Blue Sky Laws: America's Answer to Preventing Fraudulent Investment Sales

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Introduction

The tales of Ponzi and pyramid schemes are scattered throughout the history of the country, leading to losses small and large by the common investor. To protect the ordinary investor, the United States government created federal securities laws, and, in turn, the states created supporting securities laws commonly known as the Blue Sky laws.

Blue Sky laws protect the common investor from being taken advantage of via fraudulent or overly speculative investments. (Troy Segal, *Blue Sky Laws*, Investopedia (April 1, 2019), https://www.investopedia.com/terms/b/blueskylaws.asp). The laws require that the sellers register their offerings and provide financial details of the deal and the entities involved. (*Id.).* The provisions also create liability for any fraudulent statements or failure to disclose information, allowing lawsuits and other legal actions to be brought against the security issuer. (*Id.).*

History of the Blue Sky Laws

In the years leading up to the 1929 crash, the stock market was rife with fraudulent and overly speculative investments. (*Id.).* Many companies issued stock or promoted real estate by making unsupported promises of higher profits to come. (*Id.).* Those fraudulent activities contributed to the inflated stock market leading to its inevitable collapse.

After the stock market crash, and the onset of the Great Depression, Congress enacted the Securities Act of 1933 and Securities Exchange Act of 1934 to regulate the stock market and the financial industry on a federal level and to establish the Securities and Exchange Commission ("SEC"). (*Id.).* In 1956, the Uniform Securities Act was passed, which was a model law providing a framework that guided –and still guides –states in the crafting of their own securities legislation, their "Blue Sky laws". (*Id.).*

Blue Sky Laws' Common Features

Despite the differences between statutes from state to state, the Blue Sky laws share certain features in their approach to prevent the security issuer from promising unrealistic returns and misinforming investors about investment risks. (*Blue Sky Law,* Legal Information Institute (December 28, 2019), https://www.law.cornell.edu/wex/blue_sky_law). The state laws provide oversight of the sales process and create liability for fraudulent sales in two ways.

First, the state laws require the registration of securities that will be offered or sold within the state, unless the offerings fall within specified exemptions from registration. (*Id.).* In addition, brokerage firms, issuers selling their securities, and individual brokers must be

registered with and licensed by the state; some states also require additional certifications for brokers. State securities agencies and commissions administer these processes. (*Id.).*

Second, Blue Sky laws have antifraud provisions that create liability for any fraudulent statements or failure to disclose information as required. (*Id.).* The specific kinds of statements and acts that can form the basis of a fraudulent claim will depend on a state's statutes and case law. (*Id.).* The right of actions and remedies available to investors bringing private suits also differ from state to state, but may include rescission of the transactions, forcing the seller to give up profits, or other measures of damages. (*Id.).*

Exempt Offerings

Section 18 of the Securities Act of 1933 says that states cannot require the registration or qualification of certain "covered securities." (Practical Law Corporate & Securities, *US Securities Laws: Overview*, Practical Law (December 28, 2019). Covered securities are exempt from state pre-sale qualification requirements as a result of the National Securities Markets Improvement Act of 1966. (*Id.)* Certain securities offerings that are exempt from registration may only be offered to or purchased by persons who are accredited investors. (*Frequently asked questions about exempt offerings*, U.S. Securities and Exchange Commission (December 29, 2019). The SEC has listed a variety of investors that qualify as an accredited investor, some of which include banks, insurance companies, employee benefit plans invested in by a bank or insurance company, tax-exempt charitable organizations, or an individual with a net worth of at least one million dollars. (*Id.)* Despite exemption, all securities transactions are subject to the antifraud provisions of the federal securities laws. (*Id.)*

Conclusion

The Blue Sky laws can be complicated, but their purpose is to protect the common investor from fraudulent claims and propositions. To ensure that all parties in a securities transaction are protected, it is pivotal that the Blue Sky laws are known, understood, and followed in every securities transaction.