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PROVIDING EQUAL ACCESS TO CAPITAL IN THE AGE OF THE STARTUP: THE CASE FOR FEDERAL PRE-EMPTION OF STATE BLUE-SKY LAWS

Gerry Griffith*

INTRODUCTION

In what has become a common refrain in the investing community, a recent Wall Street Journal headline reads: "Where Have All the Public

Companies Gone?"[1] Since 1996, the number of public companies has fallen from 7,322 to 3,671.[2] According to a recent survey of 315 public-company chief financial officers, the average total cost of an initial public offering ("IPO") is $4.2 million.[3] In addition, the cost of remaining a public company is more than $1 million annually.[4] Due to the cost-inhibitive process and the maze of regulations that accompany access to public markets, many early stage companies choose to pursue private funding.[5]

As startup ventures become increasingly prevalent in the digital economy, capital demand for those entities has sharply increased.[6] To remain relevant players in the global economy, startups must increase their operating scale quickly, a reality that demands ready access to substantial capital.[7] While the United States federal government has developed several innovative statutes and regulations in an effort to ensure corporate mobility and efficient capital management, state securities laws, commonly known as "blue sky laws," often substantially impede startups' capital acquisition.[8]

In a private offering, a corporation raises funds by issuing restricted securities, which are sold to investors without being registered on a publicly traded exchange and thereafter cannot be freely transferred.[9] Because restricted securities are often shares of unproven companies and used by those

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[1] *See* Jason M. Thomas, *Where Have All the Public Companies Gone?*, WALL ST. J. (Nov. 16, 2017), https://www.wsj.com/articles/where-have-all-the-public-companies-gone-1510869125.

[2] *Id.*

[3] *Considering an IPO to fuel your company's future?*, PRICE WATERHOUSE COOPER, https://www.pwc.com/us/en/services/deals/library/cost-of-an-ipo.html (last visited Feb. 16, 2020).

[4] *Id.*

[5] *See generally* Jeremy Abelson & Ben Narasin, *Why Are Companies Staying Private Longer?*, BARRON'S (Oct. 9, 2015), https://www.barrons.com/articles/why-are-companies-staying-private-longer-1444411528 (last visited Feb 16, 2020).

[6] Sramana Mitra, *How Startups Overcome the Capital Gap*, HARV. BUS. REV. (July 10, 2013), https://hbr.org/2013/07/how-startups-overcome-the-capi.

[7] *See* Eliot Brown, *More Venture Capital Money Is Going into Fewer Startup Deals*, WALL ST. J. (Nov. 11, 2018), https://www.wsj.com/articles/more-venture-capital-money-is-going-into-fewer-startup-deals-1541944089?ns=prod/accounts-wsj.

[8] Rutherford B. Campbell Jr., *The Case for Federal Preemption of State Blue Sky Laws*, CLS BLUE SKY BLOG (May 18, 2017), http://clsbluesky.law.columbia.edu/2017/05/18/the-case-for-federal-preemption-of-state-blue-sky-laws/.

[9] *See Private Placements, Explained*, FINRA (July 1, 2015), https://www.finra.org/investors/insights/private-placements-explained (last visited Feb. 16, 2020).

entities as means for raising capital, they often raise relatively small amounts of capital.[10] While a restricted offering is substantially cheaper than a public offering, its costs can still be prohibitively expensive and can require extensive use of professionals, such as investment bankers, securities attorneys, and public accountants.[11] When large entities seek to raise funding by the prescribed mechanisms, they nearly always possess the financial capabilities to hire the requisite professionals to navigate both federal and state securities regulations.[12] However, due to the early stage of their business cycle, startups are less likely to have such financial means and are therefore unlikely to access the capital necessary to grow.[13] While Congress has instituted several acts to encourage startup growth, blue sky regulation often stymies these attempts.[14]

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[10] *See* Scott Bauguess, Rachita Gullapalli & Vladimir Ivanov, *Capital-Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2017*, U.S. S.E.C. Div. ECON. & RISK ANALYSIS (Aug. 2018), https://www.sec.gov/files/DERA%20white%20paper_Regulation%20D_082018.pdf.

[11] *See* Akhilesh Ganti, *Private Placement*, INVESTOPEDIA, https://www.investopedia.com/terms/p/privateplacement.asp (last visited Feb. 17, 2020).

[12] *See id.*

[13] *See* Rutherford B. Campbell Jr., Chapter 6: The Case for Federal Pre-Emption of State Blue Sky Laws, HERITAGE FOUND., https://www.heritage.org/sites/default/files/2017-02/06_ProsperityUnleashed_Chapter06.pdf.,

> In all cases, the registration requirements of state blue sky laws amount to economic waste, generating costs without any economic benefit. These state registration requirements, however, have been especially debilitating on small businesses in need of external capital. The reason that the harmful effects of state registration provisions fall disproportionately on small businesses is due principally to the structural and economic circumstances that small businesses face when they attempt to access external capital. Small businesses usually seek relatively small amounts of external capital . . . [t]he yield from small offerings simply will not support the fees required by competent and honest financial intermediation. For example, in my research, I found that only 5.8 percent of Regulation D offerings of $1 million or less reported having any financial intermediation.

Id.

[14] *See* Ruthford B. Campbell Jr., *The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions*, Ohio St. Entrepreneurial Bus. L.J. 287, 301 (2012).

> Briefly stated, high offering costs generally prevent small issuers from raising their external capital through registered offerings of their securities. Regulation A offerings have fallen into nearly total disuse, due principally to the impact of state blue sky laws. Offerings under section 4(2) are limited to sophisticated offerees and purchasers and apparently require access to or disclosure of the same information that would be required in a registration statement . . . [f]inally, offerings under the intrastate exemption provided by Rule 147 are restricted to a single state, which inhibits any broad search for capital.

Id.

This comment explores the utility of blue sky laws in the ever-evolving digital economy. Due to the discriminatory and burdensome requirements of blue sky laws, which restrict access to capital acquisition by startups, this comment considers whether the value these laws add offsets any stymying of capital acquisition for startups.

Section I examines the global opportunities available to startups in the digital economy and how startups' capital demands evolved in the new era of business.[15] Section II analyzes the differences between merit-based securities regulation existing at the state level and disclosure-based regulation, which is the federal regulatory scheme.[16] This Section provides an overview of the three most common methods of restricted securities registration at the state level.[17] Section III examines the development of blue sky laws and the role states originally played in protecting investors.[18] This Section further explores the evolving relationship between state and federal securities regulation, as federal lawmakers sought to make securities regulation more conducive to corporate activity and growth, while state securities regulators seek to remain relevant.[19]

Section IV examines the economic efficiency of a singular regulatory body in comparison to the current dual regulatory system in the United States.[20] Section IV also analyzes Congress's recent trend in encouraging looser capital acquisition, which substantially diminished states' regulatory purview.[21] The Comment concludes by recommending that, due to significant investor protections inherent in the federal regulatory framework and the discriminatory effect that the blue sky law framework imposes on startups, blue sky laws should be subjected to a blanket preemption by federal securities statutes.[22]

I. EVOLVING CAPITAL NEEDS FOR STARTUPS IN THE DIGITAL ECONOMY

An increasingly interconnected global and international economy, fueled by increased internet use across the world, enables startups in the United States to compete not only nationally but also internationally.[23] For example,

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[15] *See infra* Section I.
[16] *See infra* Section II.
[17] *See id.*
[18] *See infra* Section III.
[19] *See id.*
[20] *See infra* Part IV.
[21] *See id.*
[22] *See infra* Conclusion.
[23] Kate Rogers, *How E-Commerce Helps US Small Businesses Go Global*, CNBC (Apr. 28, 2015), https://www.cnbc.com/2015/04/27/how-e-commerce-helps-us-small-businesses-go-global.html. "A report commissioned by eBay finds that

consider the current state of the e-commerce industry. Online retailers benefit from lower operating costs than do "brick and mortar" traditional retailers, enabling nimble operational strategies centered around order and service fulfillment.[24] The relatively low capital expenditure costs related to online retail sparked a dramatic rise in e-commerce revenue, and this trend is expected to accelerate in the future.[25] Predictably, demand for capital among these retailers increased substantially as well.[26]

A startup can be any venture demonstrating a rapid growth stage.[27] In the venture capital industry, a startup is generally defined as an innovative venture in its early stages of growth, with the reasonable prospect of exponential growth of the initial investment.[28] An instructive way to determine whether a company is a startup is to consider its capital requirements and the cycle of its business plan.[29]

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more than 190,000—or 90 percent—of its small and medium-sized businesses used its platform to export in 2014. To compare, in 2009, fewer than 30,000 were exporting." *Id.* Of sellers who export on eBay's platform, 80% of them sell in more than five export markets. *Id. See also* Chamber of Commerce, *infra* note **Error! Bookmark not defined.**. "Tapping into the global digital economy is a huge multiplier for small businesses. More than 95% of the small firms on eBay have become exporters, and they tend to export to 25 or more countries per year." *Id.*

[24] *See* Daphne Howland, *Study: Online operating costs crushing brick-and-mortar retailers*, RETAIL DIVE, (May 4, 2016), https://www.retaildive.com/news/study-online-operating-costs-crushing-brick-and-mortar-retailers/418613/.

[25] *See* J. Clement, *Retail e-commerce sales in the United States from 2017-2024,* STATISTA, https://www.statista.com/statistics/272391/us-retail-e-commerce-sales-forecast/ (last visited Feb. 5, 2019). In 2017, online retail sales in the United States totaled $446,811,000. *Id.* Online retail sales are projected to increase to 735,358,000 by 2023. *Id.*

[26] *See* Mitra, *supra* note **Error! Bookmark not defined.**.

[27] Caron Beesley, *How and Why to Determine If Your Business is Small*, SBA BLOGS (Jan. 10, 2019, 8:19 PM), https://www.sba.gov/blogs/how-and-why-determine-if-your-business-small. Whether the SBA considers a business to be small is based on the number of employees over the last year or average annual receipts for the past three years. *Id.* The two most widely used standards to qualify a business as small are 500 employees for most manufacturing and mining industries and $7.5 million in average annual receipts for many nonmanufacturing industries. Standards vary depending on the industry. *Id.*

[28] *See* Alex Wilhelm, *The Definition of a Startup in 2018 (By The Numbers)*, CRUNCHBASE NEWS (Sept. 13, 2018), https://news.crunchbase.com/news/the-definition-of-a-startup/ (defining a startup as producing less than $100 million in annual recurring revenue or $100 million in trailing revenue, and having less than 500 employees, and having a valuation of less than $2.5 billion).

[29] *See* Campbell Jr., *supra* note **Error! Bookmark not defined.**, at 301. Only 5.8% of Regulation D filings for less than one million dollars required the use

The advent of global internet use provides an array of commercial opportunities in the digital economy and produced a large number of startups seeking to capitalize on this market opportunity.[30] E-commerce startups are especially well-suited for scaling in the digital economy because online-based retailers, such as Amazon and eBay, gave startups the opportunity to reach customers on a level previously unattainable for companies of their size.[31] Indeed, sixty-six percent of startups rely on online retailer platforms to sell their products.[32]

Nationally and globally integrated supply chains and the reliability of those supply chains are also persuading many United States-based startups to pursue global markets.[33] Startups are now able to compete in the global economy in an unprecedented manner.[34] Access to new physical and virtual markets often requires nimble access to capital markets. With a wide range of suppliers present around the globe, retailers can utilize localized networks to fulfill orders without a large corporate footprint.[35] Other startups access social media platforms as a means to advertise, gaining access to a global audience that was unthinkable at the turn of the twenty-first century.[36]

With access to a global marketplace and supply chains to fulfill consumer demand, startups are positioned to rapidly develop like never before.[37] Internet use is a global phenomenon, enabling startups to meet consumer or business demands in developed and developing economies.[38] Rapidly developing startups need an unprecedented amount of capital.[39]

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of a financial mediator, such as a securities attorney, a certified public accountant, or an investment banker. *Id.*

[30] *See* Mike Dempsey, Webinar: *The Changing Landscape of Global E-Commerce*, CB INSIGHTS (Aug. 1, 2019, 3:14 PM), https://www.cbinsights.com/research-global-ecommerce.

[31] *See* Stephanie Pandolph, *Here's how small businesses can benefit from online marketplaces*, BUS. INSIDER (Apr. 5, 2018), https://www.businessinsider.com/heres-how-small-businesses-can-benefit-from-online-marketplaces-2018-4. In a recent poll, about 70% of small business owners said that online platforms like Amazon and eBay had helped then increase sales. *Id.*

[32] *See id.*

[33] *See* Rob Moffat, *When should your startup expand into international markets?*, VENTURE BEAT (May 5, 2018), https://venturebeat.com/2018/05/05/when-should-your-startup-expand-into-international-markets/.

[34] *See* Rogers, *supra* note 23.

[35] *See id.*

[36] *See id.* A good example of this type of business is games companies and consumer apps that use the app stores and Facebook for distribution. *Id.*

[37] *See id.*

[38] *See* Moffat, *supra* note **Error! Bookmark not defined.**.

[39] *See* Howland, *supra* note **Error! Bookmark not defined.**.

II. MERIT-BASED EVALUATION VERSUS MATERIAL DISCLOSURE

Blue sky and federal securities laws differ not only by jurisdiction but also by their method of regulation.[40] Federal securities laws are based on disclosure,[41] meaning securities issuers must disclose all material facts relating to their operations or financial outlook that might reasonably form a basis for investment or divestment.[42] In contrast, most blue sky laws substantively analyze securities' merits.[43] State regulators determine whether a security is particularly risky, speculative, or fraudulent, and determine, based on those factors, whether it should be issued in the state.[44]

Material disclosure is based on the premise that an individual, provided with all material information, is best positioned to determine which securities will best meet his or her financial goals.[45] This approach is epitomized at the federal level, where the issuer's liability is determined by the extent to which they have disclosed material information.[46] A fact is material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[47]

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[40] *See generally* JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 27.03 (3d ed. 2018).

[41] *See* 15 U.S.C. § 10(b) (1934).

[42] *TSC Indus. v. Northway*, 426 U.S. 438, 439 (1976).

[43] *See* Robert S. Karmel, *Blue-Sky Merit Regulation: Benefit to Investors or Burden on Commerce?*, 53 BROOK. L. REV. 105, 105 (1987). "Merit regulation gives a state, through its blue-sky commissioner, the authority to prevent an issuer from selling its securities in that state when the offering or the issuer's capital structure is substantively unfair or presents excessive risk to the investor." *Id.*

[44] *Id.*

[45] *See* Kenneth I. Denos, *Blue and Gray Skies: The National Securities Market Improvement Act of 1996 Makes the Case for Uniformity in State Securities Law*, UTAH L. REV. 101, 110 (1997).

> Disclosure-based regulation implemented by the Securities Act of 1933 was premised on Justice Brandeis's notion that the availability of information would allow the market to evaluate investments, but would not, and should not, try to keep investors from making bad bargains. Brandeis compared disclosure in securities to the pure food laws of the day: the laws would not keep consumers from purchasing undesirable food—the laws would simply help them to judge the quality of the food by disclosing the ingredients.

Id.

[46] *Id.*

[47] *TSC Indus.*, 426 U.S. at 449. Whether a fact would not have caused an investor to change his or her vote does not determine if the fact is material. A fact is material if it would have been significant in the investor determining his or her decision.

Blue sky regulation is conducted by a merit analysis.[48] Regulators examining securities seek to "prevent unscrupulous dealers foisting on inexperienced persons unfair, spurious, and worthless securities."[49] In most states, administrative officials have substantial power to prevent a security from being issued in their state, based on whether they believe the security is too risky to be sold in the state.[50] Officials exercise their right to deny securities registration frequently.[51] While each state has adopted a blue sky regulatory framework, among the states the definition of "merit" regulation differs substantially, as various states prioritize different elements of a security in determining its risk profile.[52]

There are three principal ways by which states register securities in their jurisdictions and allow for their sale in the state: registration by notification, registration by coordination, and registration by qualification.[53] Registration by notification, by far the most common form of registration, enables a security to be sold on the basis of a notification to the state that the issue is within a certain securities class.[54] Under the Uniform Securities Act (Uniform Act), registration by notification is available if the company "(1) has been in continuous existence for five years (including its predecessors), (2) has not defaulted in the past year (or in the past three years) on fixed interest, dividend, or maturity obligations of securities, and (3) has had specified average net earnings in the past three years."[55] However, all publicly traded

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[48] *See* COX & HAZEN, *supra* note 40.

[49] *Id.*

[50] *See id.*

[51] *See id.; see also* Denos, *supra* note 45. A famous example of a state regulator exercising discretion to prevent a security from being sold in their state is the Apple IPO in 1980, where the Massachusetts Secretary of State prevented the securities being sold in the IPO to be sold in Massachusetts due to their perceived speculative nature. *Id.* While state regulation for a public offering on a national securities exchange would now be prohibited due to the National Securities Market Improvement Act of 1996, the act did not exist the time. *See* Kevin A. Jones, *The National Securities Markets Improvement Act of 1996: A New Model for Efficient Capital Formation*, 53 Ark. L. Rev. 153, 162 (2000). In contrast to the merit analysis that the Massachusetts official conducted, a filing in a disclosure-oriented jurisdiction would have enabled the securities to be sold in the state. *See* Denos, *supra* note 45.

[52] Mark A. Sargent, *Report on State Merit Regulation of Securities Offerings*, 41 THE BUS. LAW. 785, 788 (1988). Some states more actively regulate securities than others. *Id.* Some states do not allow for merit examination, and their reviews are based on disclosure, a system mirroring the SEC's. *Id.* Of the states that do enable merit regulation, various methods exist. *Id.*

[53] Cox & Hazen, *supra* note 40, at § 27.5.

[54] *See id.*

[55] *See id.*

securities are exempt from registration by notification, significantly limiting the impact of this registration method.[56]

Registration by coordination involves automatic enrollment when the securities are issued under the Uniform Act, enabling coordination between state and federal registrations.[57] Registration by coordination is permitted most commonly in conjunction with a Regulation A offering.[58] While a preemptive-type registration by coordination method is a highly efficient capital acquisition strategy, some states impose additional requirements that can destroy the viability of registration by coordination.[59]

Registration by qualification is the most demanding state securities filing, "requir[ing] filing of detailed disclosure documents in each state in which the securities without an applicable exemption are to be offered."[60] Under the Uniform Act, there are sixteen separate forms of disclosure required.[61] Subsequent to these filings, the issuer cannot issue securities until after the state securities administrator gives permission.[62]

While there have been attempts to codify state securities laws under a common code, similar to Article 2 of the Uniform Commercial Code, such efforts have had limited success.[63] In order to reduce the substantial discrepancies between respective states' blue sky laws, states adopted uniform securities regulation standards in 1930, 1956, 1980, and 2002.[64] The 2002 Uniform Act made several significant changes, such as including banks within the definition of broker-dealers, giving qualified immunity for termination form disclosures, and harmonizing Uniform Act antifraud provisions with

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[56] *See id.*

[57] *Id.*

[58] *See* Ruthford B. Campbell, Jr., *Regulation A: Small Businesses' Search for "A Moderate Capital,"* 31 DEL. J. CORP. L. 77, 108 (2006); *see also* 17 C.F.R. §§ 230.251-230.363 (2015). Registration A offers are exempted from registration and has two offering tiers. The first tier allows raising up to $20 million over a twelve-month period. The second tier allows raising up to $50 million over a twelve-month period.

[59] For example, some states "require that the issuer either file a qualification registration or meet the requirements of some small or limited offering exemption that does not permit general advertising. Either of these options effectively destroy Regulation A as a vehicle for small businesses to use in raising capital." *Id.*

[60] *Id.*

[61] *See id.*

[62] *See id.*

[63] *See generally* Edmund W. Kitch, *Proposals for Reform of Securities Regulation: An Overview*, 41 VA. J. INT'L L. 629 (2001).

[64] *See Securities Regulation and the Uniform Securities Act of 2002*, FAEGRE DRINKER BIDDLE & REATH LLP, https://www.faegrebd.com/en/insights/publications/2007/7/securities-regulation-and-the-uniform-securities-act-of-2002 (last visited Oct. 29, 2018).

federal ones.[65] The 2002 Uniform Act's greatest detriment has been that in its nearly seventeen years of existence, and despite its significant changes to the 1980 Uniform Act, only thirteen states adopted it, substantially undermining its drafters' intent to form a cohesive blue sky regulatory framework.[66]

Many commentators argue that state activism undermined the federal government's role in regulating securities.[67] According to these critics, the dual-regulatory system threatens economic vitality by providing an uncertain corporate operating environment.[68] In addition, some commentators argue that the current blue sky scheme is arcane and unwieldy, imposing an undue burden on corporations.[69] They argue that corporations expend substantial resources that could be distributed more efficiently and that would be more likely to stimulate economic growth.[70]

The dual-regulatory and differing registration procedures impose distinct capital acquisition requirements on startups conducting fundraising.[71] Federal regulations, based on disclosure, and blue sky laws, based on a substantive evaluation, present separate burdens for the fundraising entity.[72] While states have sought to lessen the fundraising burden by introducing various renditions of the Uniform Act, such efforts struggled to gain uniform adoption.[73]

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65 *See id.*

66 *See id.*

67 *See* Steve A. Radom, *Balkanization of Securities Regulation: The Case for Federal Preemption*, 39 TEX. J. BUS. L. 295, 304 (2003). First, SEC officials argue that recent state actions have undermined the effectiveness of the SEC and intruded into an area traditionally reserved for that federal body. Second, critics have pointed out that monies collected have largely gone to the states themselves, and not to bereaved investors. Third, commentators note that a hard-hitting enforcement regime effectively undermines the integrity of the securities markets.

68 *See id.* at 304305. "[T]he threat of balkanization arises when securities regulators at various levels act in a fragmented manner, undermining uniformity and budding hostility among them . . . recent aggressive actions by state regulators have largely undermined the federal government's role as primary regulator of the markets." *Id.*

69 *See* generally Rutherford B. Campbell Jr., *Blue-sky laws and the Recent Congressional Preemption Failure*, 22 J. CORP. L. 175 (1997); Rutherford B. Campbell Jr., *An Open Attack on the Nonsense of Blue Sky Regulation*, 10 J. CORP. L. 553 (1985).

70 *See id.*

71 *See* Karmel, *supra* note **Error! Bookmark not defined.**, at 105.

72 *See* Radom, *supra* note 67, at 304.

73 *See generally* Kitch, *supra* note **Error! Bookmark not defined.**.

III. THE DEVELOPMENT OF SECURITIES LAWS IN THE UNITED STATES

States initially passed blue sky laws to address the increasing need to protect investors from fraudulent transactions, a development inherent in states' traditional police power.[74] Reflecting this initial concern, state lawmakers worried, as public investing became more prevalent, "if securities legislation was not passed, financial pirates would sell citizens everything in [the] state but the blue sky."[75] Because early blue sky laws impacted investments that used instrumentalities of interstate commerce, their constitutionality was challenged initially.[76] However, the United States Supreme Court upheld blue sky regulation as constitutional, holding the statutes fell within the state police power.[77] The Great Depression precipitated passage of the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act), as Congress recognized the need to restore public confidence in capital markets and to address investor protection concerns that state regulators could not.[78]

A. Pre-Depression Securities Laws

Prior to the Great Depression, securities were not subject to federal regulation.[79] Instead, states protected investors by a patchwork composition of blue sky laws, with Kansas enacting the first state securities laws in 1911.[80] Initial blue sky laws were a reaction not only to "fraudulent" securities offerings but also to "highly speculative" offerings.[81] Similar to the Securities Act and the Exchange Act that later passed, blue sky laws regulated both securities issuances, known as "licensing laws," and fraudulent activities related to securities after they had been issued.[82] Due to political, economic,

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[74] *See* Elisabeth Keller & Gregory A. Gehlmann, *Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 331 (1988).

[75] *Id.* Between 1900 and 1928, the number of securities-holders increased from 4.4 million to 18 million, resulting in a dramatic increase in securities-related claims and imposing political pressure on lawmakers to protect constituents. *Id.*

[76] *See generally* Hall v. Geiger-Jones, 242 U.S. 539 (1917).

[77] *See id.*

[78] *See infra* note 82.

[79] *See* Jonathan. R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 361 (1991).

[80] *See id.*

[81] *Id.* at 350.

[82] Keller & Gehlmann, *supra* note 74. Regulators were empowered to act under anti-fraud provisions only when the fraudulent activity was imminent, and when justified, regulators could initiate investigations and enjoin fraudulent activities. *Id.* Licensing activity resembled the modern state securities regulation process, whereby regulators evaluated disclosure documents and determined the extent to which the securities were speculative and whether they should be allowed to be distributed to the investing public. *Id.*

and administrative limitations, early blue sky laws had limited success in combatting fraudulent offerings.[83] Though there was sentiment among certain lawmakers that the federal government should close some of the obvious holes present in the blue sky regulatory framework, the economic expansion of the early 1920s created a political environment that was not conducive to such regulation.[84] Prevailing adherence to laissez faire economic policies throughout this period ensured that securities regulation was left to the states.[85]

B. *Blue Sky Constitutionality*

When they were initially challenged, the United States Supreme Court upheld the constitutionality of blue sky laws.[86] The Court recognized the utility of enabling states to protect their residents.[87] In *Hall v. Geiger-Jones*, the Court upheld state commissioners' right to regulate securities, reasoning that securities regulation is a sophisticated topic, affecting a wide number of stakeholders in a state.[88] In *Caldwell v. Sioux Falls Stock Yards Co.*, the defendant argued that a statute criminalizing the fraudulent sale of a security violated the Commerce Clause and was therefore unconstitutional.[89] The Court upheld the constitutionality of the statute under the police power, deferring to its holding in *Hall*.[90] In *Merrick v. N.W. Hasley*, the defendant argued that a state statute forbidding sales of securities without a license and approval of a state securities commission violated the Commerce Clause.[91] As in *Caldwell*,

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[83] *See id.* at 331-32. Ineffectiveness of early blue-sky laws stemmed from, among other factors: untrained attorneys were often assigned to securities regulatory positions; changes in political administrations often meant changes among professional regulators; individual states feared that if they imposed their securities laws, businesses might flee to friendlier jurisdictions; and sellers often avoided states with stringent securities regulations. *Id.*

[84] *See id.* at 336. One bill "would have eliminated the largest loophole in state blue sky laws. The bill would have made it illegal for any person to use the mails or any facilities of interstate commerce to sell securities in any state, unless there had been compliance with the state's blue sky laws." *Id.* The bill passed the House of Representatives but never received a vote in the Senate. *Id.*

[85] *See id.* at 336-37. Although President Hoover was briefed developments in the securities markets at the onset of the Great Depression, he maintained a deference to state regulation of securities markets, limiting the federal government's response to the financial crisis. *Id.*

[86] *See* Edgar v. MITE Corp., 45 U.S. 624, 631 (1982).

[87] *See* Francis J. Facciolo & Richard L. Stone, *Avoiding the Inevitable: The Continuing Viability of State Law Claims in the Face of Primary Jurisdiction and Preemption Challenges under the Securities Exchange Act of 1934*, COLUM. BUS. L. REV. 525, 529 (1997) (arguing that the Court has been very reluctant to rule state actions unconstitutional under the Exchange Act).

[88] *See* Hall v. Geiger-Jones, 242 U.S. 539, 553 (1917).

[89] *See* Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559, 564 (1917).

[90] *See id.* at 568.

[91] *See* Merrick v. N.W. Hasley & Co., 242 U.S. 568, 570 (1917).

the Court deferred to its holding in *Hall* and held that the right to establish a state securities commission is within the police power and does not violate the United States Constitution.[92]

C. *The Great Depression*

The 1920s were marked by rampant and reckless securities purchases, exacerbated by highly leveraged financing and an opaque market system.[93] As a result, "of the $50 billion in new securities offered during this period, half became worthless."[94] The effects of the economic crisis brought public faith in the United States capital markets to an all-time low, resulting in investors fleeing the stock market and culminating in the New York Stock Exchange decreasing 83% in the three years following 1929.[95] In order to restore public confidence in capital markets and to stimulate economic activity, Congress passed the Securities Act and the Exchange Act, which currently comprise the bulk of the federal securities regulation apparatus.[96] Reflecting the prevailing belief that the federal government's role was to arm investors with sufficient information to protect themselves, officials opted for a federal regulatory system premised on disclosure.[97]

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[92] *See id.* at 590; *see also* William I. Friedman, *The Fourteenth Amendment's Public/Private Distinction Among Securities Regulators in the U.S. Marketplace—Revisited*, 23 ANN. REV. BANKING & FIN. L. 727 (2004).

[93] *See What We Do*, U.S. SEC. & EXCH. COMM'N (June 10, 2013), https://www.sec.gov/Article/whatwedo.html.

[94] *Id.* "When the stock market crashed in October 1929, public confidence in the markets plummeted . . . . There was a consensus that for the economy to recover, the public's faith in the capital markets needed to be restored." *Id.*

[95] Robert G. Eccles & Jean Rogers, *The SEC and Capital Markets in the 21st Century: Evolving Accounting Infrastructure for Today's World*, BROOKINGS (Sept. 23, 2014), https://www.brookings.edu/research/the-sec-and-capital-markets-in-the-21st-century-evolving-accounting-infrastructure-for-todays-world/.

[96] *Id.*

[97] *See* James M. Landis, *Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30 (1959). In a speech prior to passage of the 1933 Securities Act, President Roosevelt stated:

> Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit. There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

Id.

1. Securities Act of 1933

The Securities Act governs the initial issuance of securities.[98] Importantly, the Securities Act expressly does not preempt blue-sky laws.[99] Under the statute, an individual or entity is liable if a "material fact" is stated or omitted in the registration statement.[100] A party has an affirmative defense to liability if he or she proves they conducted a "reasonable investigation" and there was no omission of material fact.[101] Recognizing that not all securities need to be subject to regulation, Congress included in the Securities Act § 4(a)(2), which states that "transactions by an issuer not involving any public offering" are excluded from registration requirements.[102] Securities offerings

[98] *See* 15 U.S.C. § 77a (1933).

[99] *See* 15 U.S.C. § 77r (1982). "Nothing in this subchapter shall affect the jurisdiction of the securities commission . . . of any State . . . over any person or security . . . ." 15 U.S.C. § 77zzz (1933).

[100] *See* 15 U.S.C. § 77k (1933). Individuals who can be liable include:

> (1) every person who signed the registration statement; (2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted; (3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner; (4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him; (5) every underwriter with respect to such security.

Id.

[101] *Id.* An individual is not liable if:

> after reasonable investigation, [he or she had] reasonable ground[s] to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

Id. The standard for reasonableness is "that required of a prudent man in the management of his own property." *Id.*

[102] 15 U.S.C. § 4(a)(2) (1934); *see also* Adam Hull & Rick Jordan, *Securities Laws*, Tex. CLE Advanced Bus. L. 1 VII (2017). While there is no formal definition for a "public offering," there are several factors for determining under the statute whether an offering is public: investor suitability—whether the investor is sophisticated and has substantial financial knowledge; whether there is a limited number of investors—there is no formal requirement under the statute, but the offering cannot be made to an unlimited number of investors; there can be no general solicitation and advertising; relevant financial information relating to the company which emulates that of a public offering; the securities cannot be transferred freely;

under § 4(a)(2) became known as "private offerings."[103] Private offerings are a vital source of funding for startups.[104] Section 4(a)(2) was intended to avoid registration for offerings when registration did not advance the underlying policy goals of the Securities Act, and it provided the basis for early restricted offerings.[105] However, because the statute did not issue significant guidance, issuers were often on uncertain legal ground.[106]

2. *Securities Exchange Act of 1934*

The Exchange Act governs transfers of securities and entities' disclosures regarding those securities subsequent to issuance.[107] The statute is enforced primarily through § 10(b), which states, "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails . . . [t]o use or employ . . . any manipulative or deceptive device or contrivance."[108] Congress also established the Securities and Exchange Commission (SEC) as part of the Exchange Act, in order to enforce its provisions.[109] Since its passage, Congress has amended the Exchange Act, and the SEC used its rulemaking authority under the act to adapt securities regulations to changing economic demands.[110]

3. *The SEC*

The SEC is often lauded as the most successful New Deal agency.[111] Part of the SEC's strength results from the efficiency afforded from its national

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and investors must buy the securities with the intent to invest, not to sell them to a third party. *Id.*

[103] 15 U.S.C § 4(a)(2) (1934).

[104] U.S. Sec. & Exch. Comm'n, *Investor Bulletin: Private Placements Under Regulation D*, INVESTOR ALERTS AND BULLETINS (Sept. 24, 2014), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html. A private offering, alternately referred to as "restricted offerings" or private placements, is an offering that is exempt from registration requirements under the Securities Act. Securities procured in a private offering are "restricted" in that they cannot be sold in public markets. *Id.*

[105] *See id.*

[106] *See id.*

[107] *See* Securities Exchange Act of 1934, 15 U.S.C. § 78a (1934).

[108] 15 U.S.C. § 78j (1934)*; see also* Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (1948). Rule 10b-5 is the tool used most often by SEC regulators to punish fraudsters and is derived from § 10(b) of the Exchange Act. *Id.*

[109] *See* 15 U.S.C. § 78(a) (1934).

[110] *See generally infra* Section IV.

[111] *See generally* Phil Nicholas, *The Agency That Kept Going: The Late New Deal SEC and Shareholder Democracy*, 16 J. OF POL'Y HIST. 212 (2004) (discussing the widely held belief that the SEC was the most beneficial agency to be created from the New Deal, in part because of its commitment to non-partisan

jurisdiction, as well as its transparency and its highly skilled professionals.[112] Indicative of its national presence, the SEC has eleven regional offices throughout the country, with five functional divisions.[113] In addition, the agency oversees organizations such as the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), and the Public Company Accounting Oversight Board (PCAOB).[114] The SEC has procured settlements from fraudulent actors very successfully—completing 821 actions in 2018 alone and distributing $794,000,000 to harmed investors.[115]

In passing the Securities Act and the Exchange Act, Congress recognized that states lacked the credibility, given their exposure to political pressures, and the jurisdiction necessary to effectively regulate United States capital markets.[116] By establishing the SEC with a broad base of powers and national jurisdiction, Congress set the SEC's encroachment on state regulatory power into motion, furthering what began prior to the Great Depression.[117] Congress's foresight in structuring the SEC made it one of the most effective federal agencies, capable of nimble regulatory efforts in the global economy.[118]

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behavior and its statutorily mandated procedure to have at least two of five board members to be of different parties than the majority members).

[112] *See generally 2019 Examination Priorities*, U.S. SEC.. & EXCH. COMM'N, https://www.sec.gov/files/OCIE%202019%20Priorities.pdf (last visited Feb. 19, 2020) (detailing the SEC's strategic plan and examination priorities for 2019).

[113] *See Summary of Performance and Financial Information*, U.S. SEC.. & EXCH. COMM'N, https://www.sec.gov/files/2017-03/sec-summary-of-performance-and-financial-info-fy2016.pdf (last visited Feb. 19, 2020).

[114] *See id.*

[115] *Division of Enforcement: Annual Report (2018)*, U.S. SEC.. & EXCH. COMM'N, https://www.sec.gov/files/enforcement-annual-report-2018.pdf (last visited Feb. 19, 2020). *See also 2019 Examination Priorities*, U.S. SEC.. & EXCH. COMM'N, https://www.sec.gov/files/OCIE%202019%20Priorities.pdf (last visited Feb. 19, 2020) (detailing the SEC's strategic plan and examination priorities for 2019). In 2019, enforcement highlights included the following: initiating 868 enforcement actions; obtaining judgments for penalties in excess of $4 billion; charging seventy-eight parties with insider trading; pursuing actions against fourteen municipal underwriting firms and seventy-one municipal issuers; bringing 160 cases against investment advisers and companies; and awarding over $57 million to thirteen whistleblowers.

[116] *See* Eccles & Rogers, *supra* note **Error! Bookmark not defined.**.

[117] *See* 15 U.S.C. § 78(a) (1934).

[118] *See generally* Nicholas, *supra* note 111.

IV. FEDERAL ENCROACHMENT ON TRADITIONAL BLUE SKY REGULATORY PURVIEW

In the 1990s, Congress began systematically curtailing states' regulatory powers, a trend that continues today,[119] by limiting the type of issuers subject to state regulation and judicial procedures.[120] Throughout this period, Congress's explicit policy goal has been to reduce capital acquisition friction for corporations by streamlining the fundraising process, prohibit certain securities litigation suits from being brought into state courts, and lower disclosure requirements for developing corporations.[121] In the Securities Act, Congress explicitly noted that several securities classes should be exempt from registration.[122] The SEC used its rulemaking power to further clarify which securities are exempt from registration.[123] In response to the 2008 economic collapse, Congress used lower regulatory requirements for capital acquisition and disclosure as a means to stimulate economic activity.[124]

A. Private Securities Litigation Reform Act of 1995

Congress passed the Private Securities Litigation Reform Act (PSLRA) in 1995.[125] The act sought to prevent securities plaintiffs from filing frivolous claims against public corporations, which often discouraged

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[119] *See generally* Campbell Jr., *supra* note **Error! Bookmark not defined.**.

[120] *See id.*

[121] *See* Jeremy Derman, *Does the SEC Rule the Job Creation Roost? Squaring SEC Rulemaking with the JOBS Act's Relaxation of the Prohibition Against General Solicitation and Advertising*, 47 SUFFOLK U.L. REV. 139, 139 (2014).

[122] *See* 15 U.S.C. § 4(a)(2) (1934).

[123] *See generally* 17 C.F.R. §§ 230.501–230.506 (2017).

[124] *See id.*

[125] *See* Michael P. Catina & Cindy M. Schmitt, *Private Securities Litigation: The Need for Reform*, 13 ST. JOHN'S J. LEGAL COMMENT. 295, 305 (1998).

disclosure.[126] PSLRA instituted a uniform pleading requirement in all states.[127] In addition, company representatives were no longer liable for statements when they had no knowledge the statements were false or when statements "were accompanied by meaningful cautionary statements."[128] Due to its "super-heightened pleading standard," PSLRA, in conjunction with related, subsequent legislation, has substantially reduced the number of class-action securities suits.[129] The passage of PSLRA initially appeared to achieve policymakers' goal of reducing frivolous lawsuits.[130] However, subsequent

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[126] *See id.* at 301–303 ("Many investors filed meritless fraud claims and 'strike suits' against companies . . . Strike suits . . . [are] based on the allegation that the defendant company used misleading statements to induce customers to purchase securities . . . Strike suits are feared because of the stigma attached to defendants charged with violations of the 1934 Act. A company that relies on investor confidence cannot afford the consequences associated with public accusations that it engaged in deceptive practices. Frivolous claims are even a greater nuisance for corporations due to the prior knowledge by plaintiffs that the companies usually settle because of the high cost of pre-trial discovery . . . These suits were often filed by parties lacking any actual evidence of fraud. The plaintiffs often used pre-trial discovery proceedings to go on 'fishing expeditions' to substantiate their claims. Due to the high cost of discovery incurred by companies out of court, settlements were usually favored.").

[127] *Compare id.* at 306. Under §10(b) of the 1934 Act, plaintiffs had to plead specific facts that supported a "strong inference of scienter." *Id.* Under Rule 9(b) of the Federal Rules of Civil Procedure, however, plaintiffs had to 'plead fraud with particularity,' while 'malice, intent, knowledge, and other conditions of the mind [could be] averred [to] generally.[']" . . . "[t]he standard adopted by the PSLRA mirrored the section 10(b) approach." *with* Brian S. Sommer, *The PSLRA Decade of Decadence: Improving Balance in the Private Securities Litigation Arena with a Screening Panel Approach*, 44 Washburn L.J. 413, 423 (2005). In PLSRA, Congress imposed a more stringent pleading standard:

> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

Id.

[128] *Id.* at 307.

[129] Arthur R. Miller, *From Conley to Twombly to Iqbal: A Double Play on The Federal Rules of Civil Procedure*, 60 Duke L. J. 1, 11 (2010). Claims are often dismissed "on complex questions such as scienter, loss causation, reliance, and materiality—questions that formerly would have been considered trial worthy." *Id.*

[130] *See* Stephen J. Choi & Robert B. Thompson, *Securities Litigation And Its Lawyers: Changes During The First Decade After The PSLRA*, 106 Columbia L. Rev. 1489, 1496 (2006)

changes to securities laws that preempted state court jurisdiction returned the number of securities suits filed in federal courts to a pre-PSLRA level.[131]

B. National Securities Market Improvement Act of 1996

In 1996, Congress indicated a shift in its intent to take public offerings out of state regulatory jurisdiction when it passed the National Securities Market Improvement Act (NSMIA) in 1996, an amendment to the Investment Company Act of 1940 and the Investment Advisers Act of 1940.[132] NSMIA streamlines securities regulation by placing "covered securities" exclusively in the federal domain.[133] Although the NSMIA reduced the scope of state regulators' authority, it preserved the states' traditional police power role.[134] However, Congress was careful to explicitly limit state regulatory authority in

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[131] *See id*. at 1497-1500. Several other changes resulted from the passage of PSLRA: less lower-value claims are being filed; while most cases continue to settle out of court, the time between filing and settling has lengthened; because less lower-value claims are being brought, the mean settlement amount has risen; investors are regaining a smaller percentage of losses; and the number of cases brought in the Ninth Circuit and against Silicon Valley technology companies have dropped. *Id.*

[132] *See* 15 U.S.C. § 78(a) (1996). *See also* Securities and Exchange Commission, *The Laws That Govern the Securities Industry*, Fast Answers (Aug. 24, 2019, 9:23 PM), https://www.sec.gov/answers/about-lawsshtml.html. The Investment Company Act of 1940 "regulates the organization of companies, including mutual funds, that engage primarily in investing, reinvesting, and trading in securities, and whose own securities are offered to the investing public." *Id.* The Investment Advisers Act of 1940 "regulates investment advisers. With certain exceptions, this Act requires that firms or sole practitioners compensated for advising others about securities investments must register with the SEC and conform to regulations designed to protect investors." *Id.*

[133] *Id.* A security is "covered" if it is listed on a national stock exchange, registered by an investment company under the Investment Company Act of 1940, or is sold to a qualified purchaser. *See also* Jones, Kevin A., *The National Securities Markets Improvement Act of 1996: A New Model for Efficient Capital Formation*, 53 Ark. L.R. 152, 162 (2000). Covered securities include most exempted securities under §3(a) of the Securities Act, which includes,

> [C]ertain government and bank securities, securities issued by certain pension, profit-sharing and similar plans, notes having a maturity of less than nine months, interests in railroad equipment trusts, certain certificates issued in a case under Title 11, and certain insurance, endowment, or annuity contracts." Covered securities are exempt primarily because "of the character of the issuer, such as government securities, or because of the existence of some other regulatory structure that adequately protects investors."

Id.

[134] *See id.* ". . . the securities commission (or any agency or officer performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions." *Id.*

order to eliminate any implied means of regulation.[135] The passage of NSMIA resulted in blue sky laws being inapplicable to nearly all publicly traded securities beyond notice or coordinated filings.[136]

C. Securities Litigation Uniform Standards Act of 1998

The passage of PSLRA remedied many of the maladies its drafters hoped to address, but it spawned a particularly significant and unintended consequence, as many plaintiffs chose to avoid the uniform pleading requirement by filing their claims in state court.[137] To prevent this perceived loophole, Congress passed the Securities Litigation Uniform Standards Act (SLUSA) in 1998. [138] SLUSA bars certain state law-based class action suits.[139] In addition, SLUSA mandates that a federal court must determine whether the statute precludes the action from being brought in state court.[140] Demonstrating

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[135] *See* Jones, Kevin A., *The National Securities Markets Improvement Act of 1996: A New Model for Efficient Capital Formation*, 53 Ark. L.R. 152, 162 (2000). Legislative history reflects Congress's intent to "eliminate States' authority to require or otherwise impose conditions on the disclosure of any information for covered securities." *Id.*

[136] *See* Cox & Hazen, *supra* note 40.

[137] *See id.*

[138] *See* Selby P. Brown, *Don't Throw the Baby out with the Bath Water: The Merits of the Intermediate Approach to the Securities Litigation Uniform Standards Act*, 66 Okla. L. Rev. 363, 375 (2014).

[139] *See id.* (internal citations omitted) "[P]laintiffs are barred from bringing 'class-actions that (1) consist of more than fifty prospective members; (2) assert state-law claims; (3) involve a nationally listed security; and (4) allege 'an untrue statement or omission of a material fact in connection with the purchase or sale of' that security.'" *But see* Michael B. de Leeuw *Why Are There Still So Many State Law Security Cases*, Aspatore 1, 3 (2016):

> The Delaware Carve-Out exempts an otherwise covered class action if the claim arises from the statutory law or common law *of the state in which the issuer is incorporated* and if the claim involves (i) "the purchase or sale of securities by the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer" or (ii) "any recommendation, position, or other communication with respect to the sale of securities of the issuer that (I) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of the issuer; and (II) concerns decisions of those equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights." The cases brought under Delaware Carve-Out are, broadly speaking, M&A cases—cases that challenge aspects of mergers and other deals, usually styled as breaches of fiduciary duty claims on the basis, for example, that the price paid was too low or that inadequate disclosures were given to shareholders.

Id.

[140] *See id.* at 376-77. This is because a narrow reading of the statute would undermine the utility of the statute and would not remedy the harm it was intended to combat. *Id.*

Congress's intent that the covered securities from NSMIA be preempted under federal law, SLUSA re-affirms that covered securities are not subject to state law.[141]

D. *Regulation D*

Seeking to clarify registration exemptions pursuant to § 4(a)(2) of the Securities Act, the SEC used its rulemaking power to exempt certain transactions from the purview of the blue sky laws, in what is known as "Regulation D."[142] The regulation is broken into five pertinent rules.[143] While Regulation D was initially hailed as a useful capital acquisition tool, some blue sky laws have prevented startups from having easier access to capital, as was originally intended.[144] The regulation's underwhelming impact can be attributed to applicable blue sky laws' mitigating effect.[145] Indeed, Regulation

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[141] *See* Rutherford B. Campbell Jr. *The Role of Blue-sky laws and NSMIA and the JOBS Act*, 36 No. 6 Banking & Fin. Services Pol'y Rep. 15 (2007). "The adoption of SLUSA makes largely irrelevant the impact if any of NSMIA on private actions under state blue-sky laws as the covered securities of NSMIA in large part are the covered securities of SLUSA." *Id.*

[142] 15 U.S.C. § 77(d) (1934).

[143] *See* 17 C.F.R. § 230.501 (2017). Rule 501 defines an "accredited investor" as a bank, financial institution, investment institution, or 501(c) entity with over $5,000,000 in assets or a singular individual with net assets excluding his or her home exceeding $1,000,000 or an individual whose income for the last two years has exceeded $200,000 and whose income is reasonably expected to exceed that amount in the future. *Id. See* 17 C.F.R. § 230.502 (2017). Rule 502 determines whether the party raising funds is abusing the exemption by examining whether different rounds of capital acquisition should be integrated and exceed the allotment. *Id. See* 17 C.F.R § 230.503 (2017). Rule 503 requires that the issuer notify the SEC within 15 days after issuance of the securities that the party has issued exempted securities. *Id. See* 17 C.F.R. § 230.504 (2017). Rule 504 enables a company to issue up to $5,000,000 but it does not pre-empt state law. *Id. See* 17 C.F.R. § 230.506 (2017). Rule 506 enables a company to sell an unlimited number of restricted securities to accredited investors and to sell the securities to up to thirty-five unaccredited investors. *Id.*

[144] *See* Campbell Jr., *supra* note 14, at 291.

> In short, state blue sky laws have wrecked the sensible, balanced and efficient regime that the Commission enacted in Regulation D. What is interesting and, indeed, unfortunate for small issuers and the economy generally is that the Commission, which acted so appropriately in the construction of Regulation D, has without even a whimper of protest permitted the beneficial effects of Regulation D to be largely neutralized in this manner, making it more difficult for issuers, especially small issuers, to find the capital they need to do business.

Id.

[145] *See* 17 C.F.R. § 230.500. "Nothing in Regulation D obviates the need to comply with any applicable state law relating to the offer and sale of securities." *Id.*

D states that "special attention" should be given to relevant state laws and regulations.[146]

Section 4(a)(2) of the Securities Act exempts certain securities issuances from regulation.[147] As part of Regulation D, Rule 506 expands capital acquisition capabilities for restricted offerings by enabling companies to sell securities to an unlimited number of investors and up to thirty-five unaccredited investors, as well as allowing for unlimited solicitation to all investors.[148] To qualify for the exemption, an issuer must satisfy the requirements of Rule 501 and 502.[149] The introduction of Rule 506, and particularly § 506(c), which allows for unlimited investor solicitation, was met with great fanfare by the investing community, who expected it to provide a capital boon to startups.[150] However, an overwhelming majority of issuers continue to rely on Rule 506(b) as their primary means of private placements.[151] According to a 2015 study, less than 11% of issuers utilized Rule 506(c) for their private offering.[152] Despite the expectations to the

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[146] *Id.*

[147] *See* 15 U.S.C. § 4(a)(2) (1934).

[148] *See* 17 C.F.R. § 230.506 (2017).

[149] *See* 17 C.F.R. § 230.506(b) (2017); Rule 502 requires that "[a]ll sales that are part of the same Regulation D offering must meet all terms and conditions of Regulation D. *See* 17 C.F.R. § 230.502 (2017). *See also* 17 CFR § 230.501 (2017). Under Rule 501, an accredited investor is:

> Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity . . . Any private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940 . . . Any organization described in section 501(c)(3) of the Internal Revenue Code . . . with total assets in excess of $5,000,000 . . . Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer . . . any natural person whose individual net worth, or joint net worth with that person's spouse, exceeds $1,000,000; Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year . . . Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in § 230.506(b)(2)(ii); and [a]ny entity in which all of the equity owners are accredited investors.

Id.

[150] *See* Manning Gilbert Warren III, *The False Promise of Publicly Offered Private Placements*, 68 SMU L. Rev. 899, 900 (2015).

[151] *See id.*

[152] *Id.* at 902, 905. Filings using Rule 506(b) constituted 73.84% of private placements during the same period. *Id.* Rule 506(b) offerings raised over $858

contrary, issuers continue to use Rule 506(b) for a variety of reasons, including a lack of familiarity with Rule 506(c) and general solicitation not being required to meet their capital needs.[153]

E. Jumpstart Our Business Startups Act of 2012

In 2011, in an attempt to stimulate the United States economy following the economic collapse of 2008, Congress enacted the Jumpstart Our Business Startups Act of 2012 (JOBS Act), which amended § 2(a) of the Securities Act.[154] The Act is designed to stimulate the growth of "Emerging Growth Companies"[155] by lowering their reporting requirements.[156] In an effort to promote investment in Emerging Growth Companies, Congress directed the SEC to modify Regulation D to allow general solicitation and advertisement to individuals and institutions who are not sophisticated investors.[157] Congress also sought to accelerate the growth of Emerging Growth Companies by significantly streamlining and limiting reporting requirements during the registration and early growth stage of the company.[158] Recognizing that Emerging Growth Companies are in a crucial growth stage, Congress limited for five years the companies' reporting requirements until

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billion during the time in question while Rule 506(c) offerings sold over $22 billion. *Id.*

[153] *See id.* Reasons also include industry inertia and comfort with pre-existing private placement rules, issuers often do not want offer securities to individuals outside of their existing professional network, and there is regulatory uncertainty regarding Rule 506(c) requirements. *Id.*

[154] *See* 15 U.S.C. § 77(b) (2012).

[155] 17 C.F.R. § 240.12b-2 (2018). An Emerging Growth Company is an issuer that had total annual gross revenue of less than $1,070,000,000 in its most recent fiscal year. *Id.* An issuer can be considered an Emerging Growth company until the earliest of: (1) the end of the fiscal year when its total annual gross revenue exceeds $1,070,000,000; or (2) the end of its fifth fiscal year from when it issued securities; or (3) the end of a three year period over which the issuer issued more than $1,000,000,000 in non-convertible debt; or (4) the date on which the issuer is considered to be a large accelerated filer. *Id.*

[156] Glenn R. Pollner, *The JOBS Act: What It Means for Market Practices and Capital-Raising Strategies*, Aspatore, (Apr. 5, 2012), https://www.gibsondunn.com/wp-content/uploads/documents/publications/Pollner-TheJOBSAct.pdf. "The goal of the JOBS Act is to promote capital formation in the United States by making it easier for emerging growth companies . . . to go public, and by otherwise facilitating the ability of both public and private companies . . . to raise capital." *Id.*

[157] *See* Elga A. Goodman, Kristina K. Pappa, & Brent A. Olson, Business Law Deskbook § 30:3 (2018-2019).

[158] *See id.* Registration requirements are substantially reduced. *Id.* The registrant must provide two years of audited financial statements instead of three, the registrant is not required to submit any data prior to the earliest period in which it was audited, and the registrant may provide confidential information to the SEC up to 21 days prior to its roadshow and may withdraw the bid to go public prior to the 21 days expiring. *Id.*

they reached a mature financial level and can sustain compliance costs more easily, and Congress preempted blue sky regulations for Emerging Growth Companies while they were labeled as such.[159]

By passing a plethora of acts, beginning with PSLRA in 1995, Congress has substantially limited blue sky regulatory power, to the point of rendering it toothless regarding most securities issuances.[160] While blue sky regulation remains potent, it does so by mounting administrative hurdles to capital acquisition, even as its substantive regulatory power is increasingly limited.[161] Congress has increasingly sought to use regulatory relief as a means of economic stimulation, and this trend will likely continue to limit the remnants of regulatory authority state regulators maintain.[162] Congress's encroachment has resulted in blue sky laws that are progressively limited in jurisdiction but which can be a substantial hurdle for startups subject to their regulation.[163]

V. THE CASE FOR COMPLETING THE DEMISE OF BLUE SKY LAWS

State securities regulators will never be able to match the efficiency of a national regulatory agency like the SEC.[164] While states have struggled to adopt the Uniform Act of 2002, the SEC is efficiently coordinated within its five divisions and maintains supervision of various agencies that assist in fulfilling its mission.[165] Congress has demonstrated a willingness to encroach further and further on traditional state regulatory and judicial jurisdiction.[166] Its actions have left state securities regulators with increasingly limited jurisdiction, but with the ability to be a substantial roadblock for entities within their regulatory purview.[167]

A. Economic Efficiency of a Single Regulatory Regime

Federal regulation should preempt state securities regulation because of its unparalleled ability to efficiently regulate capital markets in comparison to the fifty individual state jurisdictions.[168] The SEC is perhaps the most widely

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[159] *See id.*

[160] *See* Section IV, *supra* Subsections A-E (discussing the passage of PSLRA, NSMIA, SLUSA, Regulation D, and the JOBS Act).

[161] *See* Campbell Jr., *supra* note 14, at 291.

[162] *See* Pollner, *supra* note 138.

[163] *See* Campbell Jr., *supra* note 14, at 291.

[164] *See* Securities and Exchange Commission, *supra* note 112.

[165] *See id.*

[166] *See supra*, Section IV.

[167] *See* Campbell Jr., *supra* note 14, at 291.

[168] *See* 15 U.S.C. § 78(a) (1934). Only the SEC, through implementation of the Exchange Act, may regulate interstate securities transactions. *Id.*

respected agency to result from the New Deal.[169] It is widely lauded as a model federal agency that is, to a degree, insulated from external political pressure, an issue that can plague state regulators, through its appointment of bipartisan commissioners.[170] Because it is the preeminent securities regulatory body in the country, its methods of regulation and its standard practices have been thoroughly vetted, and when problematic for investors, challenged.[171] The stable and predictable nature of the SEC provides a financial climate conducive to growth for startups and established industry players.[172]

The federal government as one entity can be, and has proven to be, significantly more flexible in responding to investors' needs than the fifty states are.[173] Statutes such as PSLRA, SLUSA, NMSIA, and the JOBS Act indicate that the SEC is attuned to national investor concerns, as well as the national and international economic challenges faced by companies seeking to raise capital.[174] Because of its national perspective, the SEC, in conjunction with Congress, can tailor solutions that serve the national economy best and enable American corporations to compete in the global economy.[175] Even if one or more states are attuned to startups' capital markets challenges, it is unlikely that each state will respond in kind and in the most efficient way possible, as demonstrated by the inability to coordinate their state securities' apparatuses.[176] Therefore, due to the SEC's and Congress's national perspective and demonstrated willingness to confront issues of national scale, federal regulators are far better equipped to handle capital acquisition issues in the interconnected national economy.[177]

The inefficiency of a regulatory jurisdiction divided into fifty separate components has not been sufficiently curtailed by the passage of uniform securities acts, the most recent act being passed in 2002.[178] Perhaps recognizing the untenable nature of a regulatory scheme in a global economy that is divided into fifty jurisdictions, state regulators have attempted in 1930, 1956, 1980, and 2002 to provide a common basis of regulation by creating a uniform regulatory system.[179] However, demonstrating states' inability to coordinate for the sake of economic efficiency, in the seventeen years since its

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[169] *See generally* Nicholas, *supra* note 111.
[170] *See id.*
[171] *See id.*
[172] *See id.*
[173] *See generally* Nicholas, *supra* note 111.
[174] *See supra*, Section IV.
[175] *See generally* Nicholas, *supra* note 111.
[176] *See id*.
[177] *See id*.
[178] *See* Faegre Baker Daniels, *supra* note 64.
[179] *See id.*

passage, only thirteen states have actually adopted the most recent Uniform Securities Act of 2002.[180]

The attempt to maintain a semblance of a uniform securities regime among states begs the question as to the purpose of such a regulatory tool when a more efficient and coordinated one has already been established at the federal level.[181] Setting aside the merits of the regulation for a moment, the greater concern is rooted in the fact that startups who are most likely to be subject to state regulation, due to not being covered securities under NSMIA, are left to grapple with the uncertainty about regulatory variances from state to state.[182] Particularly in an economy where most startups, through platforms such as Amazon or eBay, are able to establish a substantial sales presence in every state, being unable to tap a potential pool of investors in every state can have a deleterious impact and can result in lost capital acquisition opportunities.[183] Therefore, the inability of state regulators to collaborate regarding the bases of state securities regulation imposes a substantial opportunity cost on corporations who need capital most.[184]

With fifty different state regulatory bodies, separate bureaucratic systems, and different electoral concerns, the likelihood of inefficient capital acquisition policies among the states is increased by a factor of fifty.[185] Because startups often lack the sufficient number of personnel qualified to grapple with a diverse range of regulations, capital that could be spent in growing operations will often be spent on compliance and regulatory experts, decreasing the entity's efficient use of capital.[186] In contrast, many large regional, national, or multinational companies face similar legal and compliance challenges.[187] However, due to substantially higher operating budgets, large companies' growth is less likely to be inhibited by the funds spent on complying with securities regulations.[188] A single regulatory authority at the federal level will reduce this latent inefficiency inherent in the dual-regulatory model.[189]

A singular regulatory regime will provide more opportunity to non-institutional investors resulting from the concentration of information and regulations in a single place.[190] One of the heaviest burdens for a startup

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[180] *See id.*
[181] *See* Securities and Exchange Commission, *supra* note 112.
[182] *See* Radom, *supra* note 67, at 304.
[183] *See* Pandolph, *supra* note 31.
[184] *See id.*
[185] *See* Campbell Jr., *supra* note 58, at 571.
[186] *See id.* at 578.
[187] *See id.* at 571.
[188] *See id.*
[189] *See id.*
[190] *See* Campbell Jr., *supra* note 8.

regarding state securities regulation is the uncertainty about how the state will enforce its regulations and the political pressures associated with such enforcement.[191] Particularly for entities that cannot afford the substantial legal costs that are associated with a dual-regulatory system, they could be more likely to enter into the capital acquisition space, which could lead to economic growth opportunities for both investors and the businesses.[192] If startups are required to consider only the effects of federal regulation, they will preserve the cash flows and operational costs associated with such expenditures and spend the capital on growing their capabilities.[193] Regulating securities only at the federal level will provide issuers with confidence and certainty about the regulations they are likely to encounter.[194]

States' securities authority is already substantially limited to the point where the burden of blue sky regulation outweighs their utility.[195] States have almost no regulatory authority over national corporations, whose securities are "covered" and subject only to federal regulation.[196] The SEC has proven to be substantially proficient in regulating national and multinational corporations and disclosures.[197] While states can, through merit evaluation, ferret out patently fraudulent issuances, a federal regulator is just as likely to be able to do so, and the efficiency afforded by operating on a national scale means that investors throughout the rest of the country will reap the benefits from a streamlined and standardized process.[198]

B. Preempting Blue Sky Laws as a Natural Continuation of Congressional Policy

Congress has recognized that the dual-federal and state securities regulatory system limits startups' growth potential at a crucial stage.[199] The NSMIA was an early attempt to limit the scope of state regulation in favor of capital efficiency.[200] Covered securities under the statute are those that are already subject to regulation or are likely to be safe investments due to the character of the issuance.[201] Recognizing the inefficient nature of dual-regulation for public companies, Congress sought to improve capital efficiency by eliminating what it perceived as unnecessary double

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[191] *See id.*
[192] *See id.*
[193] *See id.*
[194] *See id.*
[195] *See* 15 U.S.C. § 78 (a) (1996).
[196] *See id.*
[197] *See* Nicholas, *supra* note 111.
[198] *See id.*
[199] *See supra*, Section IV.
[200] *See* 15 U.S.C. § 78(a) (1996).
[201] *See id.*

regulation.[202] Similarly, in passing SLUSA, Congress sought to limit the effect of strike suits, recognizing that corporations spend capital in more efficient ways when they are not fighting strike suits in the discovery phase or settling with plaintiffs.[203] In passing the JOBS Act, Congress recognized that the regulatory burden on Emerging Growth Companies prevented them from maturing when they were at a crucial stage of development.[204] Importantly, Congress saw the need to explicitly give an exception to Emerging Growth Companies regarding state securities regulation. Acknowledging that limiting regulation for this class of growing companies would mean more efficient capital utilization, Congress substantially decreased developing companies' reporting requirements.[205]

Congress revisited the concept of making capital markets more efficient by limiting states' judicial jurisdiction by first passing the PSLRA in 1995 and later SLUSA in 1998.[206] Recognizing that plaintiff strike suits constituted a form of corporate harassment and that corporations could allot capital with more efficiency than defending against meritless claims, Congress sought to eliminate this abuse by instituting uniform pleading requirements.[207] However, plaintiffs recognized an inefficiency in this new regulation and simply began avoiding the new pleading requirements by filing in state courts, the dual-regulatory system once again imposing substantial litigation costs on corporate interests.[208] SLUSA was a response to this perceived inefficiency by precluding all class-actions suits with more than fifty members, asserting state-law claims, involving a nationally listed security and which allege an omission or untrue statement related to the purchase or sale of a security.[209] SLUSA, then, moved a substantial amount of state regulatory power to federal courts and, operating in conjunction with the PSLRA, limits the impact of any potential state claim.[210]

Because class action suits are composed of a large number of retail investors, those individuals whom blue sky laws purport to protect most, SLUSA's removal of regulatory authority from the states significantly undermines this fundamental blue sky regulatory goal.[211] Since class action suits involving less than fifty plaintiffs are the only suits that can be brought in state court, sophisticated investors are the parties most likely to bring a claim

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[202] *See id.*
[203] *See* Catina & Schmitt, *supra* note 101 at 301303.
[204] *See* 17 C.F.R. § 240.12b-2 (2018).
[205] *See id.*
[206] *See supra*, Section IV.

[207] *See* Catina & Schmitt, *supra* note 101, at 301303.
[208] *See* Cox & Hazen, *supra* note 40, at § 27:5.
[209] *See* Brown, *supra* note 138, at 375.
[210] *See id.*
[211] *See id.*

in state court, since most class action suits are brought on behalf of retail investors.[212] Rather ironically, sophisticated investors are the parties least likely to require the protection of a merit-based regulatory system, since such investors are capable of performing sophisticated legal and financial analyses themselves.[213] The Delaware carve-out exception demonstrates this irony.[214] These cases, based in state statutory or common law, most often involve mergers and acquisitions (M&A), which nearly always involve sophisticated investors.[215] Therefore, an inefficiency exists between blue-sky laws, which purport to protect investors on the merits of a security, and who logically must therefore be relatively unsophisticated investors, and those who actually bring most of the suits in state court—sophisticated investors engaged in M&A activity.[216] Protection from blue-sky laws does not flow to vulnerable retail investors but instead to institutional parties or high net worth individuals under Rule 501.[217]

C. *Federal Regulation's Evolving Role in Relation to Blue Sky Laws' Purpose*

Blue sky laws no longer serve the essential purpose their initial proponents envisioned.[218] Initial blue sky laws were the only legal remedy for investors who had been swindled out of their money by fraudsters.[219] In contrast, today the SEC provides a sophisticated regulatory body that is substantially capable of efficiently ensuring that investors are protected, while avoiding inhibiting capital formation.[220] The blue sky framework has outlived its benefits, and it is a relic of economies past.[221]

While eliminating blue sky regulation would promote substantial gains in regulatory efficiency, it could eliminate states' role in protecting their residents from fraudulent transactions, a role the Supreme Court has found to be integral, regardless of its effects on interstate commerce.[222] As the Court reasoned, states are uniquely positioned to understand the particular challenges facing their residents, and their proximity to state residents can enable them to

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212 *See* de Leeuw, *supra* note 115, at 3 (discussing the "Delaware Carve-Out exception).

213 *See id.*

214 *See id.*

215 *See id.*

216 *See id.*

217 *See* 17 CFR § 230.501 (2017).

218 *See id.*

219 *See* Macey & Miller, *supra* note 79, at 361.

220 *See* Nichols, *supra* note 111, at 212.

221 *See* Campbell Jr., *supra* note 8.

222 *See* Caldwell v. Sioux Falls Stock Yards Co., 242 U.S. 559, 564 (1917) (holding a state statute criminalizing the fraudulent sale of a security was within the police power and did not violate the Commerce Clause).

provide additional investor protection.[223] Fraudulent securities issuances could be concentrated in a particular state, imposing an outsized effect on that state in comparison to the rest of the economy, particularly in sales of restricted securities.[224]

Blue sky laws were born out of the idea that, without state intervention and protection, investors would be vulnerable to manipulative enterprises.[225] The Supreme Court determined in early cases involving blue sky constitutionality that the police power should be preserved.[226] However, the passage of the Securities Act and the Exchange Act, and the many statutes and regulations which have passed subsequent to those statutes, have eliminated the purpose for which blue sky laws were created initially.[227] As the federal government's reach has increasingly limited the scope of state regulation, state regulatory authority has shrunk.[228] With this decrease, blue sky laws' existence is increasingly difficult to justify, especially when compared to the actual and opportunity costs of the dual-regulatory system upon business interests.[229] For instance, the passage of PSLRA, NSMIA, and SLUSA has resulted in a dramatic drop-off in securities claims brought in state court.[230]

D. The Blue Sky Swiss Cheese Dilemma

The number of corporate actions and parties exempted from state regulation creates a troublesome cost–benefit analysis for blue sky laws' continued utility.[231] Since the passage of PSLRA in 1995, Congress has continued to poke holes in states' regulatory sphere.[232] The NSMIA effectively removed most publicly traded securities out states' regulatory purview.[233] SLUSA and PSLRA have resulted in most securities lawsuits being removed to federal court, especially since most class action suits are not worth pursuing if there are less than fifty plaintiffs.[234] The JOBS Act further

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[223] *See* Hall v. Geiger-Jones, 242 U.S. 539, 553 (1917) (reasoning that securities regulation is a sophisticated field, affecting a wide range of state resident stakeholders).

[224] *See id. See also* FINRA, *supra* note 10. Private offerings are more likely to be circulated in a small geographic area, especially given the presence of SEC regulations, such as Rule 147, which limit issuances to within state boundaries.

[225] *See* Macey & Miller, *supra* note **79**, at 361.

[226] *See generally Hall*, 242 U.S. 539; *Caldwell*, 242 U.S. 559; *Merrick*, 242 U.S. 568.

[227] *See supra*, Section IV.

[228] *See id.*

[229] *See id.*

[230] *See generally* Brown, *supra* note 138.

[231] *See supra*, Section IV.

[232] *See id.*

[233] *See* 15 U.S.C. § 78(a) (1996).

[234] *See* Choi & Thompson, supra note 130, at 1496.

reduced states' regulatory authority by preempting state authority in many instances of restricted offerings.[235]

The SEC, through its national presence and coordination with national agencies, provides an unparalleled regulatory efficiency that states will never be able to match by coordinating among themselves.[236] Congress, through enactment of acts such as PSLRA, NSMIA, SLUSA, and the JOBS Act, among others, has increasingly rendered state regulators toothless, resulting in blue sky laws' value being substantially less than the investor protection they provide.[237] As federal lawmakers and regulators continue their assault on traditional state jurisdiction, the essential purposes for which blue sky laws were founded—investor protection from fraudulent actors—is now being robustly fulfilled by the SEC and its component agencies and divisions.[238] While state regulators once fulfilled a vital and constitutionally sanctioned role in protecting investors, that role, where it is not preempted, is merely duplicative, resulting in substantial regulatory inefficiency.[239]

CONCLUSION

In no way does this Comment argue for decreased investor protection. However, the Comment does advocate for a more efficient regulatory system, which will effectively police securities issuances while avoiding hindering startup growth. In the digital economy, where multi-billion-dollar companies develop in a matter of months, the United States' dual-regulatory regime is woefully unequipped for competition in the modern economy.[240] An unwieldy and cumbersome tool, blue sky laws risk damaging startups' growth prospects by hampering their ability to raise capital efficiently.[241] It can be tempting to carve out another exception to blue sky regulation, but such a proposal would not address the underlying structural concern regarding blue sky laws and capital acquisition.[242] The patchwork regulatory framework provides little investor protection in comparison to the hurdle it can present for startups raising capital.[243]

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[235] *See supra*, Section IV.

[236] *See* Securities and Exchange Commission, *supra* note 112 (detailing the SEC control over and relationship with organizations such as FINRA, PCAOB, and the MSRB).

[237] *See supra*, Section IV.

[238] *See supra*, Section III.

[239] *See id.*

[240] *See generally Promote Digital Trade and Data-Driven Economy*, U.S. Chamber of Commerce, (Aug. 15, 2017), https://www.uschamber.com/issue-brief/promote-digital-trade-and-the-data-driven-economy.

[241] *See* Campbell Jr., *supra* note 8.

[242] *See generally* Campbell Jr., *supra* note 58, at 571.

[243] *See* Campbell Jr., *supra* note 14, at 301.

Paternalistic, merit-based regulation is best-suited to protect individuals who are not capable of making such assessments themselves, such as retail investors possessing small amounts of capital.[244] However, such investors are likely to be weeded out by capital requirements, such as those under Rule 501,[245] especially since most public securities will be considered covered under NSMIA and SLUSA.[246] With the federal government's increasing encroachment on investor protection, and the efficient manner in which it can operate, the time has passed for state regulators to stop imposing inefficiencies on the national economy.[247]

While blue sky laws provided a valuable service in protecting investors in the past, the scope of securities regulation in the global economy has outgrown regional regulatory efforts and the police power.[248] Furthermore, federal government entities are capable of completing the tasks states have sought to preserve for themselves, with substantially more efficiency.[249] Because state regulatory efforts have had a discriminatory effect against startups and startups by limiting their ability to acquire capital, all state blue sky laws should be preempted by federal securities regulation.[250]

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[244] *See* North American Securities Administration, *supra* note 32. Stating that one of the primary purposes of state regulators is to protect retail investors. *Id.*

[245] *See* 17 CFR § 230.501 (2017).

[246] *See U.S.C.* § 78(a) (1996). (defining covered securities, which are not subject to blue-sky regulation).

[247] *See* Campbell Jr., *supra* note 58:

> The case for substantially eliminating state blue sky laws is based, fundamentally, on a cost-benefit analysis [there is] . . . no meaningful benefit to society from state regulation of securities . . . blue sky laws merely duplicate the federal requirements and as a result add no additional protection for investors.

Id.

[248] *See id.*

[249] *See id.*

[250] *See* Campbell, Jr., *supra* note 14.

> The pernicious effect of state registration rules is easily and vividly demonstrated . . .
>
> It is impossible, however, to find any material benefit in such a regulatory system. If state registration authority were eliminated, investors would still be protected by federal registration provisions and by both state and federal antifraud requirements. Imposing on top of these protections 50 separate state registration regimes administered under each separate state's registration rules and by each separate state's securities administrators adds no material protection for investors. It does, however, significantly increase the issuer's offering costs to an extent that may make access to capital more difficult. While state registration requirements in all cases amount to economic waste, they are especially debilitating for small businesses. This is the result of the structural and economic circumstances that small businesses face when they attempt to access external capital. *Id.*