchanges, such as the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX), as well as regional exchanges, such as the Midwest Stock Exchange or the Pacific Stock Exchange.
26. NASDAQ is the NASD computerized quotation system established in 1971. The system displays price quotations that are continuously updated on a real-time basis on computer terminals located in a subscriber's office.
27. FLA. STAT. § 517.082(3)(a) (Supp. 1986).
28. Id. § 517.082(3)(b) (Supp. 1986).
29. Id. § 517.082(3)(c) (Supp. 1986).
31. Id. at 1514.

There is a general understanding that a merit regulator has the authority to deny registration to an offering on the ground that it is substantively unfair or presents excessive investment risk to the investor, but there has been little formal inquiry into merit’s goals and assumptions.21

Why then was there a return to merit regulation in the 1986 legislation? In the first place, it is important to understand that the 1986 legislation is not a complete return to merit regulation; it is far from it. Indeed, the vast majority of federally registered offerings may avail themselves of “notification registration.” Section 7 of CS/CS/HB 644 rewards section 517.082(1) of the Florida Statutes to provide that except as provided in subsection (3), securities offered and sold pursuant to a registration statement filed under the [federal] Securities Act of 1933 or the [federal] Investment Company Act of 1940 shall be entitled to registration by notification in the manner provided in subsection (2) provided that prior to the offer or sale the registration statement has become effective.22

Notification registration pursuant to section 517.082(2) is not merit regulation. It requires an application be filed with the Department of Banking and Finance containing: an application to sell by the issuer, any person on whose behalf the offering is being made, a dealer registered in Florida, and their duly authorized agents; the name and address of the applicant and issuer and the title of the securities to be offered; copies of documents filed with the SEC, as required by the Department by rule; an irrevocable written consent to service of process; and a nonreturnable fee of $1,000 per application.23 Section 517.082(3) contains the exceptions from the notification registration procedures.24 In other words, this provision addresses those situations where notification registration will not apply to federally registered offerings and will, instead, require a full de novo merit review by the State of Florida. Put simply, these situations are (1):

Securities where the offering price at the time of effectiveness with the securities and Exchange Commission is $5 or less per share or

23. Id. § 517.082(2)(a)(1-d).
24. Id. § 517.082(3)(a)(b).
with respect to the exchange exemption, that "[i]t is as if the admission of a security to trading, particularly on one of the smaller exchanges, were a hallmark of soundness or quality."** The earlier version of the new Act did not contain any such exemption, rather, it required state registration of all securities offerings of $5 or less per share or per unit.

Why did there appear to be a particular problem with low priced, non-listed, non-NASDAQ securities? One answer seems to lie with the proliferation of "penny stocks"** in recent years. One reason for this may have been the adoption of the Form S-8 Registration Statement under the Securities Act of 1933** by the SEC. Form S-8 was originally adopted in 1979, to address the concern that the costs and time required to prepare and file a full-blown S-1 type registration statement was impairing the ability of small businesses to raise capital.** Form S-8 is considerably simpler than the standard Form S-1 Registration Statement. It is available only for United States and Canadian issuers that are not reporting companies, investment companies, certain insurance companies, nor majority-owned subsidiaries of any such companies. It is to be used to register securities "not to exceed an aggregate offering price of $7.5 million . . ." Unlike the Form S-1, which must be filed in Washington, D.C. with the Commission or in the appropriate regional office of the SEC.**

12. L. LOS, SECURITIES REGULATION 43 (1911); see also Warren, supra note 36, at 1551.
13. See CS/HB 644, supra note 4, at section 7. The Task Force Report recommends on the other hand, did provide for an exemption for "securities listed on a recognized stock exchange or the NASDAQ National Market System." TASK FORCE REPORT, supra note 3, at 58.
14. TASK FORCE REPORT, supra note 3, at 56 states:
   "The first concern penny stocks so called because the shares of stock are sold for nominal amounts. These are often highly speculative, undercapitalized offerings and usually sold in states where the registration standards provide for no merit review. Florida has a significant number of these questionable, investment opportunities, due to the current absence of review for all federally registered offerings."
16. See Los, supra note 2, at 339.
17. General Instructions to Form S-8, Rule as to Use of Form S-8-I.A. (1988).
18. The limit had been $5 per share in 1964. Form S-8, Rule as to Use of Form S-8-I.A. (1964).
20. There has been some concern over the interpretation of the specific language "$5 or less per share or per unit" Fla. Stat. § 517.02(2) (1985). For example, some practitioners have taken the descriptor "or" to mean that the issuer can "package" the offering in such a way that although the shares are less than $5 per share, the minimum offering will be of a "unit" consisting of a number of shares, which "unit" itself is over $5, thus avoiding merit review. This observation is based upon conversations between the author and private practitioners. The problem will, one hopes, be addressed in the regulations to be promulgated by the Department.
21. TASK FORCE REPORT, supra note 3, at 56-59. There has been a fur-ranging conflict with "penny stock," also called "cheap stock," offerings by state securities administrators. See e.g., N.C. STATE, STATEMENT OF POLICY ON CHEAP STOCK, 1 Blue Sky L. Rep. (CCH) 53 539-537 (1986). This particular policy statement has been judicially described in the Ad Hoc Report as "a case study of merit regulation overkill."
22. See supra note 19, at 840 n. 246.
with respect to the exchange exemption, that "[i]t is as if the admission of a security to trading, particularly on one of the smaller exchanges, were a hallmark of soundness or quality." The earlier version of the New Act did not contain any such exemption, rather, it required state registration of all securities offerings of $5 or less per share or per unit.

Why did there appear to be a particular problem with low-priced, non-listed, non-NASDAQ securities? One answer seems to lie with the proliferation of "penny stocks" in recent years. One reason for this may have been the adoption of the Form S-18 Registration Statement under the Securities Act of 1933 by the SEC. Form S-18 was originally adopted in 1979, to address the concerns that the costs and time required to prepare and file a full-blown S-1 type registration statement was impairing the ability of small businesses to raise capital. Form S-18 is considerably simpler than the standard Form S-1 Registration Statement. It is available only for United States and Canadian issuers that are not reporting companies, investment companies, certain insurance companies, nor majority-owned subsidiaries of any such companies. It is to be used to register securities "not to exceed an aggregate offering price of $7.5 million." Unlike the Form S-1, which must be filed in Washington, it may be filed either with the Commission in Washington, D.C. or in the appropriate regional office of the SEC.

32. L. Loss, Securities Regulation 43 (1951); see also Warren, supra note 26, at 1513.
33. See CS/ HB 644, supra note 4, at section 7. The Task Force Report recommendation on the other hand, did provide for an exception for "securities listed on a recognized exchange or the NASDAQ National Market System." Task Force Report, supra note 3, at 58.
34. Task Force Report, supra note 3, at 56 states: The first concerns penny stocks so called because the shares of stock are sold for nominal amounts. These are often highly speculative, undercapitalized offerings and usually sold in states where the registration standards provide for no merit review. Florida has a significant number of these questionable, investment opportunities due to the current absence of review for all federally-registered offerings.
36. See Loss, supra note 2, at 339.
38. Id. The limit had been $5 million until 1984. Form S-18 may also be used for secondary offerings, but only if the aggregate offering price does not exceed $1.5 million. 1983-84 Transfer Binder 2 Fed. Sec. L. Rep. (CCR) ¶ 83,430 (Release No. 6489) (increase from $5 million to $7.5 million effective March 31, 1984).

The narrative disclosure called for in Form S-18 is somewhat less extensive than it is for Form S-1. And audited financial statements, which are required for only two rather than the three fiscal years of Form S-1, must comply only with generally accepted accounting principles, not with [the more stringent requirements of] Regulation S-X.

While Form S-18 has doubtless been a godsend to legitimate small businesses in capital formation, it seems to have been used as a loophole of sorts for less savory issuers. As Florida's previous exemption was for all federally-registered offerings, the use of registration on Form S-18 allowed these less stringently regulated offerings to come on mass, into this state. The first provision, denying notification registration for certain issues of less than $5 per share or per unit, was intended to address the "penny stock" issue. The Task Force heard compelling testimony from Royce Griffin, the president of the North American Securities Administrators Association and the Securities Commissioner of the State of Colorado, with regard to the penny stock issue. Mr. Griffin indicated that the principle abuses of penny stock offerings may include some or all of the following: (1) tremendous volatility in a very thin market; (2) issuer's with an insolvent operating history availing themselves of the low-priced capital markets; (3) inexperienced management, generally lacking the business acumen to carry forward the issuer's business plan; (4) loans to insiders whereby a substantial part of the offering proceeds are used to pay back monies ad-

40. Loss, supra note 2, at 339-40.
41. TASK FORCE REPORT, supra note 3, at 69.
42. There has been some concern over the interpretation of the specific language "$5 or less per share or per unit" Fla. STAT § 517.083(2) (1985). For example, some practitioners have taken the disjunctive "or" to mean that the issuer can "package" the offering in such a way that although the shares are less than $5 per share, the minimum offering will be of "a unit consisting of a number of shares, which "unit" itself is over $5, thus avoiding merit review. This observation is based upon conversations between the author and private practitioners. This problem will, one hopes, be addressed in the regulations to be promulgated by the Department.
43. TASK FORCE REPORT, supra note 3, at 56-58. There has been a far-ranging concern with "penny stock," also called "cheap stock," offerings by state securities administrators. See, e.g., NASDA Statement of Policy on Cheap Stock, 1 Blue Sky L. Rep. (CCR) ¶ 5311-5314 (1984). This particular policy statement has been pejoratively described in the Ad Hoc Report as "a case study of merit regulation overkill." Ad Hoc Report, supra note 18, at 840 n.246.
44. Testimony of Royce Griffin before the Task Force, January 13-14, 1986, Miami, Florida.
vanced to the company by the insiders; (5) substantial dilution to the public purchasers of the shares; (6) inadequate offering size to produce enough funds for the issuer to actually engage in any substantial business operations; (7) promoters having taken their stock at prices outrageously below the public offering price; (8) nonvoting stock offerings, so that shareholders take virtually all the risk and have little or no control over the issuer; (9) excessive salaries to management in the start-up phases of the business; and (10) excessive underwriters' compensation. According to Mr. Griffin, these types of abusive offerings are made only in "free" as opposed to "merit" states. Mr. Griffin characterized the penny stock phenomenon as a "real grassroots, consumer protection issue. The losers in the penny stock game are the people who don't understand that it's a fixed game, who don't realize that in 6 weeks the stock is going to be worthless, who think this is a wonderful opportunity to get into ground-floor capitalism. They're the ones that wind up holding the bag." Mr. Griffin suggested that the new law include both the $5 limit as well as a requirement of a firm commitment underwriting. The second of those provisions was not included in the new legislation. Clearly, there are drawbacks to merit regulation. It can have a chilling effect on legitimate issues. One of the most often used examples is the case of the merit review denial of the offering of Apple Computer securities in Massachusetts. As Former Governor Askew stated, "we are looking for a balance... Something that is workable and something that will allow the market to operate fairly and at the same time reduce the incidence of people being taken on outright fraudulent schemes." The second type of situation requiring merit review of federally registered offerings are offerings involving persons with a "history of securities law violations." This second proviso is perhaps unique to Florida insofar as the measuring period for "reportable acts" is ten years. The federal equivalent to the "bad boy" provisions is generally subject to a measuring period of five years. The term "reportable act" is defined in § 157.082(4)(c). It includes bankruptcy, as well as conviction, and entry of a plea of guilty or no contest to any criminal act (excluding traffic violations or other minor offenses). It also includes being subject to any order, judgment, or decree or to a temporary restraining order with respect to acting as a securities or commodities professional, or with respect to employment by, or a responsible person or to any type of business.

45. Id.
46. Id. The five free states were Colorado, Utah, Nevada, New Jersey, New York. Illinois and, prior to the new Act, Florida. Mr. Griffin indicated that penny stock offerings would completely fail merit review, so generally these offerings are not made in merit states.
47. Id.
48. Id.
49. Id.
50. Id. These are colloquially known as "bad boy" provisions. Florida has also kept its requirement for merit review of intrastate offerings.

https://nsuworks.nova.edu/nlr/vol11/iss4/3
vanced to the company by the insiders; (5) substantial dilution to the public purchasers of the shares; (6) inadequate offering size to produce enough funds for the issuer to actually engage in any substantial business operations; (7) promoters having taken their stock at prices outrageously below the public offering price; (8) nonvoting stock offerings, so that shareholders take virtually all the risk and have little or no control over the issuer; (9) excessive salaries to management in start-up phases of the business; and (10) excessive underwriters' compensation.54 According to Mr. Griffin, these types of abusive offerings are made only in "free" as opposed to "merit" states.55 Mr. Griffin characterized the penny stock phenomenon as a "real grassroots, consumer protection issue. The losses in the penny stock game are the people who don’t understand that it’s a fixed game, who don’t realize that in 6 weeks the stock is going to be worthless, who think this is a wonderful opportunity to get into ground-floor capitalism. They’re the ones that wind up holding the bag."

Mr. Griffin suggested that the new law include both the $5 limit as well as a requirement of a firm commitment underwriting.56 The second, of these provisions was not included in the new legislation. Clearly, there are drawbacks to merit regulation. It can have a chilling effect on legitimate issues. One of the most often used examples is the case of the merit review denial of the offering of Apple Computer securities in Massachusetts. As former Governor Askey stated, "we are looking for a balance. . . something that is workable and something that will allow the market to operate fairly and at the same time reduce the incidence of people being taken out on outright fraudulent schemes."57 The second type of situation requiring merit review of federally registered offerings are offerings involving persons with a "history of securities law violations."58 This second proviso is perhaps unique to Florida insofar as the measuring period for "reportable acts" is ten years. The federal equivalent to the "bad boy" provisions is generally subject to a measuring period of five years.59 The term "reportable act" is defined in 517.082(4)(c).60 It includes bankruptcy,61 as well as conviction, and entry of a plea of guilty or no contest to any criminal act (excluding traffic violations or other minor offenses).62 It also includes being subject to any order, judgment, or decree or to a temporary restraining order with respect to acting as a securities or commodities professional, or with respect to employment by, or a responsible position with, a bank, savings and loan, investment company or insurance company,63 or with respect to engaging in any type of business

54. See 17 C.F.R. § 230.252 (1985) (SEC. Rule 230(c)(1), (2), (3), (4), (5), (6)(d)(2), (5) and 252(c)(1), (2)). 17 C.F.R. § 230.252 (1985) (SEC. Rule 220(f)), however, provides for a ten-year period as follows: No exemption under Rule 221 to 264 shall be available for the securities of any issuer, if any of its directors, officers, general partners, or beneficial owners of ten percent or more of any class of equity securities any of its promoters presentively connected with it in any capacity, any underwriter of the securities to be offered, or any partner, director or officer of any such underwriter—has been convicted within ten years prior to the filing of any duly or in any manner in connection with the purchase of or sale of any security, involving the making of a false filing with the Commission, or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment adviser.
55. 517.082(4)(c) (Supp. 1986).
56. "Involvement in either state or federal bankruptcy proceedings either as the bankrupt petitioner or as the subject of an involuntary petition," 517.082(4)(c).
57. Id. § 230(c)(1).
58. Id. § 230(c)(13) states.
59. Being the subject of any order, judgment, or decree, not subsequently reversed, suspended, or vacated, of any court of competent jurisdiction permanently or temporarily enjoining or otherwise limiting the following activities:
   a. Acting as a futures commission merchant, introducing broker, commodity trading adviser, commodity pool operator, floor broker, leveraged transaction merchant, any other person regulated by the Commodity Futures Trading Commission, or an associated person of any of the foregoing; or
   b. As an investment adviser, underwriter, broker, or dealer in securities, or
   c. Acting in any activity in connection with the purchase or sale of any security or commodity in connection with any violation of federal or state securities or commodity laws . . .

50. Id. These are colloquially known as "bad boy" provisions. Florida has also kept its requirement for merit review of intrastate offerings.
practice or with respect to activities in connection with the purchase or sale of commodities or securities in violation of state or federal law. In addition, it includes being the subject of any order, judgment or decree suspending or limiting, for a period of more than sixty days, the right of a person to engage in any activity as a securities or commodities professional, employee or director or officer of an investment company, insurance company, bank or savings and loan, or being associated with any such person. Also included as a reportable act is having been found in violation of any state or federal securities or commodities law. Section 517.082(d) provides that the term "reportable act" doesn't include otherwise reportable acts as defined in 517.082(c) if the Department of Banking and Finance determines, pursuant to the procedure set forth in section 517.082(d), "that the public interest and protection of investors do not require that such act be treated as a reportable act to preclude registration of securities."

III. Redefining "Investment"

Another key change wrought by the 1986 Act is the redefining of the term "investment" in section 517.301(2). The previous definition, in section 517.021(11), was convoluted to say the least. The term "investment" means any commitment of money or property principally induced by a representation that an economic benefit may be derived from such commitment, except that the term "investment" does not include commitments of money or property for: (a) A purchase of a business opportunity, business enterprise, or real property through a person licensed under chapter 475 or registered under chapter 496; or (b) The purchase of tangible personal property through a person not engaged in telephone solicitation, or real property through a person not engaged in telephone solicitation, where said property is offered and sold in accordance with the following conditions: 1. There are no specific representations or guarantees made by the offeror or seller as to the economic benefit to be derived from the purchase. 2. The tangible property is delivered to the purchaser within 30 days after sale (except for market conditions). 3. The seller has offered the purchaser a full refund policy in writing, exercisable by the purchaser within 10 days of the date of delivery of such tangible personal property (the section goes on to provide for the calculation of the refund amount).

This definition is clearer than the previous one for several reasons. In the first place, the definition was moved into section 517.301, dealing with fraudulent transactions, rather than in the general definitional section, 517.021. Secondly, the section itself limits the application of the definition to sections 517.301, 517.311, and 517.312. The oft confusing language, concerning an investment as being a commitment of money or property not otherwise a security as defined in this chapter, has been eliminated. These changes should clarify that the definition of "investment" is not to be used in contexts other than

57. Id. § 517.082(c)(4)(b) (Supp. 1986).
58. Id. § 517.082(c)(5).
59. Id. § 517.082(c)(6).
60. Id. § 517.301(2).
61. The term "investment" had been defined in Fla. Stat. § 517.021(11) (1985) as follows:

"Investment" means any commitment of money or property, not otherwise a security as defined in this chapter, in expectation of receiving an economic benefit, offered or sold in violation of § 517.301 (Fraudulent Transactions) or § 517.311 (False Representations), except that the term "investment" does not apply to:

(a) any "business opportunity" as defined in the Sales of Business Opportunities Act, ss. 559.80-559.815;
(b) lands subject to the jurisdiction of chapter 498; or (c) the offer or sale of tangible personal property made in accordance with the following conditions: 1. There are no specific representations or guarantees made by the offeror or seller as to the economic benefit to be derived from the purchase. 2. The tangible personal property is delivered to the purchaser within 30 days after sale, except that such 30-day period may be extended by the department if market conditions so warrant; and 3. The seller has offered the purchaser a full refund policy in writing, exercisable by the purchaser within 10 days of the date of delivery of such tangible personal property (the section goes on to provide for the calculation of the refund amount).
practice or with respect to activities in connection with the purchase or sale of commodities or securities in violation of state or federal law.** In addition, it includes being the subject of any order, judgment or decree suspending or limiting, for a period of more than sixty days, the right of a person to engage in any activity as a securities or commodities professional, employee or director or officer of an investment company, insurance company, bank or savings and loan, or being associated with any such person.** Also included as a reportable act is having been found in violation of any state or federal securities or commodities law.** Section 517.08(2)(d) provides that the term "reportable act" doesn't include otherwise reportable acts as defined in 517.08(2)(e) if the Department of Banking and Finance determines, pursuant to the procedure set forth in section 517.08(2)(d), "that the public interest and protection of investors do not require that such act be treated as a reportable act to preclude registration of securities . . . ."**

III. Redefining "Investment"

Another key change wrought by the 1986 Act is the redefining of the term "investment" in section 517.301(2).** The previous definition, in section 517.021(11), was convoluted to say the least.** The term "in-

57. Id. § 517.08(2)(e)(4)(d) (Supp. 1986).
58. Id. § 517.08(2)(e)(5).
59. Id. § 517.08(2)(6).
60. Id. § 517.301(2).
61. The term "investment" had been defined in Fla. Stat. § 517.021(11) (1985) as follows:  "Investment" means any commitment of money or property, not otherwise a security as defined in this chapter, in expectation of receiving an economic benefit, offered or sold in violation of § 517.301 (Fraudulent Transactions) or § 517.311 (False Representations), except that the term "in-
vestment" does not apply to:
(a) any "business opportunity" as defined in the Sale of Business Opportunities Act, ch. 559.80-559.815; or
(b) land subject to the jurisdiction of chapter 498, or (c) land subject to the jurisdiction of chapter 498, or (c) the offer or sale of tangible property made in accordance with the following conditions: 1. There are no specific representations or guarantees made by the offeror or seller as to the economic benefit to be derived from the purchase; 2. The tangible personal property is delivered to the purchaser within 30 days after sale, or more than such 30-day period may be extended by the department if market conditions so warrant; and 3. The seller has offered the purchaser a full refund policy in writing, exercisable by the purchaser within 10 days of the date of delivery of such tangible personal property, except that the amount of such refund is not refund shall be based on the bid price in effect at the time the property is returned to the seller. If the applicable seller's market is closed at the time the property is returned to the seller for a refund, the amount of such refund shall be based on the bid price for such property at the next opening of such market or the rules and regulations of the Commodity Futures Trading Commission.
63. Id. § 517.021(11).
64. Id. § 517.301 (False Representations).
65. Id. § 517.312 (Securities, Investments, Boiler Rooms, Prohibited Practices).
66. Id. § 517.021(11).

published by NSUWorks, 1987

1190

Nova Law Review [Vol. 11

1191

1987

those specifically intended.

The definition as proposed in CS/HB 644 had been far more streamlined. It stated simply that “Investment” means any commitment of money or property except for the purchase of real property through a person licensed under chapter 475 or registered under chapter 498, principally induced by a representation that an economic benefit may be derived from such commitment. 67

That definition, however, was apparently thought to have been too broad. In fact, according to the Staff Analysis, “it is intentionally broad in order to reach practically every type of investment fraud.” As enacted, the definition “retains the current exemption for transactions involving tangible personal property such as gems and precious metals unless such products are sold by telephone solicitation.” 68

The Task Force had presented a very broad definition 67 that would have included sales of tangible personal property where the sale had been induced by a representation of economic benefit. The Task Force saw the then (and now) existing exemption for sales of tangible personal property without representation of economic value to be “an area of extensive abuse.” 69 One impetus for the Task Force recommendation was undoubtedly the International Gold Bullion Exchange (IGBE) fiasco, whereby investors were induced by a “boiler room” operation to invest in gold. Ultimately, the “gold” proved to be pieces of wood painted gold. IGBE’s 13,000 customers from across the country have claimed losses of $75 million. 70 Because of the “boiler room” nature of the operation, it seems that if an IGBE-type case were brought under the new legislation, it would be subject to anti-fraud consequences. The new legislation, however, does leave some room for shenanigans, particularly with respect to sales of tangible personal property. The use of the phrase “principally induced,” for example, may be interpreted strictly by the courts. On the other hand, the difficulty in the regulation of securities or investments is always to balance the need for economic freedom (the right to make a fool of oneself) against the need to prevent or punish fraud (the right not to let someone else make a fool of you).

It is important to understand that this definition is to be used in connection with prosecution for fraud under sections 517.301, 517.311, and 517.312 of the Florida Statutes, and not in connection with the definition of a security under section 517.021(20). What this means is that “dealing in investments will not alone subject a person to regulation under Chapter 517. Regulation under the statute is reserved for securities; however fraud in connection with either securities or investments is a violation punishable under that [anti-fraud law].” 71 As indicated above, one potentially troublesome area was avoided in the final legislation by placing the definition of “investment” in the anti-fraud section of the statute. 72 It was proposed in CS/HB 644 64 and in the Task Force Report 71 that the term “investment” be defined in section 517.021, “Definitions,” 73 the general definitional provision. The provision had started with the words, “[W]hen used in this chapter, unless the context otherwise requires, the following terms have the following respective meanings.” 74 Problems could have arisen through importation of the definition of “investment” under section 517.021(11) to the

67. Compared to the previous definition, this is a model of conciseness. See supra note 61. As to its clarity, however, there will undoubtedly be much litigation over the meaning of the words “principally induced.” FLA. STAT. § 517.301(12) (Supp. 1988).

68. According to the Staff Analysis, the definition “does not appreciably broaden the definition; it is intentionally broad in order to reach practically every type of investment fraud.” STAFF ANALYSIS, supra note 5, at 3. The Task Force Report states that the definition is “intentionally broad but not vague.” TASK FORCE REPORT, supra note 3, at 26. Time and the courts will tell.

69. STAFF ANALYSIS, supra note 5, at 3.

70. Final STAFF ANALYSIS, supra note 3, at 8.

71. Id. at 27. The Task Force had also recommended the removal of the exemption for “business opportunities,” “on the request of the agency charged with their regulation.” Id. This exemption was, however, retained in the legislation.

72. Id. at 83.

73. Under Florida law at the time the Comptroller had to be able to prove that
Published by NSUWorks, 1987

The Task Force had proposed a very broad definition\textsuperscript{67} that would have included sales of tangible personal property where the sale had been induced by a representation of economic benefit. The Task Force saw the then (and now) existing exemption for sales of tangible personal property without representation of economic value to be "an area of extensive abuse."\textsuperscript{68} One impetus for the Task Force recommendation was undoubtedly the International Gold Bullion Exchange (IGBE) fiasco, whereby investors were induced by a "boiler room" operation to invest in gold. Ultimately, the "gold" proved to be pieces of wood painted gold. IGBE's 13,000 customers from across the country have claimed losses of $75 million.\textsuperscript{69} Because of the "boiler room" nature of the operation, it seems that if an IGBE-type case were brought under the new legislation, it would be subject to anti-fraud consequences. The new legislation, however, does leave some room for shenanigans, particularly with respect to sales of tangible personal property. The use of the phrase "principally induced," for example, may be interpreted strictly by the courts. On the other hand, the difficulty in the regulation of securities or investments is always to balance the need for economic freedom (the right to make a fool of oneself) against the need to prevent or punish fraud (the right not to let someone else make a fool of you).

It is important to understand that this definition is to be used in connection with prosecution for fraud under sections 517.301, 517.311 and 517.312 of the Florida Statutes, and not in connection with the definition of a security under section 517.021(20). What this means is that "dealing in investments will not alone subject a person to regulation under Chapter 517. Regulation under the statute is reserved for securities; however fraud in connection with either securities or investments is a violation punishable under that [anti-fraud] law."\textsuperscript{70} As indicated above, one potentially troublesome area was avoided in the final legislation by placing the definition of "investment" in the anti-fraud section of the statute.\textsuperscript{71} It was proposed in CS/ HB 644\textsuperscript{72} and in the Task Force Report\textsuperscript{73} that the term "investment" be defined in section 517.021, "Definitions,"\textsuperscript{74} the general definitional provision. The provision had started with the words, "[W]hen used in this chapter, unless the context otherwise requires, the following terms have the following meanings:"\textsuperscript{75} Problems could have arisen through importations of the definition of "investment" under section 517.021(11) to the

---

\textsuperscript{67} Compared to the previous definition, this is a model of consciousness. See supra note 61. As to its clarity, however, there will doubtless be much litigation over the meaning of the words "principally induced." FLA. STAT. § 517.301(2) (Supp. 1998).

\textsuperscript{68} According to the Staff Analysis, the definition "... does not appreciably broaden the definition; it is intentionally broad in order to be able to reach practically every type of investment fraud." STAFF ANALYSIS, supra note 3, at 3. The Task Force Report states that the definition is "intentionally broad but not vague." TASK FORCE REPORT, supra note 3, at 26. Time and the courts will tell.

\textsuperscript{69} STAFF ANALYSIS, supra note 3, at 3.

\textsuperscript{70} STAFF ANALYSIS, supra note 3, at 5.

\textsuperscript{71} STAFF ANALYSIS, supra note 3, at 8.

\textsuperscript{72} STAFF ANALYSIS, supra note 3, at 3, at 27.

\textsuperscript{73} Id. at 27. The Task Force had also recommended the removal of the exemption for "business opportunities," "on the request of the agency charged with their regulation." Id. This exemption was, however, retained in the legislation.

\textsuperscript{74} Id. at 83.

\textsuperscript{75} Under Florida law at the time the Comptroller had to be able to prove that IGBE was selling a "security," as that term had come to be defined by the courts. (Notwithstanding IGBE's misrepresentations, since its early activities did not constitute sales of securities it was not violating the anti-fraud provisions of Chapter 517. The case points to the ease with which regulation could be avoided prior to 1984 by designing an investment program that would fall outside the technical definition of a security. Id.) (The Comptroller did bring a suit, but IGBE filed for bankruptcy before it could be heard. The principles of IGBE were sentenced to serve prison terms.)

---

155 Published by NSUWorks, 1987
term "investment contract" in section 517.021(20)(g). The term "investment contract" is itself one of the definitions of "security" in section 517.021(20). The definition of the term "investment contract" has a long and hoary history, both under federal and state law. The seminal 1946 Supreme Court case of SEC v. W.J. Honeyman defined the term "investment contract" as follows: "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." It is significant that the Supreme Court, in defining the term "investment contract" for purposes of Section 2(1) of the Securities Act of 1933, recognized that the term was not defined in that Act nor in the legislative reports, and, hence, resorted to the blue sky laws for guidance as to a proper definition. The Court stated:

the term "investment contract" was common in many state "blue sky" laws in existence prior to the adoption of the federal statute [the Securities Act of 1933] and, although the term was also unde- fined by state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. Form was disregarded for substance and emphasis was placed upon eco- nomic reality. This definition was uniformly applied by state courts to a variety of situations where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of someone other than themselves. By including an investment con- tract within the scope of 2(1) of the Securities Act, Congress was using a term the meaning of which had been crystalized by this prior [state] judicial interpretation.

The cases defining "investment contract" for the purposes of the

1194 Nova Law Review, Vol. 11, Iss. 4 [1987], Art. 3
https://nsuworks.nova.edu/nlr/vol11/iss4/3

term "investment contract" move into section 517.301(2), thus limiting the app-

1987] Blue Sky Laws 1195

federal securities laws are legion. Nor have the Florida courts been q

quaint with respect to the definition for purposes of the state's blue

sky law. In an interesting turn of events, the state courts seem first to

turn to Howey (where, as you will recall, the United States Supreme

Court turned first to state court definitions of "investment contract")

and its progeny or the definition of an "investment contract."\textsuperscript{85} Although the intent of the legislation as initially proposed was that the definition of "investment" was not to be engrafted onto the definition of "investment contract," thus muddying the waters still further, there was a potential problem by placing the definition in the general defi-

nitional section of the statute.

For the sake of clarity, in the final legislation, the definition of "investment" was moved into section 517.301(2), thus limiting the ap-


86. See, e.g., Adams v. State, 443 So. 2d 1003, 1005 (Fla. 2d Dist. Ct. App. 1984) (citing Honey, 328 U.S. at 293, and SEC v. Glen W. Turner Enterprises, 474 F.2d 471 (5th Cir. 1973), cert. denied 441 U.S. 821 (1973); SEC v. Knott Interchange- tory, Inc., 497 F.2d 471 (5th Cir. 1974)). These cases stand for the proposition that the

now old, involved an offering in Florida. As the Executive Summary in the

The task force report states, \"[N]ational attention has often focused on Florida as a boot for one artists.\" Task Force Report, supra note 3, at 13. Honey was not an att-

red fraud, per se, but rather a failure to register case. However, many of the factors

that make the Honey scheme possible in the 1940's are still present today in this state.

81. Honey, 328 U.S. at 301.
83. Honey, 328 U.S. at 301.
84. Id.

https://nsuworks.nova.edu/nlr/vol11/iss4/3/16
term "investment contract" in section 517.021(20)(g). The term "investment contract" is itself one of the definitions of "security" in section 517.021(20). The definition of the term "investment contract" has a long and checkered history, both under federal and state law. The seminal 1946 Supreme Court case of SEC v. W.J. Howey defined the term "investment contract" as follows: "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." It is significant that the Supreme Court, in defining the term "investment contract" for purposes of Section 2(1) of the Securities Act of 1933, recognized that the term was not defined in that Act nor in the legislative reports, and, hence, resorted to the blue sky laws for guidance as to a proper definition. The Court stated:

the term "investment contract" was common in many state "blue sky" laws in existence prior to the adoption of the federal statute (the Securities Act of 1933) and, although the term was also undefined by state laws, it had been broadly construed by state courts so as to afford the investing public a full measure of protection. Form was disregarded for substance and emphasis was placed upon economic reality... This definition was uniformly applied by state courts to a variety of situations where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through efforts of the promoter or of someone other than themselves. By including an investment contract within the scope of 2(1) of the Securities Act, Congress was using a term the meaning of which had been crystallized by this prior [state] judicial interpretation.

The cases defining "investment contract" for the purposes of the federal securities laws are legion. Nor have the Florida courts been quiescent with respect to the definition for purposes of the state's blue sky law. In an interesting turn of events, the state courts seem first to turn to Howey (where, as you will recall, the United States Supreme Court turned for the first time to statute court definitions of "investment contract") and its progeny on the definition of an "investment contract." Although the intent of the legislation as initially proposed was that the definition of "investment" was not to be engraved in the definition of "investment contract," thus muddying the waters still further, there was a potential problem by placing the definition in the general definitional section of the statute.

For the sake of clarity, in the final legislation, the definition of "investment" was moved into section 517.301(2), thus limiting the ap
pleasability of the definition to the anti-fraud and enforcement sections of the statute. The courts will continue to refine and evolve the definition of the term "investment contract" as they have done over the decades. Keep in mind that if a transaction is deemed to be a "security," including, but not limited to an "investment contract," not only do the anti-fraud provisions apply, but the registration provisions apply as well.

Section 517.07 of the Florida Statutes provides, in pertinent part, that "No security [except exempt securities under s. 517.051 or securities sold in an exempt transaction under s. 517.061] shall be sold or offered for sale within this state unless such securities have been registered..." Further, section 517.12(1) states, "No dealer, associated person, or issuer of securities shall sell or offer for sale any securities in or from offices in this state, or sell securities in this state to persons of this state from offices outside this state, by mail or otherwise, unless the person has been registered with the department..."

The penalty for the violation of section 517.07 (failure to register securities) or section 517.12 (failure to register as a dealer, associated person, etc.) in that the purchaser may rescind the sale, pursuant to section 517.21. This remedy is available notwithstanding any lack of fraud, falsification or deception of any kind in connection with the transaction. In contrast, section 517.301(1) makes it unlawful for a person..."
plicability of the definition to the anti-fraud and enforcement sections of the statute.\(^8\) The courts will continue to refine and evolve the definition of the term "investment contract" as they have done over the decades.\(^9\) Keep in mind that if a transaction is deemed to be a "security," including, but not limited to an "investment contract," not only do the anti-fraud provisions apply, but the registration provisions apply as well.

Section 517.07 of the Florida Statutes provides, in pertinent part, that "No securities [except exempt securities under s. 517.051 or securities sold in an exempt transaction under s. 517.061] shall be sold or offered for sale within this state unless such securities have been registered . . . .\(^{90}\) Further, section 517.12(1) states, "No dealer, associated person, or issuer of securities shall sell or offer for sale any securities in or from offices in this state, or sell securities in this state to persons of this state from offices outside this state, by mail or otherwise, unless the person has been registered with the department . . . .\(^{91}\)

The penalty for the violation of section 517.07 (failure to register securities) or section 517.12\(^{\circ}\) (failure to register as a dealer, associated person, etc.) is that the purchaser may rescind the sale, pursuant to section 517.211.\(^{92}\) This remedy is available notwithstanding any lack of fraud, falsification or deception of any kind in connection with the transaction.

In contrast, section 517.301(1) makes it unlawful for a person,

\(^{88}\) Fla. Stat. § 517.301(2) (Supp. 1986).

\(^{89}\) The Task Force had considered the possibility of adopting a definition for the term "investment contract," "After careful consideration it was the consensus of the panel that this should be left to judicial construction." TASK FORCE REPORT, supra note 3, at 64-65.


\(^{91}\) Fla. Stat. § 517.12(1) (Supp. 1986) (emphasis added). Fla. Stat. § 517.12 (2) provides exemptions from dealer-type registration for exempt securities under § 517.051. Section 517.12(2) provides similar dealer-type exemptions for certain exempt transactions, namely those in § 517.061 (1)(12), (14) and (15), except as provided in § 517.061(3)(a)(4). This exception to the exemption applies to the widely used "private placement", exemption from registration. That exemption from registration is predicated on the fact that "[n]o person who is defined as a dealer [defined in the statute] unless such person is registered as a dealer under this chapter." Id. § 517.061(1)(a)(4).


\(^{93}\) Id. § 517.211

\(^{94}\) Id. § 517.311(1) (False representations; deceptive words; enforcement) (emphasis added).

\(^{95}\) Id.

\(^{96}\) Id. § 517.311(3).

\(^{97}\) Please note that Fla. Stat. § 517.311 (1985) had been, by its terms, enforceable only by the Department, and conferred no private right of action. That provision has been deleted by the new Act. This gives rise to the question of whether the intent was to provide a private right of action for violation. The prior statute in § 517.311(5) was anomalous because § 517.312(3) had already provided explicit remedies for a purchaser (rescission and damages under § 517.211) for a violation of § 517.311 or § 517.301. The deletion of that portion of § 517.311(5) seems logical and consistent.

\(^{98}\) Fla. Stat. § 517.312 (1985) (Securities investments; "boiler rooms"; prohibited practices; remedies).

\(^{99}\) Id. § 517.312(1)(a).

\(^{100}\) The term "boiler room" is defined in § 517.012(5) as "an enterprise in
which two or more persons engage in telephone communications with members of the public using two or more telephones at one location in a common scheme or enterprise.


102. Id. § 571.312(2) (1985).

103. 18 U.S.C. §§ 1961-1968 (1985). "Racketeering activity" is defined in 18 U.S.C. § 1961(1), and includes, inter alia, "fraud in the form of securities." It is not my intention to delve into the legal nuances of RICO. It is important to note, however, that the American Bar Association Task Force had found that of 270 known civil RICO cases at the trial court level, 40% involved securities fraud, 37% common-law fraud in a commercial or business setting, and only 9% "allegations of criminal activity of a type generally associated with professional criminals." Sedima, S.P.R.L. v. Imesa Co., 473 U.S. 479 n.6 (1985).

104. Fla. Stat. §§ 895.01-895.09 (Supp. 1986). There is, perhaps, an issue of whether a violation of the Florida Blue Sky anti-fraud law would be deemed actionable under the Florida RICO statute if it involved an "investment" rather than a "security." Section 895.02(1)(a)(3) states, in pertinent part, "Racketeering activity means to commit, to attempt to commit, to conspire to commit, or to submit. . . . Any crime which is chargeable by indictment or information under the following provisions of the Florida Statutes: . . . Chapter 571, relating to sales of securities." Fla. Stat. § 895.02(1)(a)(3) (Supp. 1986) (emphasis added). This may be read broadly to mean any indictable offense under Chapter 571, with the emphasized words merely to give a general description of the chapter involved. On the other hand, it may be limited to the sale of securities, by reading the provision literally. If the former is intended, it would be well for the legislature to clarify Section 571 to make the intent of the provision clear. As this article goes to press, Florida's RICO statute has been amended.

For a thorough bibliography of civil RICO decisions and commentary, see Miler, A Civil RICO Primer, 84 Cal. W.L. Rev. 393 (1985).

105. See also Fla. Stat. §§ 895.05(1) (1986); see also discussion of Civil Remedies for Criminal Practices infra text accompanying notes 174 to 176.

106. Id. § 517.2(16).

107. Id. § 517.2(16).

108. A primary dealer of government securities is currently regulated by the Federal Reserve Board and is used by the Board to purchase and sell Treasury issues. A government securities dealer, however, is a broker/dealer who is exempt from registration with the SEC and who by choice only deals in government issues.


110. These are dealers who "sell only their own securities (i.e., issue/dealers)." See Task Force Report supra note 3, at 41. According to the Final Staff Analysis, the potential public economic impact which the bill will have on the private sector will be felt by a limited number of persons. It is the provision found in section 8 of CS/CS/HB 644 which will require broker/dealers or investment advisors to register with the SEC as a condition of doing business (i.e., being registered) in Florida. The impact of this provision is limited because currently the only persons who are not federally registered are dealers who deal exclusively in government securities or who deal only in Florida. Therefore, all persons in Florida are registered with the SEC except for 34 dealers, 14 branch offices, and approximately 75 associated persons.

111. Staff Analysis, supra note 3, at 9.
"sells or offers for sale any security or investment" in violation of sections 517.301 or 517.311.

Another salient point is that a mere failure to register is not itself a "reckless activity" for purposes of either the federal Racketeer Influenced and Corrupt Practices Act (RICO) nor the Florida RICO statute. Securities fraud, on the other hand, is "reckless activity." The potential availability of treble damages and attorney's fees to private plaintiffs under RICO makes this issue of no small interest.

IV. New Broker/Dealer Requirements

Another significant change in Florida's Blue Sky Law is the addition which two or more persons engage in telephone communications with members of the public using two or more telephones at one location in a common scheme or enterprise. Fla. Stat. § 517.02(25) (Supp. 1986).

101. Id. § 517.312 (1985).
102. 18 U.S.C. §§ 1961-1968 (1985). "Reckless activity" is defined in 18 U.S.C. § 1961(1), and includes, inter alia, "fraud in the sale of securities." It is not my intention to delve into the legal morass of RICO. It is important to note, however, that the American Bar Association Task Force had found that "that of 270 known civil RICO cases at the trial court level, 40% involved securities fraud, 37% common-law fraud in a commercial or business setting, and only 9% "allegations of criminal activity of a type generally associated with professional criminal." Sedima, S.P.R.L. v. Imrex Co., Inc., 473 U.S. 479 (1985).
104. There is, perhaps, an issue of whether a violation of the Florida Blue Sky anti-fraud law would be deemed actionable under the Florida RICO statute if it involved an "investment" rather than a "security." Section 895.02(1)(a)(3) states, in pertinent part, "Reckless activity means to commit, to attempt to commit, to conspire to commit, or to solicit... Any crime which is chargeable by indictment or information under the following provisions of the Florida Statutes... Chapter 517, relating to sale of securities..." Fla. Stat. §§ 895.02(1)(a)(3) (Supp. 1986) (emphasis added). This may be read broadly to mean any indictable offense under Chapter 517, with the emphasized words merely to give a general description of the chapter involved. On the other hand, it may be limited to the sale of securities, by reading the provision literally. If the former is intended, it would be wise for the legislature to clarify Section 895.02 by adding the phrase, "or investments." In any case, it would be wise for the legislature to make the intent of the provision clear. As this article goes to press, Florida's RICO statute has been amended.

For a thorough bibliography of civil RICO decisions and commentary, see Milner, At Civil RICO Bibliography, 26 Cent. W.L. Rev. 409 (1985).
105. But see Fla. Stat. § 895.06(7) (Supp. 1986); see also discussion of Civil Remedies for Criminal Practices infra text accompanying notes 174 to 176-74.

106. Id. § 517.21(16).
107. Id.
108. A primary dealer of government securities is currently regulated by the Federal Reserve Board and is used by the Board to purchase and sell Treasury issues. A government securities dealer, however, is a broker/dealer who is exempt from registration with the SEC and who by choice only deals in government issues. Task Force Report, supra note 3, at 41. There has been much recent activity at the federal level with respect to government securities brokers/dealers. See, e.g., Government Securities Act of 1986.
109. Id. at 41. According to the Final Staff Analysis, the general public economic impact which the bill will have on the private sector will be felt by a limited number of persons. It is the provision found in section 8 of the bill (CS/HB 644) which will require broker/dealers or investment advisers to register with the SEC as a condition of doing business (i.e., being registered) in Florida. The impact of this provision is limited because currently the only persons who are not federally registered are dealers who deal exclusively in government securities or who deal only in Florida. Therefore, all persons in Florida are registered with the SEC except for 34 dealers, 14 branch offices, and approximately 75 associated persons.

For a thorough bibliography of civil RICO decisions and commentary, see Milner, At Civil RICO Bibliography, 26 Cent. W.L. Rev. 409 (1985).
105. But see Fla. Stat. § 895.06(7) (Supp. 1986); see also discussion of Civil Remedies for Criminal Practices infra text accompanying notes 174 to 176-74.

106. Id. § 517.21(16).
107. Id.
108. A primary dealer of government securities is currently regulated by the Federal Reserve Board and is used by the Board to purchase and sell Treasury issues. A government securities dealer, however, is a broker/dealer who is exempt from registration with the SEC and who by choice only deals in government issues. Task Force Report, supra note 3, at 41. There has been much recent activity at the federal level with respect to government securities brokers/dealers. See, e.g., Government Securities Act of 1986.
109. Id. at 41. According to the Final Staff Analysis, the general public economic impact which the bill will have on the private sector will be felt by a limited number of persons. It is the provision found in section 8 of the bill (CS/HB 644) which will require broker/dealers or investment advisers to register with the SEC as a condition of doing business (i.e., being registered) in Florida. The impact of this provision is limited because currently the only persons who are not federally registered are dealers who deal exclusively in government securities or who deal only in Florida. Therefore, all persons in Florida are registered with the SEC except for 34 dealers, 14 branch offices, and approximately 75 associated persons.

For a thorough bibliography of civil RICO decisions and commentary, see Milner, At Civil RICO Bibliography, 26 Cent. W.L. Rev. 409 (1985).
105. But see Fla. Stat. § 895.06(7) (Supp. 1986); see also discussion of Civil Remedies for Criminal Practices infra text accompanying notes 174 to 176-74.
curiosities, Inc debacle and the GIC Government Securities, Inc. scandal. In addition to the registration requirements, the 1986 Act amends section 517.12(7) to require fingerprint cards for associated persons where none is currently on file with the National Association of Securities Dealers ("NASD") or a national securities exchange registered with the SEC (e.g., the New York Stock Exchange). In the broker/dealer area, there was a concern over "shell registrations," that is, when a broker/dealer is registered and then control is given over to "someone who might not have been initially approved for registration." Section 517.12(13) has been amended to require any person or group of persons who propose to directly or indirectly acquire a "controlling interest" in a registered dealer or investment adviser to first submit an initial application for registration as such with the Department. Provision has been made for the Department to adopt rules allowing a waiver of this requirement where the proposed acquiree is itself registered in Florida or where the filing of the initial application "is otherwise unnecessary in the public interest." The new Act requires calendar year reregistrations for dealers, investment advisers, associated persons and branch offices, eliminates the staggering of expiration dates, and provides a grace period for such renewals until January 31 for retroactivity to January 1.

111. See TASK FORCE REPORT, supra note 3, at 74-78. The alleged losses caused by ESM Government Securities, Inc., and affiliated companies is $300 million.
112. See TASK FORCE REPORT, supra note 3, at 78-82.
114. See TASK FORCE REPORT, supra note 3, at 41.
115. The term "controlling interest" is not defined, however, the term "control" is defined in Fla. Stat. § 517.02(5)(a) (Supp. 1986). That section defines the term as follows: "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."
116. Id. § 517.12 (13).
117. Id.
118. Id. § 517.12(11). Note, however, that a late fee equal to the amount of the fee for renewal will be assessed for any renewal during the January grace period. According to the Staff Analysis, the elimination of the staggered renewals was "[i]n accordance with the Auditor General's recommendation . . . " (Staff Analysis, supra note 3, at 5.)

V. Arbitration of Claims

Immediately prior to this article going to press, the United States Supreme Court, in Shearson/American Express v. McMahon, held that both Rule 10b-5 and federal civil RICO claims are arbitrable pursuant to a pre-dispute arbitration agreement between a broker and a customer. This decision reverses the Second Circuit's judgment and has laid to rest the split among the circuits as to the enforcement of such agreements. Insofar as the Eleventh Circuit is concerned, this decision overrules Driscoll v. Smith Barney, Harris, Upham & Co. which held that Rule 10b-5 and federal civil RICO claims were not subject to compulsory arbitration notwithstanding an agreement to arbitrate which was upheld as to Florida civil RICO claims. Justices Blackmun, Brennan and Marshall concurred with the majority as to the arbitrability of federal civil RICO claims, but dissented with respect to Rule 10b-5 claims. The thrust of the dissent states:

As even the most ardent supporter of arbitration would recognize, the arbitral process at best places the investor on equal footing with the securities industry personnel against whom the claims are brought. Furthermore, there remains the danger that at worst, compelling an investor to arbitrate securities claims puts him in a forum controlled by the securities industry. This result directly contradicts the goals of both securities acts to free the investor from the control of the [market] professionals.

One dramatic change proposed by the Task Force Report was to require that any contract entered into after January 1, 1987 by a Florida registered broker/dealer and its customer should include the American Arbitration Association as an arbitrator which could be selected by the aggrieved party. There is no requirement to provide for arbitration in either Florida or federal law. This provision was to govern only if the parties chose to include arbitration in the brokerage contract. The pertinent section of CS/HB 644 read as follows:

113. Smith Barney, Harris, Upham & Co. v. Driscoll, 744 F.2d 265 (11th Cir. 1984).
114. McMahon, 788 F.2d 94 (2d Cir. 1986).
115. Id. at 99 (Blackmun, Brennan, & Marshall, JJ., dissenting in part, dissenting in part).
116. TASK FORCE REPORT, supra note 3, at 54-55.
curriculum, Inc. debacle and the GIC Government Securities, Inc. scandal. In addition to the registration requirements, the 1986 Act amends section 517.12(7) to require fingerprint cards for associated persons where none is currently on file with the National Association of Securities Dealers ("NASD") or a national securities exchange registered with the SEC (e.g., the New York Stock Exchange). "

In the broker/dealer area, there was a concern over "shell registrations," that is, when a broker/dealer is registered and then control is given over to "someone who might not have been initially approved for registration." Section 517.12 (13) has been amended to require any person or group of persons who propose to directly or indirectly acquire a "controlling interest" in a registered dealer or investment adviser to first submit an initial application for registration as such with the Department. Provision has been made for the Department to adopt rules allowing a waiver of this requirement where the proposed acquiree is itself registered in Florida or where the filing of the initial application "is otherwise unnecessary in the public interest." The new Act requires calendar year reregistrations for dealers, investment advisers, associated persons and branch offices, eliminates the staggered expiration dates, and provides a grace period for such renewals until January 31 for retroactivity to January 1.

V. Arbitration of Claims

Immediately prior to this article going to press, the United States Supreme Court, in Shearson/American Express v. McMahon, held that both Rule 10b-5 and federal civil RICO claims are arbitrable pursuant to a pre-dispute arbitration agreement between a broker and a customer. This decision reverses the Second Circuit's judgment and has laid to rest the split among the circuits as to the enforcement of such agreements. Insofar as the Eleventh Circuit is concerned, this decision overrules Driscoll v. Smith Barney, Harris, Upham & Co., which held that Rule 10b-5 and federal civil RICO claims were not subject to compulsory arbitration notwithstanding an agreement to arbitrate which was upheld as to Florida civil RICO claims.

Justices Blackmun, Brennan and Marshall concurred with the majority as to the arbitrability of federal civil RICO claims, but dissented with respect to Rule 10b-5 claims. The thrust of the dissent states:

As even the most ardent supporter of arbitration would recognize, the arbitral process at best places the investor on equal footing with the securities industry personnel against whom the claims are brought. Furthermore, there remains the danger that at worst, compelling an investor to arbitrate securities claims puts him in a forum controlled by the securities industry. This result directly contradicts the goal of both securities acts to free the investor from the control of the (market) professionals.

One dramatic change proposed by the Task Force Report was to require that any contract entered into after January 1, 1987 by a Florida registered broker/dealer and its customers should include the American Arbitration Association as an arbitrator which could be selected by the aggrieved party. There is no requirement to provide for arbitration in either Florida or federal law. This provision was to govern only if the parties chose to include arbitration in the brokerage contract. The pertinent section of CS/HB 644 reads as follows:

111. See TASK FORCE REPORT, supra note 3, at 74-78. The alleged losses caused by ESM Government Securities, Inc. and affiliated companies exceed $300 million.
112. See TASK FORCE REPORT, supra note 3, at 78-82.
114. See TASK FORCE REPORT, supra note 3, at 41.
115. The term "controlling interest" is not defined, however, the term "control" is defined in Fla. Stat. § 517.02(1)(b) (Supp. 1986). That section defines the term as follows: "Control", including the terms "controlling", "controlled by", and "under common control with", means 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.
116. Id. § 517.12 (13).
117. Id.
118. Id. § 517.12 (11). Note, however, that a loss in excess of the amount of the fee for renewal will be assessed for any renewal during the January grace period. According to the Staff Analysis, the elimination of the staggered renewals was "[i]n accordance with the Auditor General's recommendation. ..." STAFF ANALYSIS, supra note 3, at 5.
119. See infra note 140.
121. 815 F.2d 653 (11th Cir. 1987). See infra note 140.
123. TASK FORCE REPORT, supra note 3, at 54-55.

Published by NSUWorks, 2007

25
517.122 Arbitration.— Any agreement to provide services that are covered by this chapter, entered into after January 1, 1987, by a person required to register under this chapter, for arbitration of disputes arising under the agreement shall provide an aggrieved party the option of having arbitration before and pursuant to the rules of the American Arbitration Association.  

As enacted, the "shall" became "may," thus making the mandatory merely permissible. The change, as proposed, was to address a perceived problem of providing for arbitration before "panels that are associated with the securities industry." This is that, there was testimony to the effect that customers had not gotten what they considered to be a fair hearing before industry panels, such as the arbitration panel of the NASD. This was clearly a sensitive issue. The Task Force Report states:

It was the finding of this Task Force that the current provisions contained in brokerage agreements often limit the choice of arbitration panels to groups that are associated with the securities industry [e.g., the NASD or NYSE]. Although there was no evidence presented that would justify concern with the impartiality of these mediators, it was the Task Force's determination that an expanded selection of arbitration groups would strengthen the arbitration process through diversification. There is a need for at least one additional arbitration service in brokerage contracts that is sponsored by other than [a securities] industry self-regulatory organization.

There has been increasing interest in the entire issue of arbitration in securities disputes since the 1985 United States Supreme Court case of Dean Witter Reynolds Inc. v. Byrd. The Byrd decision has raised considerable comment and a fair number of cases. The Byrd case

120. C.R.A. 444, 9th Cir., 1st Sess., § 9 (emphasis added).
121. FIA Stat. § 517.122 (Sprow 1984).
122. TASK FORCE REPORT, supra note 3, at 54.
123. See generally testimony of James Frazier before the Task Force on December 9, 1985 in Orlando, Florida.
124. TASK FORCE REPORT, supra note 3, at 54.
127. See, e.g., Greenblatt v. Drexel Burnham Lambert, Inc., 763 F.2d 1352

https://nsuworks.nova.edu/nlr/vol11/iss4/3
517.122 Arbitration.— Any agreement to provide services that are covered by this chapter, entered into after January 1, 1987, by a person required to register under this chapter, for arbitration of disputes arising under the agreement shall provide an aggrieved party the option of having arbitration before and pursuant to the rules of the American Arbitration Association.188

As enacted, the "shall" became "may," thus making the mandatory merely permissible.190 The change, as proposed, was to address a perceived problem of providing for arbitration before "panels that are associated with the securities industry."191 That is, there was testimony to the effect that customers hadn't gotten what they considered to be a fair hearing before industry panels, such as the arbitration panel of the NASD.192 This was clearly a sensitive issue. The Task Force Report states:

It was the finding of this Task Force that the current provisions contained in brokerage agreements often limit the choice of arbitration panels to groups that are associated with the securities industry [e.g., the NASD or NYSE]. Although there was no evidence presented that would justify concern with the impartiality of these intermediaries, it was the Task Force's determination that an expanded selection of arbitration groups would strengthen the arbitration process through diversification. There is a need for at least one additional arbitration source in brokerage contracts that is sponsored by other than [a securities] industry self-regulatory organization.193

There has been increasing interest in the entire issue of arbitration in securities disputes since the 1985 United States Supreme Court case of Dean Witter Reynolds Inc. v. Byrd.194 The Byrd decision has raised considerable comment195 and a fair number of cases.196 The Byrd case

120. CS/HS 644, 9th Leg., 1st Sess., § 9 (emphasis added).
122. TASK FORCE REPORT, supra note 3, at 54.
123. See generally testimony of James Frazier before the Task Force on December 9, 1985 in Orlando, Florida.
124. TASK FORCE REPORT, supra note 3, at 54.
127. See, e.g., Greenblatt v. Drexel Burnham Lambert, Inc., 763 F.2d 1352
to whether Wilko should be applied in cases arising under the Securities Exchange Act of 1934, particularly with respect to section 10(b) and SEC Rule 10b-5 thereunder. The Court in Byrd explained that in Scherk v. Alberto Calver, the Court had questioned the applicability of Wilko to a claim arising under §10(b) or under Rule 10b-5, because the 1933 and 1934 Acts differ, and because, unlike §12(2) of the 1933 Act, §10(b) of the 1934 Act does not expressly give rise to a private cause of action. The [Scherk] Court did not, however, hold that Wilko would not apply in the context of §10(b) or Rule 10b-5 claim, and Wilko has retained considerable vitality in the lower federal courts.112

The Court in Byrd did not address this controversial issue as the question of the applicability of Wilko to 1934 Act claims was not before it under the facts. Since Byrd, several federal district court opinions in Florida have held that claims arising under the Securities Exchange Act of 1934, most significantly 10b-5 claims, are themselves arbitrable.113 In three late-1986 cases, the Eleventh Circuit addressed the

135. Id. § 78j(b).
139. Id. Justice White in the concurring opinion in Byrd stated that, "Wilko's reasoning cannot be mechanically transplanted to the 1934 Act.... The Court has expressed these reservations before [cites Scherk]. I reiterate them to emphasize that the question remains open, and the contrary holdings of the lower courts must be viewed with some doubt." Id. at 224-225 (White, J. concurring).
140. See, e.g., Driscoll v. Smith Barney, Harris Upham & Co., Inc., 625 F. Supp. 1172 (D. Vt. 1985); Tenexx Transportation Inc. v. Merrill Lynch Pierce, Fenster & Smith, Inc., Fed. Soc. L. Rep. (CCH) ¶ 92,257 (M.D. Fl. March 9, 1985); Nass v. Dietz Writer Reynolds, Inc., Fed. Soc. L. Rep. (CCH) ¶ 92,059 (M.D. Fl. March 28, 1985); Guinn v. First Boston Corp., 68 F.2d 59 (5th Cir. 1986). The courts are not unanimous however. See, e.g., Rios v. Cancro v. Smith Barney, Harris Upham & Co., 612 F. Supp. 999 (S.D. Fl. 1985). Prior to this article's publication, M.B. Fl. 1985, were appealed to the Eleventh Circuit. On April 20, 1987, the court held that claims under Rule 10b-5 and Federal RICO are not subject to compulsory arbitration, but claims under Florida RICO are subject to arbitration even though the state claims are violations of federal securities laws. Driscoll v. Smith Barney, Harris Upham & Co., 815 F.2d 635, 637 (11th Cir. 1987). The reader should keep this decision in mind in order to place the proper current context on this section of the article. Plaintiff's counsel can expect that his state claims will be subject to arbitration while his analogous federal claims may proceed to trial.
142. 800 F.2d 1012 (11th Cir. 1986).
to whether Wilko should be applied in cases arising under the Securities Exchange Act of 1934, particularly with respect to section 10(b) and SEC Rule 10b-5 thereunder. The Court in Byrd explained that in Schenk v. Alberto Culver, the Court had questioned the applicability of Wilko to a claim arising under §10(b) or under Rule 10b-5 because the 1933 and 1934 Acts differ, and because, unlike §12(a) of the 1933 Act, §10(b) of the 1934 Act does not expressly give rise to a private cause of action. The Schenk Court did, however, hold that Wilko would not apply in the context of a §10(b) or Rule 10b-5 claim, and Wilko has retained considerable vitality in the lower federal courts.

The Court in Byrd did not address this controversial issue as the question of the applicability of Wilko to 1934 Act claims was not before it under the facts. Since Byrd, several federal district court opinions in Florida have held that claims arising under the Securities Exchange Act of 1934, most significantly 10b-5 claims, are themselves arbitrable. In three late-1986 cases, the Eleventh Circuit addressed the question of arbitrability of 10(b)(5) actions. In Wolfe v. E.F. Hutton, Inc. and its companion case, Gorman v. Merrill Lynch Pierce and Smith, Inc., actions were brought against the brokers for violating 10b(5) by "churning" their accounts. In both cases the appellants had signed agreements containing arbitration clauses. The court held that under Byrd the arbitration clauses were enforceable with respect to the state law claims. The court then looked to Wilko and to congressional intent to find its basis for holding that the 10(b)(5) claims were not arbitrable. The court recognized, as did the Supreme Court in Schenk and Byrd, that Wilko concerned a 12(2) action, but went on to find that even if Wilko was distinguishable, it could still be followed. The fact that the private right of action under 10b(5) is merely implied, as compared to the express rights granted by 12(2), did not change in any way the exclusive jurisdiction provision of the 1934 Act. Relying on congressional intent, the court stated that the provision of 15 U.S.C. § 78bb(b), which permits compulsory arbitration of securities claims between securities professionals, effectively endorsed Wilko when it declined to take further action as to arbitration of claims where a non-professional was involved. The court, recognizing "that the Supreme Court considers the issue open and may at some point expressly limit or overrule Wilko," agreed with the Second and Fifth Circuits in following Sibley v. Tandy Corp.

The same court, in Tasheva v. Bache, Halsey, Stuart, Shields, Inc., not only confirmed its holding in Wolfe, but went on to say that since the 10b(5) claims were not subject to arbitration, the related

should keep this decision in mind in order to place the proper current context on this action of the article. Plaintiff's counsel can expect that his state claims will be subject to arbitration while his analogous federal claims may proceed to trial.


142. 800 F.2d 1032 (11th Cir. 1986).

143. Churning refers to the practice of engaging in excessive trading to generate high commissions without regard to the customers' investment interest. See Neal, Peter, Jackson and Carey, Inc., 598 F.2d 458 (5th Cir. 1979).

144. Wolfe, 800 F.2d at 1032.

145. Id. at 1036.

146. Id.

147. Id. at 1037.

148. Id. at 1035.

149. 543 F.2d 540 (5th Cir. 1976), cert. denied, 434 U.S. 824 (1977).

150. 802 F.2d 1337 (11th Cir. 1986).
RICO actions should be decided in the same forum as the federal securities claims in order to accomplish "orderly adjudication." In Bemry v. Prudential-Bache Securities, Inc., the Eleventh Circuit again confirmed its position that pre-claim agreements to arbitrate 10(b)(5) claims are not enforceable. The court also reaffirmed its holding in Miller v. Drexel Burnham Lambert, Inc., that a court may not order arbitration unless "until it is satisfied that a valid arbitration agreement exists.""

On a related front, in 1984 the Florida Supreme Court in Oppenheimer v. Young held that claims under the Florida Securities Act are not subject to arbitration. In Oppenheimer, the trial court had entered an order compelling arbitration in a suit alleging a violation of the Florida Securities Act as well as common law fraud, negligence and breach of fiduciary duty in the handling of a brokerage account. The Third District Court of Appeal granted a writ of certiorari and quashed the trial court's order. The Florida Supreme Court approved. The trial court had relied on Merrill Lynch Pierce Fenner & Smith v. Melamed, which held that the Federal Arbitration Act compelled arbitration. The Third District Court of Appeal, on the other hand, relied on Shearson, Hammill & Co., Inc. v. Vouk for the proposition that the Florida Securities Act will control over the Florida Arbitration Code to the extent of a conflict between them. For this proposition, the court relied on Wilko, "which held that the provision of the federal Securities Act prohibiting arbitration would control over the more general Federal Arbitration Act." The Florida Supreme Court noted that "the legislature intended that Florida Securities laws be hand-in-glove with the federal securities laws and that the full range of civil remedies offered by both Florida and federal laws... Thus, we agree with the district court that we should follow Wilko v. Swan... in holding that an arbitration agreement concerning disputes in securities is unenforceable." The Florida Supreme Court was mindful of the turmoil in the federal courts over the scope of Wilko, particularly with the Byrd case then pending, and even went so far as to indicate, in a footnote, that if the Supreme Court were to "recede from Wilko by holding that arbitration agreements could not be enforced..." the case was appealed to the United States Supreme Court, which vacated the case and remanded it for further consideration in light of Byrd. On remand, the Florida Supreme Court stated that the effect of Byrd was to "preempt the earlier state law upon which the court had relied." As indicated above, the Supreme Court did not per se recede from Wilko in Byrd, but rather held Wilko to its facts, and gave warning about applying cases involving claims under the Securities Act of 1933 to cases involving claims under other securities laws. The rather broad statements in Oppenheimer concerning the application of federal securities law construction and remedies to state securities claims should not be taken too literally. At least two federal district court

151. Id.
152. 805 F.2d 1437 (11th Cir. 1986).
153. 47 So.2d 515 (11th Cir. 1986).
154. Id. at 534.
155. 47 So.2d 172 (Fla. 1984), vacated and remanded, 470 U.S. 1078, on remand, 475 So.2d 222 (Fla. 1985).
157. Oppenheimer, 456 So. 2d at 1178.
159. 247 So. 2d 733 (Fla. 3d Dist. Ct. App. 1971), cert. denied, 253 So. 2d 444 (Fla. 1971).
160. Oppenheimer, 434 So.2d at 372.

https://nsuworks.nova.edu/nlr/vol11/iss4/3
RICO actions should be decided in the same forum as the federal securities claims in order to accomplish " orderly adjudication." 151 In *Benoa v. Prudential-Bache Securities, Inc.*, 152 the Eleventh Circuit again confirmed its position that pre-claim agreements to arbitrate 10(b)(5) claims are not enforceable. The court also reaffirmed its holding in *Miller v. Drexel Burnham Lambert, Inc.*, 153 that a court may not order arbitration unless and "until it is satisfied that a valid arbitration agreement exists." 154

On a related front, in 1984 the Florida Supreme Court in *Oppenheimer v. Young* 155 held that claims under the Florida Securities Act are not subject to arbitration. In *Oppenheimer*, the trial court had entered an order compelling arbitration in a suit alleging a violation of the Florida Securities Act as well as common law fraud, negligence and breach of fiduciary duty in the handling of a brokerage account. The Third District Court of Appeal granted a writ of certiorari and quashed the trial court's order. 156 The Florida Supreme Court approved. 157 The trial court had relied on *Merrill Lynch Pierce Fenner & Smith v. Melamed*, 158 which held that the Federal Arbitration Act compelled arbitration. The Third District Court of Appeal, on the other hand, relied on *Shearson, Hammill & Co., Inc. v. Vouis* 159 for the proposition that the Florida Securities Act will control over the Florida Arbitration Code to the extent of a conflict between them. For this proposition, the court relied on *Wilko*, "which held that the provision of the federal Securities Act prohibiting arbitration would control over the more general Federal Arbitration Act." 160

The Florida Supreme Court noted that "the legislature intended that Florida Securities laws be hand-in-glove with the federal securities laws and that the full range of civil remedies offered by both Florida and federal laws... Thus, we agree with the district court that we should follow *Wilko v. Swan...* in holding that an arbitration agreement concerning disputes in securities is unenforceable." 161 The Florida Supreme Court was mindful of the turmoil in the federal courts over the scope of *Wilko*, particularly with the *Byrd* case then pending, and even went so far as to indicate, in a footnote, that if the Supreme Court were to "recede from *Wilko* by holding that arbitration agreements could be enforced to resolve disputes concerning interstate securities transactions, our decision would be different." 162 The case was appealed to the United States Supreme Court, which vacated the case and remanded it for further consideration in light of *Byrd*. 163 On remand, the Florida Supreme Court stated that the effect of *Byrd* was to preempt the earlier state law upon which the court had relied. 164

As indicated above, the Supreme Court did not per se recede from *Wilko in Byrd*, but rather held *Wilko* to its facts, and gave warning about applying cases involving claims under the Securities Act of 1933 to cases involving claims under other securities laws. 165 The rather broad statements in *Oppenheimer* concerning the application of federal securities law construction and remedies to state securities claims should not be taken too literally. 166 At least two federal district court

---

151. Oppenheimer, 456 So. 2d at 1178.
152. Id. at 1178 n. 6.
153. Oppenheimer, 470 U.S. at 1078.
154. Oppenheimer, 475 So. 2d at 221. On remand the respondent urged that the court reexamine and reverse its earlier ruling that petitioner did not waive its right to compel arbitration by failing to invoke this right in the earlier federal court proceeding. The court declined to do this, stating "We do not agree that we should hold petitioner to a knowledge of the future development of the law which we did not possess." 167 The court then quashed the earlier decision in the district court and remanded the case for further proceedings.

156. An important example of this is in the area of requisite elements for an anti-fraud action under FLSA. See 517.301 (Supp. 1986). Under this section the claim must prove (1) misrepresentation or omission (2) information material to the transaction (3) upon which the purchaser reasonably relied (4) that proximately caused his injury. Id. However, under Rule 10b-5 there is the additional requirement of scienter, that is, that the defendant knew of, or recklessly disregarded the falsity of his misrepresentation, while mere negligence satisfies Florida statutory and common law. See, e.g., Alna Capital Associates v. Wagner, 758 F.2d 562 (11th Cir.
opinions have referred to and either questioned or criticized Oppenheimer to the extent that it is asserted to preclude arbitration of state securities claims in federal court actions. As Judge Gonzalez wrote in Brown v. E.F. Hutton & Co., Inc., "Plaintiff's final argument against arbitration is that under Florida law the Florida Securities claims cannot be submitted to arbitration. The case relied upon for this proposition, Oppenheimer v. Young ... was recently vacated by the Supreme Court in light of Byrd... But regardless of what the Florida court's decision, it is plain that a federal court must apply the Federal Arbitration Act even when it pertains to state causes of action." A companion issue, yet unresolved at the Supreme Court level, is the applicability of the Byrd doctrine with respect to federal civil RICO claims. In Greenblatt v. Drexel Burnham Lambert, the Court of Appeals for the Eleventh Circuit stated, "[i]nitially, we ob serve that whether a RICO claim is a nonarbitrable federal claim is an open question in this circuit." As indicated above, the Eleventh Circuit


169. There were pending Congressional responses to curb the explosion of civil RICO actions. For example, HR 5445, introduced by Rep. Frederick Boucher (D-Va.) was approved by the House in a vote of 271 to 28 on October 7, 1986. The legislation would eliminate treble damages under RICO except where the defendant has been criminally convicted of a RICO violation or where the plaintiff is the Justice Department or a state attorney general. Treble damages would also be unavailable where the the concepts in the Second Circuit's opinion in Sedima, S.P.R.L. v. Imes Co. 741 F.2d Sedima, 473 U.S. 417 (1985). There would be no award of punitive damages in other cases, plus no summary actions. The bill provides for attorney fees to the prevailing plaintiff in a civil case, and of the relevant rule of criminal conviction. Currently there is no statute of limitations in RICO itself. See 18 U.S.C. 3232 (11th Cir. 1985).

170. 763 F.2d 1352 (11th Cir. 1985).

171. Id. at 1361.

172. 803 F.2d at 1337.

173. See supra notes 118.1 to 118.4 and accompanying text.


178. Id. § 702.102(1)(b) (Supp. 1986).

179. Id.
opinions have referred to and either questioned or criticized Oppenheimer to the extent that it is asserted to preclude arbitral state securities claims in federal court actions. As Judge Gonzales wrote in Brown v. E.F. Hutton & Co., Inc., "Plaintiff's final argument against arbitration is that under Florida law the Florida Securities claims cannot be submitted to arbitration. The case relied upon for this proposition, Oppenheimer v. Young . . . was recently vacated by the Supreme Court in light of Byrd. . . . But regardless of what the Florida court's decision, it is plain that a federal court must apply the Federal Arbitration Act even when it pertains to state causes of action." A companion issue, yet unresolved at the Supreme Court level, is the applicability of the Byrd doctrine with respect to federal civil RICO claims. In Greenblatt v. Dreisel Burnham Lambert, the Court of Appeals for the Eleventh Circuit stated, "[I]nitially, we observe that whether a RICO claim is a nonarbitrable federal claim is an open question in this circuit." As indicated above, the Eleventh Circuit in Tashene has recently held that federal RICO claims related to 10b-5 claims are not subject to arbitration. However, it is clear that more and more securities cases will be arbitrated to some extent. The choice of arbitration forum is, therefore, of significance. The issues of the arbitrability of fraud claims under the 1934 Act as well as civil RICO claims may be settled in the near future, as the United States Supreme Court has agreed to review these matters in Shearson/American Express, Inc. v. McMahon.
The implications of the changes to the Florida Blue Sky Law on Florida civil RICO claims may be of more academic than practical importance due to the major changes in the Federal RICO statute in 1986. The Florida Legislature removed the private right of action, previously found in section 895.07 of the Florida Statutes, with its remedy of treble damages and attorney's fees, from the arsenal of defrauded securities investors. It is effective for all civil proceedings filed after October 1, 1986, with sections 1, 2, 5 and 7 applying to all civil proceedings pending on October 1, 1986 for which the distribution of proceeds has yet to be determined under section 895.09 of the Florida Statutes. Thus, the issue of arbitrability of Florida civil, private RICO claims has been effectively mooted. However, the issue is still alive in a different context. What the legislature took away under Civil RICO, it gave back under another statute. Under chapter 772 of the Florida Statutes, "Civil Remedies for Criminal Practices," there are treble damages and attorney's fees available for any person who proves by clear and convincing evidence that he has been injured by reason of a violation of section 772.103. Section 772.103 makes it unlawful for any person who, with criminal intent, receives proceeds from a pattern of criminal activity. The term "criminal activity" is defined in Section 772.102(1)(a)(3)(c) to include "any crime which is chargeable by indictment or information under . . . Chapter 517, relating to securities transactions."
The initial proposal was, from some perspectives, modest. It simply provided that if an agreement contained an arbitration clause it must allow for the option of the American Arbitration Association as the arbitrator. The broker could choose not to include any arbitration clause at all, or, if included, it could provide for arbitration by the NASD, NYSE or the AAA.

VI. Registration of Bonds

The new Act repeals former section 517.07(2), which had authorized the Department to issue a permit for the sale of debt securities for a period of more than one year if the issuer had registered similar securities in each of the previous four years. In essence, the section had allowed the Department "to grant registration, without review, of bonds previously registered . . . Because of the possibility of a change in the financial condition of the issuer of the bonds, the Department has denied the one company's request submitted under this provision. Registration for each issue is always required. For that reason, s. 517.07(2) is being removed . . . at the suggestion of the Department." This hardly seems earth shattering.

What is more intriguing, however, is the fact that the new Act did not include a recommendation from the Task Force Report which would have eliminated the current exemption from registration, found in section 517.051(1), for Industrial Revenue Bonds. Specifically, it would have excluded from the exemption those bonds payable from revenues to be received from a non-governmental source, unless the payments were unconditionally guaranteed by the governmental agency. The impetus for this change seemingly came, in part, from the default of, among others, the Washington Housing Power Authority paying its bondholders (colloquially known as the "Whoops" fiasco).

177. With all due respect to Jonathan Swift.
178. CS/HB 644, 9th Leg., 1st Sess., § 9.
179. Exactly how and why the change came about is unclear from the legislative history. It is left for the reader to ponder the political legerdemain that transformed a "shall" into a "may".
181. Staff Analysis, supra note 3, at 4.
184. Id.
185. See Wash. Rev. Code § 21.20.310(1) (1985). The Washington statute states, in pertinent part, "[T]he registration and advertising provisions of the Washington blue sky law shall not apply to . . . Any security (including a revenue obligation) issued or guaranteed by the United States, any state, or other instrumentality [thereof] . . . but this exemption does not include any security payable solely from revenues to be received from a governmental industrial or commercial enterprise unless such payments are made or unconditionally guaranteed by a person whose securities are exempt by subsections (7) [regulated common carriers or public utilities] or (8) [any security which meets the criteria for investment grade securities that the director adopts by rule] . . . (unless exempted by the director, where he finds registration not necessary in the public interest or for the protection of investors.)"
187. Id. § 517.161(6)(B)(1). This requirement is itself suspended if no hearing is requested or the suspension or restriction is made in accordance with § 120.60(8) (emergency suspension of license).
188. Id. § 517.161(6)(B)(2).
189. Id. § 517.161(6)(B)(3).
The initial proposal was, from some perspectives, modest. It simply provided that if an agreement contained an arbitration clause it must allow for the option of the American Arbitration Association as the arbitrator. The broker could choose not to include any arbitration clause at all, or, if included, it could provide for arbitration by the NASD, NYSE or the AAA.

VI. Registration of Bonds

The new Act repeals former section 517.07(2), which had authorized the Department to issue a permit for the sale of debt securities for a period of more than one year if the issuer had registered similar securities in each of the previous four years. In essence, the section had allowed the Department to grant registration without review, of bonds previously registered. Because of the possibility of a change in the financial condition of the issuer of the bonds, the department has denied the one company's request submitted under this provision. Registration for each issue is always required. For that reason, subsec. 517.07(2) is being removed at the suggestion of the Department. This hardly seems earth shattering.

What is more intriguing, however, is the fact that the new Act did not include a recommendation from the Task Force Report which would have eliminated the current exemption from registration, found in section 517.051(1), for Industrial Revenue Bonds. Specifically, it would have excluded from the exemption those bonds payable from revenues to be received from a non-governmental source, unless the payments were unconditionally guaranteed by the governmental agency. The impetus for this change seemingly came, in part, from the defaults of, among others, the Washington Housing and Development Authority paying its bondholders (colloquially known as the "Whoops! fiasco").

197. With all due respect to Jonathan Swift.
199. Exactly how and why the change came about is unclear from the legislative history. It is left for the reader to ponder the political antecedents that transformed a "shalt" into a "may".
201. State Assessment, supra note 3, at 4.
204. Id.

Such legislation has been enacted in the State of Washington. This may happen another day in Florida. There seems little rationale in allowing the exemption.

VII. Enforcement Strengthened

Although many of the previously mentioned changes in effect enhanced the ability of the Department to detect and deal with potential problems in the securities industry, the new Act has added specific provisions dealing with enforcement. Section 517.161 has been substantially rewritten. The key change is the addition of subsection (6), under which registration may be denied, suspended or restricted "if an applicant or registrant is charged, in a pending enforcement action or pending criminal prosecution, with any conduct that would authorize denial or revocation under subsection (1)." The section provides for procedural safeguards, including provisions for a hearing, and a finding that a prima facie case has been made in either the enforcement action or criminal prosecution and a provision that any suspension, restriction or denial as a result of such pending proceeding will itself terminate after no longer than ten days after the department receives notice that the pending proceeding has been terminated. According to the Final Staff Analysis,

This (provision) means that during the pendency of the actions or

185. See Wash. Rev. Code § 21.20.310(1) (1985). The Washington statute is, in pertinent part, "The registration and advertising provisions of the Washington blue sky law shall not apply to... Any security (including a revenue obligation) issued or guaranteed by the United States, any state, or other instrumentality thereof..." (emphasis added).

... but this exception does not include any security payable solely from revenues to be received from a non-governmental industrial or commercial enterprise unless such payments are made or unconditionally guaranteed by a person whose securities are exempt by subsections (7) (regulated common carriers or public utilities) or (8) (any security which meets the criteria for investment grade securities that the director adopts by rule) (unless exempted by the director, where he finds registration not necessary to the public interest or for the protection of investors). Id.

188. Id. § 517.161(6)(b)(1). This requirement is itself suspended if no hearing is requested or the suspension or restriction is made in accordance with § 120.60(3) (emergency suspension of license).
189. Id. § 517.161(6)(b)(2).
190. Id. § 517.161(6)(b)(3).
prosecutions, which can last for several years, these persons [can no longer] continue defrauding investors. It is similarly in response to the failure of GIC Government Securities, Inc., which was able to register notwithstanding pending enforcement actions against one of its principals in another state, thereby resulting in large part to its defrauding investors of from $10-30 million.\textsuperscript{19}

The term “enforcement action” is defined in section 517.161(e)(1), and includes judicial or administrative proceeding brought by any state or the federal government or any agency thereof “to enforce or restrain violation of any state or federal law,” as well as, “disciplinary proceedings” brought by the securities and commodities self-regulatory organizations, such as the NASD, NYSE or the National Futures Association.\textsuperscript{185} Section 517.221, pertaining to cease and desist orders, has been amended to allow for immediately effective emergency cease and desist orders, which would be effective for a maximum of ninety days.\textsuperscript{186} This is apparently codification of existing procedures.\textsuperscript{187} That section has been further amended to authorize the Department to impose and collect an administrative fine of not more than $5,000, per violation, against any person who violates either any provision of Chapter 517, any department rule or order or any written agreement entered into with the department.\textsuperscript{188} The old law provided only for $1,000 fines for violation of cease and desist orders themselves.\textsuperscript{189} The funds collected are to be deposited in the newly created Anti-Fraud Trust Fund,\textsuperscript{190} rather than to the State Treasury.

The new legislation substantially changes Section 517.302. The old section, called “Penalty,” simply provided that whoever had violated Chapter 517 was guilty of a third degree felony (up to five years in prison and a fine of up to $5,000) and further provided a five-year statute of limitations.\textsuperscript{191} The new legislation retains this but adds quite a bit more. In the first place, it provides that if the violation is a violation of the anti-fraud and “boiler room” prohibitions of section 517.312(1) and the violator had obtained money or property exceeding, in the aggregate $50,000 from five or more persons, the violator is guilty of a first degree felony (up to thirty years in prison and a fine of up to $100,000).\textsuperscript{192} Alternatively, a new subsection provides that in lieu of the fine imposed by law, a person found guilty of, or pleading no contest to, having engaged in conduct in violation of chapter 517 may be sentenced to pay a fine not to exceed “three times the gross value gained or three times the gross value lost caused by such conduct plus court costs and the costs of investigation and prosecution, reasonably incurred.”\textsuperscript{193} This should indeed be a strong deterrent.

The Comptroller’s staff has been significantly increased. As Mr. Griffin stated, “If the full 76 people are employed, you’ll be the second largest securities agency in the country, I think, second only to California.”\textsuperscript{194}

VIII. Other Changes

Other changes made by the 1986 Act may be summarized as follows:

1. Section 20.12(2)(f) of the Florida Statutes is amended to name the Division of Securities to the “Division of Securities and Investor Protection.”\textsuperscript{195}

2. Section 517.021 is amended to include definitions for the terms “promoter”\textsuperscript{196} and “promoter.”\textsuperscript{197}


192. Id. § 517.302(1) (Supp. 1986).}

193. Id. § 517.302(1) (Supp. 1986).

194. Id. § 517.302(1) (Supp. 1986).

195. Id. § 517.302(1) (Supp. 1986).

196. Id. § 517.302(1) (Supp. 1986).

197. Id. § 517.302(1) (Supp. 1986).

198. Id. § 517.302(1) (Supp. 1986).

199. Id. § 517.302(1) (Supp. 1986).

200. Id. § 517.302(1) (Supp. 1986).

201. Testimony of Royce Griffin, supra note 44. We may be importing our problems in California. Mr. Griffin stated, “Your boiler room moved down to Newport Beach [California]. That’s basically what happened when the Florida law enforcement efforts went down to Fort Lauderdale and ran those guys out of there, they all moved to Southern California, and they have your people, the same people doing the same thing now in Newport Beach.” Id.


203. Id. § 517.302(1) (Supp. 1986).

204. Id. § 517.302(1) (Supp. 1986).

“Promoter” includes the following: (a) Any person who, acting alone or in conjunction with one or more other persons, directly or indirectly takes the initiative in founding and organizing the business or enterprise of an issuer, directly or indirectly receives in
prosecutions, which can last for several years, these persons [can no longer] continue defrauding investors. It is particularly in response to the failure of GIC Government Securities, Inc., which was able to register notwithstanding pending enforcement actions against one of its principals in another state, thereby resulting in large part to its defrauding investors of from $10-30 million.181

The term “enforcement action” is defined in section 517.161(c)(1), and includes judicial or administrative proceeding brought by any state or the federal government or any agency thereof “to enforce or restrain violation of any state or federal law,” as well as, “disciplinary proceedings” brought by the securities and commodities self-regulatory organizations, such as the NASD, NYSE or the National Futures Association.182

Section 517.221, pertaining to cease and desist orders, has been amended to allow for immediately effective emergency cease and desist orders, which would be effective for a maximum of ninety days.183 This is apparently a codification of existing procedures.184 That section has been further amended to authorize the Department to impose and collect an administrative fine of not more than $5,000, per violation, against any person who violates either any provision of Chapter 517, any department rule or order or any written agreement entered into with the department.185 The old law provided only for $1,000 fines for violation of cease and desist orders themselves.186 The funds collected are to be deposited in the newly created Anti-Fraud Trust Fund,187 rather than to the State Treasury.

The new legislation substantially changes Section 517.302. The old section, called “Penalty,” simply provided that whoever had violated Chapter 517 was guilty of a third degree felony (up to five years in prison and a fine of up to $5,000) and further provided a five-year statute of limitations.188 The new legislation retains this but adds quite a bit more. In the first place, it provides that if the violation is a violation of the anti-fraud and “boiler room” prohibitions of section 517.312(1) and the violator had obtained money or property exceeding, in the aggregate $50,000 from five or more persons, the violator is guilty of a first degree felony (up to thirty years in prison and a fine of up to $10,000).189 Alternatively, a new subsection provides that in lieu of the fine imposed by law, a person found guilty of, or pleading no contest to, having engaged in conduct in violation of chapter 517 may be sentenced to pay a fine not to exceed “three times the gross value gained or three times the gross value lost caused by such conduct plus court costs and the costs of investigation and prosecution, reasonably incurred.”190 This should indeed be a strong deterrent. The Comptroller’s Staff has been significantly increased. As Mr. Griffin stated, “If the full 56 people are employed, you’ll be the second largest securities agency in the country, I think, second only to California.”191

VIII. Other Changes

Other changes made by the 1986 Act may be summarized as follows:
1. Section 20.12(2)(f) of the Florida Statutes is amended to rename the Division of Securities to the “Division of Securities and Investor Protection.”
2. Section 517.021 is amended to include definitions for the terms “promoter” and “promoter.”

181. Id. § 517.302(2).
182. Id. § 517.302(3) (emphasis added). Shades of RICO.
183. Testimony of Royce Griffin, supra note 44. We may be exporting our problems to California. Mr. Griffin stated, “your boiler rooms moved down to Newport Beach [California]. That’s basically what happened when the Florida law enforcement officers went down to Fort Lauderdale and ran those guys out of there, they all moved to Southern California, and they have your people, the same people doing the same thing now in Newport Beach.” Id.
185. Id. § 517.021(15) states, “Promoter” means a person the major portion of whose assets have been acquired directly or indirectly by an issuer.
186. Id. § 517.021(17) states, “Promoter” includes the following: (a) Any person who, acting alone or in conjunction with one or more other persons, directly or indirectly takes the initiative in founding and organizing the business or enterprise of an issuer. (b) Any person who, in connection with the founding or organizing of the business or enterprise of an issuer, directly or indirectly receives in

Published by NSUWorks. 1987
IX. Conclusion

The Securities Industry Standards Act of 1986, together with the earlier Blue Sky legislation enacted in Florida since 1983, should make potential con-artists think long and hard about using Florida as headquarters for fraudulent securities or investment offerings, or for that matter, making such offerings into Florida. The penalties have been significantly increased, as has the enforcement staff. Many “loopholes” which had permitted now infamous securities and investments scams to take place have been closed.

Of course, there is a price to pay for this increased protection in the form of increased regulation. The Florida Blue Sky law, as amended, has many unique features as a result of responses to specific abuses in the past. The limited return to merit regulation, designed to deal with penny stock issues and certain “bad boys,” may deter some legitimate offerings, thus depriving Floridians of a measure of economic freedom. The legislation is intended to strike a balance between economic freedom and deterrence of fraud. Apparently, based on the 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 connection with property shall not be deemed a promoter if such person does not otherwise take part in founding and organizing the enterprise.

36. See § 517.051(10).
37. See § 517.311(4)(b). The required disclaimer is, “Registration does not imply that such person that has been registered, recommended, or approved by the state or any agency or officer of the state or by the United States or any agency or officer of the United States.” Id. This disclaimer must be in writing following any written representation or if the representation is oral, oral, but in either case with the same force and effect as the statement concerning the representation of registration. See id. § 517.311(4)(b)(1) and (2).
39. See supra note 6, at 11.
40. See supra note 6, at 11.
Section 517.051(10) has been amended to clarify that self-insurance agreements are included as exempt securities. 349
4. Section 517.31(4)(b) has been added to require a specific disclaimer with respect to the registration or licensure. 350

IX. Conclusion

The Securities Industry Standards Act of 1986, 351 together with the earlier Blue Sky legislation enacted in Florida since 1983, should make potential con-artists think long and hard about using Florida as headquarters for fraudulent securities or investment offerings, or for that matter, making such offerings into Florida. The penalties have been significantly increased, as has the enforcement staff. Many “loopholes” which had permitted now infamous securities and investments scams to take place have been closed. 352

Of course, there is a price to pay for this increased protection in the form of increased regulation. The Florida Blue Sky law, as amended, has many unique features as a result of responses to specific abuses in the past. The limited return to merit regulation, designed to deal with penny stock issues and certain “bad boys,” may deter some legitimate offerings, thus depriving Floridians of a measure of economic freedom. The legislation is intended to strike a balance between economic freedom and deterrence of fraud. 353 Apparently, based on the

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 connection with property shall not be deemed a promoter if such person does not otherwise take part in founding and organizing the enterprise.
354
205. [Id. § 517.051 (10).]
206. [Id. § 517.31(4)(b). The required disclaimer is, “Registration does not imply that such person that such [registered] person has been sponsored, recommended, or approved by the state or any agency of the state. Any person engaging in any activity in connection with property shall not be deemed a promoter if such person does not otherwise take part in founding and organizing the enterprise.”]

record of numerous and massive fraudulent schemes in recent years, the legislature has now tilted toward deterrence by regulation. It is difficult to predict whether the balance has been rightly struck. Indeed, it will be well nigh impossible to assess how much fraud will be deterred or how many legitimate offerings will not be made as a result of these changes. However, on the whole, the legislation seems to have been thoughtfully constructed to address serious, pressing problems.