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FOR APPROVAL

UNIFORM SECURITIES ACT (2002)

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

MEETING IN ITS ONE-HUNDRED-AND-ELEVENTH YEAR
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UNIFORM SECURITIES ACT (2002)

WITH PREFATORY NOTE AND PROPOSED COMMENTS

The ideas and conclusions set forth in this draft, including the proposed statutory language and any comments or reporter's notes, have not been passed upon by the National Conference of Commissioners on Uniform State Laws or the Drafting Committee. They do not necessarily reflect the views of the Conference and its Commissioners and the Drafting Committee and its Members and Reporters. Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal.

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UNIFORM SECURITIES ACT (2002)

Prefatory Note

There are two versions of the Uniform Securities Act currently in force.

The Uniform Securities Act of 1956 ("1956 Act") has been adopted at one time or another, in whole or in part, by 37 jurisdictions.

The Revised Uniform Securities Act of 1985 ("RUSA") has been adopted in only a few States.

Both Acts have been preempted in part by the National Securities Markets Improvement Act of 1996 and the Securities Litigation Uniform Standards Act of 1998.

The need to modernize the Uniform Securities Act is a consequence of a combination of the new federal preemptive legislation, significant recent changes in the technology of securities trading and regulation, and the increasingly interstate and international aspects of securities transactions.

The approach of this Act is to use the substance and vocabulary of the more widely adopted 1956 Act, when appropriate. The Act also takes into account RUSA, federal preemptive legislation, and the other developments that are described in this Preface and the Proposed Comments.

The Act has been reorganized to follow in large part the National Conference of Commissioners on Uniform State Laws ("NCCUSL") Procedural and Drafting Manual 15-41 (1997).

This is a new Uniform Securities Act. Amendment of the earlier 1956 Act or RUSA would not be wise given the different versions of the 1956 Act enacted by the States and the determination to seek enactment in all state jurisdictions of the new Uniform Securities Act after it is adopted by the National Conference.

The Act is solely a new Uniform Securities Act. It does not codify or append related regulations or guidelines. The Act also authorizes state administrators in Section 203 to adopt further exemptions without statutory amendment.

The Act includes headings for subsections as an aid to readers. Unlike section captions, subsection headings are not a part of the official text. Each jurisdiction in which this Act is introduced may consider whether to adopt the headings as a part of the statute and whether to adopt a provision clarifying the effect, if any, to be given to the headings.

The Drafting Committee reviewed several drafts in meetings between 1998 and 2002. The Committee had the assistance of advisors, consultants, and observers from several interested groups, including, among others, the American Bankers Association, the American Bar Association, the American Council of Life Insurers, the Certified Financial Planner Board of Standards, the Financial Planning Association, the Investment Company Institute, the Investment Counsel Association of America, the National Association of Securities Dealers, Inc., the New York Stock Exchange, the North American Securities Administrators Association, the Securities and Exchange Commission, and the Securities Industry Association. In addition, the Reporter and the Chair met on several occasions with committees or representatives of these and other groups.

In drafting the new Act, the Reporter and the Drafting Committee recognized two fundamental challenges. First, there was a general recognition among all involved of the desirability of drafting an Act that would receive broad consensus support. The success of RUSA had been limited because of fundamental differences among relevant constituencies on several issues. After the National Securities Markets Improvement Act of 1996 preempted specified aspects of state securities law with respect to federal covered securities, the opportunity to draft an Act in a less contentious atmosphere was available. Given the number of industry, investor, and regulatory interests affected by the Act and the complexity of the Act itself, building consensus was the Act's most significant drafting challenge.

Second, there was the technical challenge of drafting a new Act that could achieve the basic goal of uniformity among states and with applicable federal law against the backdrop of 46 years of experience with the 1956 Act. Over time both Uniform and non-Uniform Act states have, to varying degrees, evolved local solutions to a number of securities law issues. In increasingly global securities market, the need for uniformity has become more important. Drafting language to achieve the greatest practicable uniformity, given differences in state practice, was a key aspiration of this Act. In a few instances, such as dollar amounts for fees the Act defers to local practice. On a few other issues, bracketed language or the Official Comments articulate an alternative some states may choose to adopt rather than the language of the Act itself.

The Act is in seven Articles:

1. Title and Definitions
2. Exemptions from Registration of Securities
3. Registration of Securities and Notice Filings of Federal Covered Securities
4. Broker-Dealers, Agents, Investment Advisers, Investment Adviser Representatives, and Federal Covered Investment Advisers
5. Fraud and Liabilities
6. Administration and Judicial Review
7. Transition

There are has three overarching themes of the Act.

First, Section 608 articulates in greater detail than the 1956 Act's Section 415 the objectives of uniformity, cooperation among relevant state and federal organizations and self-regulatory organizations, investor protection and, to the extent practicable, capital formation. The theme of uniformity and the aspiration of coordination of state and local securities law is particularly stressed in the Act and Official Comments. Section 602(e), consistent with the Federal Securities Litigation Uniform Standard Act of 1998, is a new provision encouraging reciprocal state enforcement assistance.

A second overarching theme of the Act is coordination with the National Securities Markets Improvement Act of 1996 ("NSMIA"). New definitions were added to define in Section 102(6), federal covered investment adviser, and in Section 102(7), federal covered security. NSMIA also had implications for several securities registration exemptions (see Section 201(3), 201(4), 201(6), 202(4), 202(6), 202(13), 202(14), 202(15) and 202(16)); securities registration (Sections 301(1) and 302); and the broker-dealer, agent, investment adviser, and investment adviser representatives provisions (see especially Sections 402(b)(1) and (5), 403(b)(1)(A) and (2), 405 and 411).

A third theme of the Act involves facilitating electronic records, signatures, and filing. New definitions were added to address filing (Section 102(8)), record (Section 102(25), and sign (Section 102(30). Section 104 expressly permits the filing of electronic signatures and records. Collectively these provisions are intended to permit electronic filing in central information depositories such as the Web-CRD (Central Registration Depository), Investment Adviser Registration Depository (IARD), the Securities and Exchange Commission's Electronic Data Gathering, Analysis and Retrieval System (EDGAR) or successor institutions. Electronic communications also has led to an amplification of Section 610, the jurisdiction section.

The new Act makes several other significant changes compared to the 1956 Act or RUSA.

(1) The definition of "security" in Section 102(28) has been modernized to take into account amendments to the counterpart federal provisions; add new language to expressly include uncertificated securities; exclude contributory or noncontributory ERISA plans; and amplify the definition of investment contract so that it can expressly reach interests in limited partnerships, limited liability companies, or limited liability partnerships, or viatical settlement agreements, among other contracts, when they satisfy the definition of investment contract.

The new Act does not expressly exclude from the definition of security variable insurance products, but does exempt variable insurance product from securities registration in Section 201(4). The states are divided on the question of whether variable insurance products should be excluded (and not subject to fraud enforcement) or exempted (and subject to fraud enforcement). For those states that wish to continue or adopt an exclusion for variable insurance products from the definition of security, proposed statutory language is included in the Official Comments.

(2) Nineteen new definitions were added to define "bank" (Section 102(3)), "depository

institution" (Section 102(5)), "federal covered investment adviser" (Section 102(6)), "federal covered security" (Section 102(7)), "filing" (Section 102(8)), "institutional investor" (Section 102(11)), "insurance company" (Section 102(12)), "insured" (Section 102(13)), "international banking institution" (Section 102(14)), "investment adviser representative" (Section 102(16)), "offer to purchase" (Section 102(19)), "place of business" (Section 102(21)), "predecessor act" (Section 102(22)), "price amendment" (Section 102(23)), "principal place of business" (Section 102(24)), "record" (Section 102(25)), "Securities and Exchange Commission" (Section 102(27)), "self-regulatory organization" (Section 102(29)), and "sign" (Section 102(30)). The growth in definitions is suggestive of the increased complexity and detail of several revised provisions in the new Act.

(3) Specific exemptions from securities registration are broadened. Most significant is Section 202(13) which builds on a new definition of institutional investors that parallels Rule 501(a) of the Securities Act of 1933, with $10 million rather than $5 million thresholds in Sections 102(11)(F) - (K), and (O), and addresses specified employee plans, trusts, Internal Revenue Code Section 501(c)(3) organizations, small business investment companies licensed by the Small Business Administration, private business development companies under Section 202(a)(22) of the Investment Advisers Act, and other institutional purchasers. The definition of institutional investor also reaches qualified institutional buyers under Rule 144A(a)(1) of the Securities Act of 1933, major U.S. institutional investors as defined in Rule 15a-6(b)(4)(i) of the Securities Exchange Act of 1934, and federal covered investment advisers acting for their own accounts. The new institutional investor transaction exemption in Section 202(13) will also reach other persons specified by rule or order of the administrator.

The limited offering transaction exemption in Section 202(14) was broadened to reach 25 persons, in addition to those exempted by the institutional investor exemption, on condition that the transaction is part of a single issue, and other specified conditions are satisfied.

If the SEC adopts a new definition of qualified purchaser as it has proposed under Rule 146(c) of the Securities Act of 1933, there may ultimately be four preemptive or exemptive types of provision applicable to the new Act: (1) the SEC qualified purchaser provision; (2) Section 18(b)(3) which provides preemptive treatment for Rule 506 offerings under the Securities Act of 1933; (3) specified investors in Section 202(13); and (4) limited offerings in Section 202(14).

The options exemption in Section 201(6) was broadened; the "manual" exemption in Section 202(2) has been modernized for an electronic age; a broadened exemption has been provided for specified foreign securities in Section 202(3); a new exemption has been added for nonissuer transactions in securities subject to Securities Exchange Act reporting in Section 202(4); a new exemption has been added for nonissuer transactions rated at the time of a transaction by a nationally recognized statistical rating organization in one of the four highest rating categories in Section 202(5)(A); and new exemptions were added for specified foreign issuers whose securities are traded on designated securities exchanges in Section 202(9), control transactions in Section 202(18), specified out-of-state offers or sales in Section 202(20), specified sales

transactions in Section 202(22), and specified exchange transactions in Section 202(23).

The administrator must expressly authorize one of three exemptions of notes, bonds, debentures, or other evidences of indebtedness for nonprofit organizations under Section 201(7) and new conditions have been added to the unit secured transactions exemption in Section 202(11) to address two substantial areas of state regulatory concern.

The emphasis on the securities registration exemptive area is on flexibility. Securities administrators are both given broad powers to exempt other securities, transactions, or offers in Section 203 and to deny, suspend, condition or limit specified exemptions in Section 204.

(4) Relatively modest changes were made to Article 3, which concerns registration of securities. A new notice filing provision was added in Section 302. A generic waiver provision was added in Section 307. New procedural provisions for stop orders were added in Section 306(d)-(f).

Merit regulation was among the most divisive issues that confronted the RUSA Drafting Committee. After the National Securities Market Improvement Act of 1996 preempted states from applying merit regulation provisions to federal covered securities, this became a less controversial issue. The approach in this Act retains two widely adopted merit regulation provisions in Section 306(a)(7)(A)-(B):

a. the offering will work or tend to work a fraud upon purchasers or would so operate; or

b. the offering has been or would be made with unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters profits or participations or unreasonable amounts or kinds of options.

In addition, bracketed Section 306(a)(7)(C) includes the less widely adopted formulation, "the offering is being made on terms that are unfair, unjust, or inequitable." A new Section 306(b) provides: "To the extent practicable the administrator shall adopt, by rule or order, published standards that provide notice of conduct that violates [the merit regulation] Section 306(a)(7)." NASAA Guidelines provide this type of published standard. This hortatory Section is intended to address one type of criticism of merit regulation.

(5) Article 4, which concerns broker-dealers, agents, investment advisers, investment adviser representatives, and federal covered investment advisers was substantially revised to take into account the NSMIA and significant changes in administrative practice such as those occasioned by the electronic WEB-CRD and the IARD. New developments also had an impact or the definitions of "agent" (Section 102(2)), "broker-dealer" (Section 102(4)), "investment adviser" (Section 102(15)), and "investment adviser representative" (Section 102(16)). NSMIA led also to the new federal covered investment adviser notice filing procedure in Section 405.

"[A] bank, savings institution or trust company" was excluded from the 1956 Act Section 401(c) definition of broker-dealer. After the Gramm-Leach-Bliley Act was adopted in 1999, the generic exclusion of banks from the definition of broker and dealer in Sections 3(a)(4) and (5) of the Securities Exchange Act of 1934 was rescinded in favor of functional regulation. At the federal level this means that banks, unless limiting their securities activities to a specific list of excluded activities, are required to register as broker-dealers. This Act generally follows the federal approach with exceptions for private securities offerings addressed by Section 3(a)(4)(B)(vii) of the Securities Exchange Act of 1934 and de minimis transactions in Section 3(a)(4)(B)(xi) which in the new Act are limited to unsolicited transactions. The administrator is given a further residual power in Section 102(4)(E) to adopt further exclusions for banks, by rule or order. Securities issued by banks, other depository institutions, and international banking institutions are exempt from securities registration in Section 201(3). Banks, savings institutions, and other depository institutions, when not excluded from the definition of broker-dealer, will be required to register by Section 401 and generally, like all other broker-dealers, be subject to the regulatory and liability provisions of the Act in Article 4 and 5.

(6) The fraud and liabilities Article 5 and the definition of fraud in Section 102(9) is substantively little changed. This includes the general fraud provision in Section 501, the filing of sales and advertising literature in Section 504, misleading filings in Section 505, and misrepresentations concerning registration or exemption in Section 506. Technical charges were made to the evidentiary burden Section 503 and the criminal penalties Section 508.

Section 502(a), prohibited conduct in providing investment advice, is unchanged. A new rulemaking authority was added in Section 502(b) to succeed earlier statutory provisions in Section 102 of the 1956 Act. This will give the administrator broad flexibility and recognizes that most state provisions regulating investment advisers in recent years have been adopted through rules.

Section 507 is a new qualified immunity provision to protect a broker-dealer or investment adviser from defamation claims based on information filed with the SEC, a state administrator, or self-regulatory organization "unless it is proven that the person knew, or should have known at the time that the statement was made, that it was false in a material respect or the person acted in reckless disregard of the statement's truth or falsity." This Section, which is consistent with most litigated cases to date, is a response to concerns that defamation lawsuits have deterred broker-dealers and investment advisers from full and complete disclosure of problems with departing employees. The Drafting Committee was sensitive to the concern that such immunity could allow broker-dealers and investment advisers to unfairly characterize employees to protect their "book" of clients. Because of this concern the Drafting Committee rejected proposals for an absolute immunity.

Section 510 is a new rescission offer provision that should be read with the definition of offer to purchase in Section 102(19) and the exemption for rescission offers in Section 202(19). Section 510 is consistent with administrative practice in many states today, although some states

also have a filing requirement.

More thought was devoted to the civil liability Section 509 than any other provision. As ultimately drafted much in this Section is little changed from the 1956 Act. New subsections were added to recognize the preemptive Securities Litigation Act of 1998 (Section 509(a)) and civil liability for investment advice (Section 509(f)).

Significant changes were made in the statute of limitations Section 509(j). Current state law provides a wide range of statutes of limitations. The 1956 Act contained a "two years after the contract of sale" statute of limitations. The new Act has two statute of limitations provisions. Section 509(j)(1) limits violations of registration provisions to "one year after the violation occurred." Section 509(j)(2) follows the pattern of most federal securities statutes of limitations and limits fraud violations to the earlier of "one year after the a discovery of the facts constituting the violation or three years after such violation."

The derivative liability provision in Section 509(g) is not intended to change the predicates for liability for one who "materially aids" violative conduct.

(7) Several changes are made in Article 6, which concerns Administration and Judicial Review. Most are technical in nature. A new authorization for the administrator to develop and implement investor education initiatives has been added in Sections 601(d) and (e).

Considerable attention was devoted to enforcement of the Act. The 1956 Act Section 408 was a slender provision providing for injunctions. Sections 603 and 604, in contrast, provide a broad array of civil and administrative techniques including asset freezes, rescission orders, and civil penalties. Under Section 604 the administrator may issue a cease and desist order. Two other enforcement provisions in the Act are (1) stop orders in Sections 306(d)-(f), and (2) broker-dealer, agent, investment adviser, and investment adviser representative denials, revocations, suspensions, cancellations, withdrawal restrictions, conditions, or limitations of registration under Section 412. Each of the enforcement provisions in the Act includes both a summary process and due process requirements either through judicial process or guarantees of appropriate notice, opportunity for hearing, and findings of facts and conclusions of law in a written record.

Section 607 is a new provision that clarifies the scope of nonpublic records and the administrator's discretion to disclose in light of the extensive development of freedom of information and open records laws since the 1956 Act was adopted.

The jurisdiction and service of process provisions, Sections 610 and 611, generally follow Section 414 of the 1956 Act, but have been modernized to take into account electronic communications.

(8) Section 103 preserves the ability of the Act to reflect later amendments of specified federal statutes and rules to the extent they are preemptive or this is otherwise permitted by state

law.

All involved in the Drafting of this new Act owe a particular debt of gratitude to Richard B. Smith who served as our chair. His efforts were pivotal to the initiation of this project. His indefatigable leadership and high standards immeasurably improved the final Act.

UNIFORM SECURITIES ACT

ARTICLE 1

GENERAL PROVISIONS

SECTION 101. SHORT TITLE. This [Act] may be cited as the Uniform Securities Act (2002).

SECTION 102. DEFINITIONS. In this [Act], unless the context otherwise requires:

(1) "Administrator" means the [insert title of administrative agency or official].

(2) "Agent" means an individual, other than a broker-dealer, who represents a broker-dealer in effecting or attempting to effect purchases or sales of securities or represents an issuer in effecting or attempting to effect purchases or sales of the issuer's securities, but a partner, officer, or director of a broker-dealer or issuer, or an individual having a similar status or performing similar functions, is an agent only if the individual otherwise comes within the term. The term does not include an individual excluded by rule or order under this [Act].

(3) "Bank" means:

(Aa banking institution organized under the laws of the United States;

(B) a member bank of the Federal Reserve System;

(C) any other banking institution whether incorporated or not, doing business under laws of a State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to be exercised by

national banks under the authority of the Comptroller of the Currency pursuant to the first Section of Public Law 87-722 (12 U.S.C. Section 92a), and that is supervised and examined by a state or federal agency having supervision over banks, and that is not operated for the purpose of evading this [Act]; and

(D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

(4) "Broker-dealer" means a person engaged in the business of effecting transactions in securities for the account of others or for the person's own account. The term does not include:

(A) an agent;

(B) an issuer;

(C) a bank or savings institution if its activities as a broker-dealer are limited to those specified in subsections 3(a)(4)(B)(i) through (vi), (viii) through (x), and if limited to unsolicited transactions, (xi); 3(a)(5)(B); and 3(a)(5)(C) of the Securities Exchange Act of 1934 (15 U.S.C. Sections 78c(a)(4) and (5)) or the bank satisfies the conditions described in subsection 3(a)(4)(E) of the Securities Exchange Act of 1934 (15 U. S. C. Section 78c(a)(4));

(D) an international banking institution; or

(E) a person excluded by rule or order under this [Act];

(5) "Depository institution" means

(A) a bank; or

(B) a savings institution, trust company, credit union, or similar institution that is organized or chartered under the laws of a State or of the United States, authorized to receive deposits, and supervised and examined by an official or agency of a State or the United States if

its deposits or share accounts are insured by the Federal Deposit Insurance Corporation, the National Credit Union Share Insurance Fund, or a successor authorized by federal law. The term does not include:

(i) an insurance company or other organization primarily engaged in the business of insurance;

(ii) a Morris Plan bank; or

(iii) an industrial loan company.

(6) "Federal covered investment adviser" means a person registered under the Investment Advisers Act of 1940.

(7) "Federal covered security" means a security that is, or upon completion of a transaction will be, a covered security under Section 18(b) of the Securities Act of 1933 (15 U.S.C. Section 77r(b)) or rules or regulations adopted under that provision.

(8) "Filing" means the receipt under this [Act] of a record by the administrator or a designee of the administrator.

(9) "Fraud," "deceit," and "defraud" include, but are not limited to, common law deceit.

(10) "Guaranteed" means guaranteed as to payment of all principal and all interest.

(11) "Institutional investor" means any of the following, whether acting for itself or for others in a fiduciary capacity:

(A) a depository institution or international banking institution;

(B) an insurance company;

(C) a separate account of an insurance company;

(D) an investment company as defined in the Investment Company Act of 1940;

(E) a broker-dealer registered under the Securities Exchange Act of 1934;

(F) an employee pension, profit-sharing, or benefit plan if the plan has total assets in excess of $10,000,000 or its investment decisions are made by a named fiduciary, as defined in the Employee Retirement Income Security Act of 1974, that is a broker-dealer registered under the Securities Exchange Act of 1934, an investment adviser registered or exempt from registration under the Investment Advisers Act of 1940, an investment adviser registered under this [Act], a depository institution, or an insurance company;

(G) a plan established and maintained by a State, a political subdivision of a State, or an agency or instrumentality of a State or a political subdivision of a State for the benefit of its employees, if the plan has total assets in excess of $10,000,000 or its investment decisions are made by the duly designated public official or by a named fiduciary, as defined in the Employee Retirement Income Security Act of 1974, that is a broker-dealer registered under the Securities Exchange Act of 1934, an investment adviser registered or exempt from registration under the Investment Advisers Act of 1940, an investment adviser registered under this [Act], a depository institution, or an insurance company;

(H) a trust, if it has total assets in excess of $10,000,000, its trustee is a depository institution, and its participants are exclusively plans of the types identified in subparagraph (F) or (G), regardless of size of assets, except a trust that includes as participants self-directed individual retirement accounts or similar self-directed plans;

(I) an organization described in Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. Section 501(c)(3)), or a corporation, Massachusetts or similar business trust, limited liability company, limited liability partnership, or partnership, not formed for the specific

purpose of acquiring the securities offered, with total assets in excess of $10,000,000;

(J) a small business investment company licensed by the Small Business Administration under Section 301(c) of the Small Business Investment Act of 1958 (15 U.S.C. Section 681(c)) with total assets in excess of $10,000,000;

(K) a private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-2(a)(22)) with total assets in excess of $10,000,000;

(L) a federal covered investment adviser acting for its own account;

(M) a "qualified institutional buyer" as defined in Rule 144A(a)(1), other than Rule 144A(a)(1)(H), adopted under the Securities Act of 1933;

(N) a "major U.S. institutional investor" as defined in Rule 15a-6(b)(4)(i) adopted under the Securities Exchange Act of 1934;

(O) any other institutional investor with total assets in excess of $10,000,000 not organized for the specific purpose of evading the Act; or

(P) any other person specified by rule or order under this Act.

(12) "Insurance company" means a company organized as an insurance company whose primary business is writing insurance or reinsuring risks underwritten by insurance companies and which is subject to supervision by the insurance commissioner or a similar official or agency of a State.

(13) "Insured" means insured as to payment of all principal and all interest.

(14) "International banking institution" means an international financial institution of which the United States is a member and whose securities are exempt from registration under the

Securities Act of 1933.

(15) "Investment adviser" means a person that, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or the advisability of investing in, purchasing, or selling securities or that, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities. The term includes a financial planner or other person that, as an integral component of other financially related services, provides investment advice to others for compensation as part of a business or that holds itself out as providing investment advice to others for compensation. The term does not include:

(A) an investment adviser representative;

(B) a lawyer, accountant, engineer, or teacher whose performance of investment advice is solely incidental to the practice of the person's profession;

(C) a broker-dealer or its agents whose performance of investment advice is solely incidental to the conduct of business as a broker-dealer and that does not receive special compensation for the investment advice;

(D) a publisher of a bona fide newspaper, news magazine, or business or financial publication of general and regular circulation;

(E) a federal covered investment adviser;

(F) a bank or savings institution;

(G) any other person that is excluded by the Investment Advisers Act of 1940 from the definition of investment adviser; or

(H) any other person excluded by rule or order under this [Act].

(16) "Investment adviser representative" means an individual employed by or associated with an investment adviser or federal covered investment adviser and who makes any recommendations or otherwise gives investment advice regarding securities, manages accounts or portfolios of clients, determines which recommendation or advice regarding securities should be given, provides investment advice or holds herself or himself out as providing investment advice, receives compensation to solicit, offer or negotiate for the sale of or for selling investment advice, or supervises employees who perform any of the foregoing. The term does not include an individual:

(A) who performs only clerical or ministerial acts;

(B) who is an agent whose performance of investment advice is solely incidental to the individual acting as an agent and who does not receive special compensation for investment advisory services;

(C) who is employed by or associated with a federal covered investment adviser, unless the individual:

(i) has a "place of business" in this State as that term is defined by rule adopted under Section 203A of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-3a) and is an "investment adviser representative" as that term is defined by rule adopted under Section 203A of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-3a); or

(ii) has a "place of business" in this State as that term is defined by rule adopted under Section 203A of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-3a) and is not a "supervised person" as that term is defined in Section 202(a)(25) of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-2(a)(25)); or

(D) who is excluded by rule or order under this [Act].

(17) "Issuer" means a person that issues or proposes to issue a security, subject to the following:

(A) The issuer of a voting trust certificate, collateral trust certificate, certificate of deposit for a security, or share in an investment company without a board of directors or individuals performing similar functions, is the person performing the acts and assuming the duties of depositor or manager pursuant to the trust or other agreement or instrument under which the security is issued;

(B) the issuer of an equipment trust certificate or similar security serving the same purpose, is the person by which the property is, or is to be, used, or to which the property or equipment is, or is to be, leased or conditionally sold, or that is otherwise contractually responsible for assuring payment of the certificate; and

(C) the issuer of a fractional undivided interest in an oil, gas, or other mineral lease or in payments out of production under a lease, right, or royalty is the owner of an interest in the lease or in payments out of production under a lease, right, or royalty, whether whole or fractional, that creates fractional interests for the purpose of sale.

(18) "Nonissuer transaction" or "nonissuer distribution" means a transaction or distribution not directly or indirectly for the benefit of the issuer.

(19) "Offer to purchase" includes an attempt or offer to obtain, or solicitation of an offer to sell, a security or interest in a security for value. The term does not include a tender offer that is subject to Section 14(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(d)).

(20) "Person" means an individual, corporation, business trust, estate, trust, partnership,

limited liability company, limited liability partnership, association, joint venture, government; governmental subdivision, agency, or instrumentality; public corporation; or any other legal or commercial entity.

(21) "Place of business" of a broker-dealer, an investment adviser, or a federal covered investment adviser means:

(A) an office at which the broker-dealer, investment adviser, or federal covered investment adviser regularly provides brokerage or investment advice, or solicits, meets with, or otherwise communicates with customers or clients; or

(B) any other location that is held out to the general public as a location at which the broker-dealer, investment adviser, or federal covered investment adviser provides brokerage or investment advice, or solicits, meets with, or otherwise communicates with customers or clients.

(22) "Predecessor act" means the act repealed by Section 702.

(23) "Price amendment" means the amendment to a registration statement filed under the Securities Act of 1933 or, if an amendment is not filed, the prospectus or prospectus supplement filed under the Securities Act of 1933 that includes a statement of the offering price, underwriting and selling discounts or commissions, amount of proceeds, conversion rates, call prices, and other matters dependent upon the offering price.

(24) "Principal place of business" of a broker-dealer or an investment adviser means the executive office of the broker-dealer or investment adviser from which the officers, partners, or managers of the broker-dealer or investment adviser direct, control, and coordinate the activities of the broker-dealer or investment adviser.

(25) "Record," except in the phrases "of record," "official record," and "public record," means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form~~, including, but not limited to, a registration statement, report, application, book, publication, account, paper, correspondence, memorandum, agreement, document, computer file, or disk, microfilm, photograph, or audio or visual tape~~.

(26) "Sale" includes every contract of sale, contract to sell, or disposition of, a security or interest in a security for value, and "offer to sell" includes an attempt or offer to dispose of, or solicitation of an offer to purchase, a security or interest in a security for value. Both terms include:

(A) a security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing constituting part of the subject of the purchase and having been offered and sold for value;

(B) a gift of assessable stock involving an offer and sale; and

(C) a sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, and every sale or offer of a security that gives the holder a present or future right or privilege to convert the security into another security of the same or another issuer, including an offer of the other security.

(27) "Securities and Exchange Commission" means the United States Securities and Exchange Commission.

(28) "Security" means a note; stock; treasury stock; security future; bond; debenture; evidence of indebtedness; certificate of interest or participation in a profit-sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable share;

investment contract; voting trust certificate; certificate of deposit for a security; fractional undivided interest in oil, gas, or other mineral rights; put, call, straddle, option, or privilege on a security, certificate of deposit, or group or index of securities, including an interest therein or based on the value thereof; put, call, straddle, option or privilege entered into on a national securities exchange relating to foreign currency; or, in general, an interest or instrument commonly known as a "security"; or a certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

(A) The term includes both a certificated and an uncertificated security.

(B) The term does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed sum of money either in a lump sum or periodically for life or other specified period.

(C) The term does not include an interest in a contributory or noncontributory pension or welfare plan subject to the Employee Retirement Income Security Act of 1974.

(D) The term includes an investment in a common enterprise with the expectation of profits to be derived primarily from the efforts of a person other than the investor. A "common enterprise" means an enterprise in which the fortunes of the investor are interwoven with those of either the person offering the investment, a third party or other investors.

(E) The term "investment contract" may include, among other contracts, an interest in a limited partnership, a limited liability company, or a limited liability partnership; or an investment in a viatical settlement or similar agreement.

(29) "Self-regulatory organization" means a national securities exchange registered under

the Securities Exchange Act of 1934, a national securities association of broker-dealers registered under the Securities Exchange Act of 1934, a clearing agency registered under the Securities Exchange Act of 1934, or the Municipal Securities Rulemaking Board established under the Securities Exchange Act of 1934.

(30) "Sign" means, with present intent to authenticate or adopt a record:

(A) to execute or adopt a tangible symbol; or

(B) to attach or logically associate with the record an electronic symbol, sound, or process.

(31) "State" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

Proposed Comments

Prior Provisions: 1956 Act Section 401; RUSA 101.

1. Under Section 605(a) the administrator has the power to define by rule any term, whether or not used in this Act, as long as the definitions are not inconsistent with the Act.

2. All definitions include corresponding meanings. For example, "filing" would include "file" or "filed"; "sale" would include "sell."

3. Prefatory Phrase: "In this [Act], unless the context otherwise requires": Prior Provisions: 1956 Act Section 401 Preface; RUSA Section 101 Preface. This prefatory phrase which is also in the counterpart provisions of the federal securities statutes, see, e.g., Securities Act of 1933 Section 2(a), provides the basis for the courts to take into account the statutory and factual context of each definition, see, e.g., Reves v. Ernst & Young, 494 U.S. 56 (1990); 2 Louis Loss & Joel Seligman, Securities Regulation 927-929 (3d ed. rev. 1999), and will allow the courts to harmonize this Act's definitions with the counterpart federal securities definitions to the extent appropriate. Cf. Akin v. Q-L Inv., Inc., 959 F.2d 521, 532 (5th Cir. 1992) ("Texas courts generally look to decisions of the federal courts to interpret the Texas Securities Act because of obvious similarities between the state and federal laws"); Koch v Koch Indus., Inc. 203 F.3d 1202, 1235 (10th Cir. 2000) (following federal definition of materiality); Biales v. Young, 432 S.E.2d 482, 484 (S.C. 1993) ("Section 35-1-1490(2) is substantially similar to Section 12(1) of

the Federal Securities Act").

4. Section 102(2): Agent: Prior Provisions: 1956 Act Section 401(b); RUSA Section 101(14). Section (102)(2), in part, follows the 1956 Act definition. The 1956 Act used the term "agent" while the RUSA Section 101(14) used the term "sales representative." Given the broader enactment of the 1956 Act, this Act also uses the term "agent."

Whether a particular individual who represents a broker-dealer or issuer is an "agent" depends upon the same factors that create an agency relationship at common law. See, e.g., Norwest Bank Hastings v. Clapp, 394 N.W.2d 176, 179 (Minn. Ct. App. 1986) (following Official Comment that establishing agency under the Uniform Securities Act "depends upon much the same factors which create an agency relationship at common law") Shaughnessy & Co., Inc. v. Commissioner of Sec., 1971-1978 Blue Sky L. Rep. (CCH) ¶71,348 (Wis. Cir. Ct. 1977) (unlicenced person who took information relevant to securities transaction and turned it over to securities agents was himself an agent).

An individual can be an agent for a broker-dealer or issuer for a purpose other than effecting or attempting to effect purchases or sales of securities and not be a statutory agent under this Act. See, e.g., Baker, Watts & Co. v. Miles & Stockridge, 620 A.2d 356, 367 (Md. Ct. App. 1993) (attorney-client relationship is generally one of agency, but that alone does not bring attorneys within securities act definition of agent). An individual will not be considered to be an agent under Section 102(2) merely because of the person's status as a partner, officer, or director of a broker-dealer or issuer if such an individual does not effect or attempt to effect purchases or sales of securities. See, e.g., Abell v. Potomac Ins. Co., 858 F.2d 1104 (5th Cir. 1988).

Section 102(2) is intended to include any individual who acts as an agent, whether or not the individual is an employee or independent contractor. Cf. Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. *en banc* 1990), *cert. denied*, 499 U.S. 976 (1991).

The word "individual" in the term "agent" is limited to human beings and does not include a juridical "person" such as a corporation. Cf. definition of "person" in Section 102(20). The 1956 Act Section 401(b) similarly was limited to individuals and did not include juridical persons. See, e.g., Connecticut Nat'l Bank v. Giacomi, 699 A.2d 101, 111-112 (Conn. 1997) ("agent" only includes natural persons when it used the term individual); Schpok v. Fodale, 236 N.W.2d 97, 99 (Mich. Ct. App. 1975) (agent defined to be individual and did not include a corporation).

An individual whose functions are solely clerical or ministerial would not be an agent under Section 102(2). Ministerial or clerical work might include preparing written communications or responding to inquiries.

An individual acting for an issuer subject to Section 102(2) will not be exempted from relevant fraud and liability provisions in Article 5.

5. Section 102(3): Bank: Prior Provision: Subsection 3(a)(6) of the Securities Exchange Act of 1934. A United States branch of a foreign bank that otherwise satisfies this definition would be a bank.

6. Section 102(4): Broker-Dealer: Prior Provisions: 1956 Act Section 401(c); RUSA Section 101(2). This definition generally follows the definition of broker-dealer in the 1956 Act and RUSA. The use of the compound term is meant to include either a broker or a dealer. The recognized distinction is that a broker acts for the benefit of another while a dealer acts for itself (e.g., in buying for or selling from its own inventory).

The distinction between "a person engaged in the business of effecting transactions in securities" and an investor, who may buy and sell with some frequency and is outside the scope of this term, has been well developed in the case law. See 6 Louis Loss & Joel Seligman, Securities Regulation 2980-2984 (3d ed. 1990).

The 1956 Act Section 401(c) excluded from the definition of broker-dealer a person who during any 12 consecutive months did not direct more than 15 offers to buy or sell in this State. In this Act exemptions from broker-dealer registration are provided in Section 401(b).

The Gramm-Leach-Bliley Act, signed into law in November 1999, rescinded the blanket exemption of banks from the definition of broker and dealer in Sections 3(a)(4) and (5) of the Securities Exchange Act of 1934. The Gramm-Leach-Bliley Act permits a bank to avoid registration as a broker or dealer at the federal level if the bank limits its activities to those specified in the Securities Exchange Act. This Act generally adopts the activity focused exceptions for banks included in the Gramm-Leach-Bliley Act, with minor modifications relating to the private placement and de minimis brokerage activities of banks (15 U.S.C. 78c(a)(4)(B)(vii) and (xi)).

A state may decide to adopt an exclusion in Section 102(4)(C) that fully conforms with the bank exceptions contained in the Gramm-Leach-Bliley Act. For states that choose this approach, the language of Section 102(4)(C) should read:

> *(C) a bank or savings institution if its activities as broker-dealer are limited to those specified in Section 3(a)(4) or 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78c(a)(4) or (5)), or the bank or savings institution satisfies the conditions specified in Section 3(a)(4)(E) of the Securities Exchange Act of 1934 (15 U.S.C.* 78c(4)).

Section 102(4)(E) of this Act also permits a securities administrator to adopt additional exclusions that exclude banks and other depository institutions, in whole or in part, from the definition of "broker-dealer."

States that promptly adopt this Act should consider whether it is appropriate to provide banks a transition period to comply with the Act's new activity focused exceptions. The activity

focused exceptions for banks in the Gramm-Leach-Bliley Act were originally to become effective at the federal level on May 12, 2001. However, the Securities and Exchange Commission has delayed the effective date of these activity focused exceptions (and thus continued the blanket exemption for banks) beyond May 12, 2001, and commenced a rulemaking designed to clarify and define the scope of the bank exceptions in the Gramm-Leach-Bliley Act. See Sec. Ex. Act Rels. 44,291, 74 SEC Dock. 2155 (2001) (proposal); 45,897, 77 SEC Dock. ____ (2002) (proposal). To avoid disrupting the activities of banks, states should consider delaying implementation of the activity focused exceptions in this Act until these exceptions are implemented at the federal level.

Section 15(h)(1) of the Securities Exchange Act of 1934, as amended by the National Securities Markets Improvement Act of 1996, preempts state law from "[establishing] capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements for brokers, dealers, municipal securities dealers, government securities brokers, or government securities dealers that differ from, or are in addition to the requirements in those areas established under [the Securities Exchange Act]." These preemptions are recognized in the substantive broker-dealer provisions in Article 4.

7. Section 102(5): Depository institution: No Prior Provision.

8. Section 102(6): Federal covered investment adviser: No Prior Provision. This provision is necessitated by Section 203A of the Investment Advisers Act of 1940, added by Title III of the National Securities Markets Improvement Act of 1996, which allocates to primary state regulation most advisers with assets under management of less than $25 million. SEC registration is permitted, but not required, for investment advisers having between $25 and $30 million of assets under management and is required of investment advisers having at least $30 million of assets under management. Investment Advisers Act of 1940 Rule 203A-1. Most advisers with assets under management of $25 million or more register solely under Section 203 of the Investment Advisers Act of 1940 and not state law. This division of labor is intended to eliminate duplicative regulation of investment advisers.

9. Section 102(7): Federal covered security: No Prior Provision. The National Securities Markets Improvement Act of 1996, as subsequently amended, partially preempted state law in the securities offering and reporting areas. Under Section 18(a) of the Securities Act of 1933, no state statute, rule, order, or other administrative action may apply to:

(1) The registration of a "covered" security or a security that will be a covered security upon completion of the transaction;

(2)(A) any offering document prepared by or on behalf of the issuer of a covered security;

(2)(B) any proxy statement, report to shareholders, or other disclosure document relating to a covered security or its issuer that is required to be filed with the SEC or any national securities

association registered under Section 15A of the Securities Exchange Act such as the National Association of Securities Dealers (NASD); or

(3) the merits of a covered security or a security that will be a covered security upon completion of the transaction.

2. Section 18(b) of the Securities Act of 1933 applies to four types of "covered securities":

(1) Securities listed or authorized for listing on the New York Stock Exchange (NYSE), the American Stock Exchange (Amex); the National Market System of the Nasdaq stock market; or securities exchanges registered with the Securities and Exchange Commission (SEC) (or any tier or segment of their trading) if the SEC determines by rule that their listing standards are substantially similar to those of the NYSE, Amex, or Nasdaq National Market System, which the SEC has done through Rule 146; and any security of the same issuer that is equal in seniority or senior to any security listed on the NYSE, Amex, or Nasdaq National Market System;

(2) securities issued by an investment company registered with the SEC (or one that has filed a registration statement under the Investment Company Act of 1940);

(3) securities offered or sold to "qualified purchasers." This category of covered securities will become operational when the SEC defines the term "qualified purchaser" as used in Section 18(b)(3) of the Securities Act of 1933, by rule. To date the SEC has proposed, but not adopted, Rule 146(c) of the Securities Act of 1933; and

(4) securities issued under the following specified exemptions of the Securities Act of 1933:

(A) Sections 4(1) (transactions by persons other than an issuer, underwriter or dealer), and 4(3) (dealers after specified periods of time), but only if the issuer files reports with the Commission under Sections 13 or 15(d) of the Securities Exchange Act;

(B) Section 4(4) (brokers);

(C) Securities Act exemptions in Section 3(a) with the exception of the charitable exemption in Section 3(a)(4), the exchange exemption in Section 3(a)(10), the intrastate exemption in Section 3(a)(11), and the municipal securities exemption in Section 3(a)(2), but only with "respect to the offer or sale of such [municipal] security in the State in which the issuer of such security is located"; and

(D) securities issued in compliance with SEC rules under Section 4(2) (private placement exemption).

Section 18(c)(1) preserves state authority "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."

The National Securities Markets Improvement Act, in essence, preempts aspects of the securities registration and reporting processes for specified federal covered securities. The Act does not diminish state authority to investigate and bring enforcement actions generally with respect to securities transactions.

The states are authorized to require filings of any document filed with the SEC for notice purposes "together with annual or periodic reports of the value of securities sold or offered to be sold to persons located in the State (if such sales data is not included in documents filed with the Commission), solely for notice purposes and the assessment of any fee, together with a consent to service of process and any required fee." Section 18(c)(2). However, no filing or fee may be required with respect to any listed security that is a covered security under Section 18(b)(1) (traded on specified stock markets). Section 302 of this Act addresses notice filings and fees applicable to federal covered securities.

10. Section 102(8): Filing: Prior Provision: RUSA Section 101(4). The RUSA definition was revised to recognize that records may be filed in paper form or electronically with the administrator, or designees such as the Web-CRD (Central Registration Depository) or Investment Advisor Registration Depository (IARD) or the Securities and Exchange Commission's Electronic Data Gathering, Analysis and Retrieval System (EDGAR) or successor systems.

In the RUSA definition, the term "filed" referred to "actual delivery of a document or application." This Act substitutes the term "record" which is defined in Section 102(25) to refer broadly to "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perishable form". This definition requires the receipt of a record. The definition does not limit filing to any specific medium such as mail, certified mail, or a particular electronic system. The definition is intended to permit an administrator to accept filings over the Internet or through a direct modem system, both of which are now used to transmit documents to EDGAR, or through new electronic systems as they evolve.

"Receipt" refers to the actual delivery of a record to the administrator or a designee and does not refer to a subsequent review of the record by the administrator. See, e.g., Fehrman v. Blunt, 825 S.W.2d 658 (Mo. Ct. App. 1992). If a deficient form was filed with a designee, but not provided to the administrator because of the deficiency, it would not be filed under this definition.

11. Section 102(9): Fraud, deceit and defraud: Prior Provisions: 1956 Act Section 401(d); RUSA Section 101(6). This definition, which is substantially identical to the 1956 Act and RUSA, codifies the holdings that "fraud" as used in the federal and state securities statutes is not limited to common law deceit. See generally 7 Louis Loss & Joel Seligman, Securities Regulation 3421-3448 (3d ed. 1991).

12. Section 102(10): Guaranteed: Prior Provisions: 1956 Act Section 401(e); RUSA Section 401(a)(1). The 1956 Act definition of "guaranteed" applied generally to payment of "principal, interest, or dividends." The RUSA definition of "guaranteed," which was solely applicable to exempt securities, applied to the guarantee of "all or substantially all of principal and interest or dividends."

Section 102(10) follows the 1956 Act approach and applies generally to the guarantee of "all principal and all interest." Any method of guarantee that results in a guarantee of payment of all principal and all interest will suffice including, for example, an irrevocable letter of credit.

This definition does not address whether or not a guarantee, whether whole or partial, is itself a security. That issue is addressed by the definition of "security" in Section 102(28).

13. Section 102(11): Institutional investor: Prior Provisions: RUSA Section 101(5); Securities Act of 1933 Rules 144A and 501(a).

Sections 102(11)(A)-(K) are based on Rule 501(a) of the Securities Act of 1933, but do not include the paragraphs of Rule 501(a) that address natural persons.

Section 102(11)(H) concludes with an except clause meant to exclude self-directed plans for individuals from this definition.

With respect to the exclusion of Rule 144A(1)(H) from Section 102(11)(M), the substance of Rule 144A(a)(1)(H) appears in Section 102(11)(I), but with a requirement of total assets in excess of $10,000,000.

Section 102(11)(O) is meant to reach persons similar to those listed in Sections 102(11)(A)-(N), but not otherwise listed.

14. Section 102(12): Insurance company: No Prior Provision. This definition is based on Securities Act of 1933 Section 2(a)(13).

15. Section 102(13): Insured: Prior Provision: RUSA Section 401(a)(2). The RUSA definition of "insured," which was solely applicable to exempt securities, applied to the insurance of "all or substantially all of principal, interest, or dividends." Section 102(13) is applicable generally but is limited to "payment of all principal and all interest."

16. Section 102(14): International banking institution: No Prior Provision. Securities issued or guaranteed by the International Bank for Reconstruction and Development, 22 U.S.C. Section 286k-1(a); the Inter-American Development Bank, 22 U.S.C. Section 283h(a); the Asian Development Bank, 22 U.S.C. Section 285h(a); the African Development Bank, 22 U.S.C. Section 290i-9; and the International Finance Corporation, see 22 U.S.C. Section 282k; are treated as exempted securities under of Section 3(a)(2) of the Securities Act of 1933, see

generally 3 Louis Loss & Joel Seligman, Securities Regulation 1191-1194 (3d ed. rev. 1999), and are within this term.

17. Section 102(15): Investment adviser: Prior Provisions: 1956 Act Section 401(f); RUSA Section 101(7). This term generally follows the definition in Section 202(a)(11) of the Investment Advisers Act of 1940.

The first sentence in Section 102(15) is identical to the first sentence in the 1956 Act Section 401(f) and the counterpart language in Section 202(a)(11). The RUSA definition deleted the phrases "either directly or through publications or writings" and "regular" before business. These terms have been returned to Section 102(15) because of the intention that this definition be construed uniformly with the definition in the Investment Advisers Act of 1940.

The second sentence in the term addressing financial planners is new. The purpose of this sentence is to achieve functional regulation of financial planners who satisfy the definition of investment adviser. Cf. Investment Advisers Act Release 1092, 39 SEC Dock. 494 (1987) (similar approach in Securities and Exchange Commission interpretative Release). This reference is not intended to preclude persons who hold a formally recognized financial planning or consulting designation or certification from using this designation. The use by a person of the designation or certification as a financial planner or any designation or certification alone does not require registration as an investment adviser.

Sections 102(15)(A)-(H) are exclusions from the term "investment adviser." An excluded person can be held liable for fraud in providing investment advice, see Section 502, but would not be subject to the registration and regulatory provisions in Article 4.

Sections 102(15)(A) and (E) are new and recognize that investment adviser representatives and federal covered investment advisers are separately treated in this Act. See definitions in Sections 102(6) and 102(16); registration and exemptions in Sections 404-405.

Sections 102(15)(B), (C), and (G) are substantively identical to the 1956 Act, RUSA, and the Investment Advisers Act of 1940. The Official Comment to the 1956 Act Section 401(f) quoted an opinion of the Securities and Exchange Commission General Counsel in Investment Advisers Act Release 2 on the meaning of "special compensation" included in Section 102(15)(C):

> [This clause] amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business. On the other hand, that portion of clause [(C)] which refers to 'special compensation' amounts to an equally clear recognition that a broker or dealer who is specially compensated for the rendition of advice should be considered an investment adviser and not be excluded from the purview of the Act merely because he is also

> engaged in effecting market transactions in securities. . . . The essential distinction to be borne in mind in considering borderline cases . . . is the distinction between compensation for advice itself and compensation for services of another character to which advice is merely incidental.

Similarly, other broker-dealer employees such as research analysts who receive no special compensation from third parties for investment advice would not be required to register as investment advisers.

The 1956 Act definition added the word "paid" to the counterpart exclusion in Section 202(a)(11) of the Investment Advisers Act "to emphasize," as the Official Comment explained, "that a person who periodically distributes a 'tipster sheet' free as a way to get paying clients is not excluded from the definition as a 'publisher.'" After the 1956 Act was published, the United States Supreme Court construed the definition of investment adviser in Lowe v. SEC, 472 U.S. 181 (1985), and concluded:

> Congress did not intend to exclude publications that are distributed by investment advisers as a normal part of the business of servicing their clients. The legislative history plainly demonstrates that Congress was primarily interested in regulating the business of rendering personalized investment advice, including publishing activities that are a normal incident thereto. On the other hand, Congress, plainly sensitive to First Amendment concerns, wanted to make clear that it did not seek to regulate the press through the licensing of nonpersonalized publishing activities.

Id. at 185.

Responsive to this language RUSA rewrote this exclusion to provide:

> a publisher, employee, or columnist of a newspaper, news magazine, or business or financial publication, or an owner, operator, or employee of a cable, radio, or television network, station, or production facility, if, in either case, the financial or business news published or disseminated is made available to the general public and the content does not consist of rendering advice on the basis of the specific investment situation of each client.

Recent experience at the federal and state levels suggest that the 1956 Act and RUSA approaches may be too broad. The retention of the Investment Advisers Act approach provides a better balance between First Amendment concerns and protection of investors from non-"bona fide" publicizing of investment advice. The exclusion in Section 102(15)(D) is intended to exclude publishers of Internet or electronic media, but only if the Internet or electronic media publication or website satisfies the "bona fide" and "publication of general and regular circulation" requirements. Cf. SEC v. Park, 99 F. Supp. 2d 889, 895-896 (N.D. Ill. 2000) (court

declined to dismiss complaint against an Internet website when there were allegations that the website was not "bona fide" or of "general and regular circulation").

The exclusion in Section 102(15)(G) is required by the National Securities Markets Improvement Act of 1996. This exclusion will reach banks and bank holding companies as described in Investment Advisers Act Section 202(a)(11)(A) and persons whose advice solely concerns United States government securities as described in Section 202(a)(11)(E).

18. Section 102(16): Investment adviser representative: No Prior Provision. Investment adviser representatives were not required to register under the federal Investment Advisers Act, before or after the National Securities Markets Improvement Act.

The term investment adviser representative is not intended to preclude persons who hold a formally recognized financial planning or consulting designation or certification from using such a designation. The use by any person of the designation or certification as a financial planner does not require registration as an investment adviser representative.

20. Section 102(17): Issuer: Prior Provisions: 1956 Act Section 401(g); RUSA Section 101(8). This Section generally follows the 1956 Act and RUSA.

In paragraph (B), the phrase "or who is otherwise contractually responsible for assuring payment of the certificate" is intended to address forms of payment other than leases or conditional sales contracts. It would also reach guarantors.

21. Section 102(18): Nonissuer transaction or nonissuer distribution: Prior Provisions: 1956 Act Section 401(h); RUSA Section 101(9). This definition is relevant to several exempt transactions in Section 202. See, e.g., Sections 202(1)-(9).

In TechnoMedical Labs, Inc. v. Utah Sec. Div., 744 P.2d 320 (Utah Ct. App. 1987), the court declined to limit the term benefit to monetary benefit and instead held a spinoff transaction could provide direct or indirect benefits to an issuer. Id. at 323-324, *following* SEC v. Datronics Eng'r, Inc., 490 F.2d 250 (4th Cir. 1973), *cert. denied,* 416 U.S. 937; SEC v. Harwin Indus. Corp., 326 F. Supp. 943 (S.D.N.Y. 1971).

22. Section 102(19): Offer to purchase: No Prior Provision: A rescission offer under Section 510 would be an offer to purchase.

23. Section 102(20): Person: Prior Provisions: 1956 Act Section 401(i); RUSA Section 101(10). This is the standard definition used by the National Conference of Commissioners for Uniform State Laws with the addition of "limited liability partnership" to reflect current usage. The use of the concluding phrase "or any other legal or commercial entity" is intended to be broad enough to include other forms of business entities that may be created or popularized in the future.

24. Section 102(21): Place of business: Prior Provision: Rules 203A-3(b) and 222-1 of the Investment Advisers Act of 1940.

25. Section 102(23): Price amendment: Prior Provision: RUSA Section 101(11). A price amendment may be used in a registration coordinated with the Securities and Exchange Commission procedure in Section 303(d). See also Section 304(d). In the case of noncash offerings, required information concerning such matters as the offering price and underwriting arrangements is normally filed in a "price" amendment after the rest of the registration statement has been reviewed by the Securities and Exchange Commission staff. See generally 1 Louis Loss & Joel Seligman, Securities Regulation 542-550 (3d ed. rev. 1998).

26. Section 102(24): Principal place of business: Prior Provision: Rule 222-1(b) of the Investment Advisers Act of 1940.

27. Section 102(25): Record: Prior Provision: Uniform Electronic Transactions Act Section 2(13). Cf. Section 3(a)(37) of the Securities Exchange Act of 1934. The Uniform Electronic Transactions Act §2(13) defines record in nearly identical terms. The Official Comment explains:

> This is a standard definition designed to embrace all means of communicating or storing information except human memory. It includes any method for storing or communicating information, including "writings." A record need not be indestructible or permanent, but the term does not include oral or other communications which are not stored or preserved by some means.

This term is intended to embrace new forms of records that are created or popularized in the future. The illustrations provided in the definition are intended to provide guidance to the courts and are not meant to limit the definition.

28. Section 102(26): Sale: Prior Provisions: 1956 Act Section 401(j); RUSA Section 101(13). Both the 1956 Act and RUSA definition of "sale" are modeled on Section 2(a)(3) of the Securities Act of 1933.

Language in Section 401(j) of the 1956 Act also addressed the now rescinded SEC "no sale" doctrine and has been eliminated. Merger transactions are usually sales under Section 102(26), but may be exempted from the securities registration requirements by Section 202(18).

29. Section 102(28): Security: Prior provisions: 1956 Act Section 401(1); RUSA Section 101(16). Much of the definition in Section 102(28), like the definitions in the 1956 Act Section 401(l) and RUSA Section 101(16), is identical to the definition in Section 2(a)(1) of the Securities Act. State courts interpreting the Uniform Securities Act definition of security have often looked to interpretations of the federal definition of security. See generally 2 Louis Loss & Joel Seligman, Security Regulation 923-1138.19 (3d ed. rev. 1999).

The most recent amendments to Section 2(a)(1) of the Securities Act of 1933 were added by the Commodities Futures Modernization Act of 2000 which added or revised language addressing security futures and securities puts, calls, straddles, options, or privileges to the Securities Act. Identical language has been included in Section 102(28) of this Act to harmonize interpretation of the federal and state definition of a "security." With respect to a security futures product, Section 28(a) of the Securities Exchange Act of 1934, as also amended by the Commodity Futures Modernization Act of 2000, further provides: "No provision of any State law regarding the offer, sale or distribution of securities shall apply to any transaction in a security futures product, except that this sentence shall not be construed as limiting any State antifraud law of general applicability."

Preorganization certificates or subscriptions are included in this term, obviating the need for a separate definition as was included in RUSA Section 402(13).

Section 102(28) uses RUSA's "fractional undivided interest in oil, gas or other mineral rights" formulation, which originated in Section 2(a)(1) of the Securities Act of 1933, rather than the 1956 Act formulation, "certificate of interest or participation in an oil, gas or mining title." In recent years, courts interpreting Section 2(a)(1) of the Securities Act of 1933 have found certain oil, gas or mineral rights to be investment contracts (that is, securities). 2 Louis Loss & Joel Seligman, Securities Regulation 979-982 (3d ed. rev. 1999).

A new sentence was added in Section 102(28)(A) referring to certificated or uncertificated securities to indicate that the term is intended to apply whether or not a security is evidenced by a writing. Cf. Thomas v. State of Tex., 65 S.W.3d 38 (Tex. Crim. App. 2001) (Under Texas law evidence of indebtedness requires a writing).

Insurance or endowment policies or endowment or annuity contracts, other than those on which an insurance company promises to make variable payments, are excluded from this term. Variable insurance products are also excluded in many states and are exempted from securities registration in others under provisions such as Section 201(4). When variable products are included in the definition of security and exempted from registration state securities administrators can bring enforcement actions concerning variable insurance sales practices.

In many states variable products are excluded from the definition of security. Those states which intend to exclude variable products from the definition of security should add the words "or variable" to Section 102(28)(B) so that it will read:

> (B) The term does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed or variable sum of money either in a lump sum or periodically for life or other specified period.

Section 102(28)(C) includes the exception from RUSA to the 1956 definition for "an interest in a contributory or noncontributory pension or welfare plan subject to the Employee Retirement

Income Security Act of 1974."

Section 102(28)(D), is based, in part, on the leading case of SEC v. Glenn W. Turner Enter., Inc., 474 F.2d 476, 482 n.7 (9th Cir. 1973), *cert. denied*, 419 U.S. 900 (1974).

Section 102(28)(E) is consistent with state and federal securities laws which have recognized interests in limited liability companies and limited partnerships in some circumstances as "securities," see 2 Louis Loss & Joel Seligman, Securities Regulation 1028-1031 (3d ed. rev. 1999), when consistent with the court decisions interpreting the investment contract concept, see, e.g., SEC v. W.J. Howey Co., 328 U.S. 293 (1946). This Act also refers to an investment in a viatical settlement or a similar agreement to make unequivocally clear that viatical settlement and similar agreements, which otherwise satisfy the definition of an investment contract, are securities. This term is intended to reject the holding that a viatical contract could not be a security. See SEC v. Life Partners Inc., 87 F.3d 536 (D.C. Cir. 1996), *reh'g denied*, 102 F.3d 587 (D.C. Cir. 1996).

Judicial construction of the term "investment contract" has been the most frequently litigated issue concerning the term "security." See Gabaldon, A Sense of Security: An Empirical Study, 25 J. Corp. L. 307 (2000), explaining that there had been 792 cases decided to that date in which the definition of a security played a prominent role. Id. at 308. Some 461 of the 792 cases (58 percent) concerned investment contracts. Id. at 322.

30. Section 102(29): Self-regulatory organization: Prior Provision: RUSA Section 101(17). This definition was added by RUSA and is based on a counterpart provision in the Federal Securities Code. At the current time national securities exchanges are registered under Section 6 of the Securities Exchange Act of 1934; national securities associations under Section 15A; clearing agencies are registered under Section 17A; and the Municipal Securities Rulemaking Board under Section 15B.

31. Section 102(30): Sign: No prior provision. This definition is intended to facilitate electronic signatures, to the extent permitted by Section 104.

32. Section 102(31): State: Prior Provisions: 1956 Act Section 401(m); RUSA Section 101(18). This is the standard definition used by the National Conference of Commissioners on Uniform State Laws. It does include territories and possessions of the United States, as well as the District of Columbia and Puerto Rico, but does not include foreign governments, their territories, or their possessions.

SECTION 103. REFERENCES TO FEDERAL STATUTES. "Securities Act of 1933" (15 U.S.C. Section 77a et seq.), "Securities Exchange Act of 1934" (15 U.S.C. Section 78a et

seq.), "Public Utility Holding Company Act of 1935,"(15 U.S.C. Section 79 et seq.), "Investment Company Act of 1940" (15 U.S.C. Section 80a-1 et seq.), "Investment Advisers Act of 1940" (15 U.S.C. Section 80b-1 et seq.), "Employee Retirement Income Security Act of 1974," (29 U.S.C. Section 1001 et seq.) "National Housing Act," (12 U.S.C. Section 1701 et seq.), "Commodity Exchange Act" (7 U.S.C. Section 1 et seq.), "Internal Revenue Code" (26 U.S.C. Section 1 et seq.); Securities Investor Protection Act of 1970 (15 U.S.C. Section 78aaa et seq.); Securities Litigation Uniform Standards Act of 1998 (112 Stat. 3227); "Small Business Investment Act of 1958" (15 U.S.C. Section 661 et seq.); and "Electronic Signatures in Global and National Commerce Act," (15 U.S.C. Section 7001 et seq.), mean those statutes and the rules and regulations adopted under those statutes, as in effect on the date of enactment of this [Act], [or as later amended].

Proposed Comments

Prior Provisions: 1956 Act Section 401(k); RUSA Section 101(15).

1. There are a large number of references to other laws in this Act, particularly to the federal securities laws identified in Section 103, and to rules adopted by the Securities and Exchange Commission under those laws. One of the main objectives of this Act is to take account of those provisions in the federal laws that are preemptive, and to coordinate with other, nonpreemptive provisions of the federal laws where coordination between federal and state securities law is in the public interest.

2. Section 12(d) of the Uniform Statute and Rule Construction Act, adopted by NCCUSL in 1995, provides: "A statute or rule that incorporates by reference a statute or rule of another jurisdiction does not incorporate a later enactment or adoption or amendment of the other statute or rule." Nevertheless, it is not uncommon for States to permit later amendments to statutes and rules referenced in enacted legislation to become automatically effective. In those states the final bracketed language in this Section should be included in the Act.

3. In those states which do not permit automatic effectiveness of later amendments and that follow Section 12(d) of the Uniform Statute and Rule Construction Act, this problem has been addressed by either giving the administrator the power to update by rule or the duty to notify the legislature when amendment is necessary. When the legislature notification approach is adopted,

to prevent a gap period, the administrator might be given the power to act by rule until the legislature has acted.

4. After enactment, amendments to a preemptive federal statute, to an amendment of such a statute that maintains the preemption, to rules adopted by a federal agency under a preemptive provision of a federal statute, or to amendments to such rules should be enforced in all states under the Supremacy Clause of the United States Constitution. A number of such references are in this Act.

SECTION 104. ELECTRONIC RECORDS AND SIGNATURES. This [Act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, but does not modify, limit, or supersede Section 101(c) of that act (15 U.S.C. Section 7001(c)) or authorize electronic delivery of any of the notices described in Section 103(b) of that act (15 U.S.C. Section 7003(b)). This [Act] authorizes the filing of records and signatures, when specified by provisions of this [Act] or by a rule or order under this [Act], in a manner consistent with 15 U.S.C. Section 7004(a).

Proposed Comments

No Prior Provision. The purpose of this Section is to permit the filing of electronic signatures and electronic records.

ARTICLE 2

EXEMPTIONS FROM REGISTRATION OF SECURITIES

Proposed Comments

Section 201 includes exempt securities and Section 202 includes exempt transactions. Both exempt securities and exempt transactions are exempt from the securities registration, notice filing requirement of Section 302, and the filing of sales literature sections of this Act. Neither Section 201 nor Section 202 provides an exemption from the Act's antifraud provisions in Article 5, nor the broker-dealer, agent, investment adviser, or investment adviser registration requirements in Article 4.

A Section 201 exempt security retains its exemption when initially issued and in subsequent trading.

A Section 202 transaction exemption must be established before each transaction.

Neither the exempt security nor the transaction exemptions are meant to be mutually exclusive. A security or transaction may qualify for two or more of these exemptions.

Article 2 is not available to any security, transaction, or offer that, although in technical compliance with a specific section in Article 2, is part of an unlawful plan or scheme to evade the registration provisions of Article 3. In such cases registration is required. Cf. Prelim. Note 6 to Regulation D adopted under the Securities Act of 1933.

SECTION 201. EXEMPT SECURITIES. The following securities are exempt from the requirements of Sections 301 through 306 and 504:

(1) ~~[United States government and municipal securities.]~~ A security, including a revenue obligation or a separate security as defined in Rule 131 adopted under the Securities Act of 1933, issued, insured, or guaranteed by the United States; by a State; by a political subdivision of a State; by a public authority, agency, or instrumentality of one or more states; by a political subdivision of one or more states; or by a person controlled or supervised by and acting as an

instrumentality of the United States under authority granted by the Congress; or a certificate of deposit for any of the foregoing;

(2) ~~[Foreign government securities.]~~ a security issued, insured, or guaranteed by a foreign government with which the United States maintains diplomatic relations, or any of its political subdivisions, if the security is recognized as a valid obligation by the issuer, insurer, or guarantor;

(3) ~~[Depository institution and international banking institution securities.]~~ a security issued by and representing, or that will represent an interest in or a direct obligation of, or be guaranteed by:

(A) an international banking institution;

(B) (i) a banking institution organized under the laws of the United States; (ii) a member bank of the Federal Reserve System; or (iii) a depository institution a substantial portion of the business of which consists or will consist of either receiving deposits or share accounts that are insured by the Federal Deposit Insurance Corporation, the National Credit Union Share Insurance Fund, or a successor authorized by federal law or exercising fiduciary powers that are similar to those permitted for national banks under the authority of the Comptroller of Currency pursuant to the first Section of Public Law 87-722 (12 U.S.C. Section 92a); or

(C) any other depository institution, unless by rule or order the administrator proceeds under Section 204;

(4) ~~[Insurance company securities.]~~ a security issued by and representing an interest in, or a debt of, or insured or guaranteed by, an insurance company authorized to do business in this State;

(5) ~~[Common carrier and public utility securities.]~~ a security issued or guaranteed by a

railroad, other common carrier, public utility, or public utility holding company that is:

(A) regulated in respect to its rates and charges by the United States or a State;

(B) regulated in respect to the issuance or guarantee of the security by the United States, a State, Canada, or a Canadian province or territory; or

(C) a public utility holding company registered under the Public Utility Holding Company Act of 1935 or a subsidiary of such a registered holding company within the meaning of that Act;

(6) ~~[Certain options and rights.]~~ a federal covered security specified in Section 18(b)(1) of the Securities Act of 1933 (15 U.S.C. Section 77r(b)(1)) or by rule adopted under that provision or a security listed or approved for listing on another appropriate securities market specified by rule under this [Act]; a put or a call option contract, warrant, a subscription right on or with respect to such securities; or an option or similar derivative security on a security or an index of securities or foreign currencies issued by a clearing agency registered under the Securities Exchange Act of 1934 and listed or designated for trading on a national securities exchange, a facility of a national securities exchange, or a facility of a national securities association registered under the Securities Exchange Act of 1934 or an offer or sale of the underlying security in connection with the offer, sale or exercise of an option or other security that was exempt under this Section when the option or other security was written or issued. For purposes of this paragraph, a derivative security is similar to an option if it has been designated by the Securities and Exchange Commission under Section 9(b) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78i(b));

(7) ~~[Nonprofit organization securities.]~~ a security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, social, athletic, or

reformatory purposes or as a chamber of commerce and not for pecuniary profit, no part of the net earnings of which inures to the benefit of a private stockholder or other person, or a security of a company that is excluded from the definition of an investment company under Section 3(c)(10)(B) of the Investment Company Act of 1940 (15 U.S.C. Section 80b-3(c)(10)(B)); with respect to the offer or sale of a note, bond, debenture or other evidence of indebtedness, a rule under this [Act] may limit the availability of this exemption by classifying securities, persons and transactions and adopting different requirements for different classes; such a rule may require an issuer

(A) to file a notice specifying the material terms of the proposed offer or sale and copies of any proposed sales and advertising literature to be used and provide that the exemption becomes effective if the administrator does not disallow the exemption within the time period established by the rule;

(B) to file a request for exemption authorization for which a rule under this [Act] may specify the scope of the exemption; the requirement of an offering statement; the filing of sales and advertising materials; the filing of consent to service of process; and grounds for denial or suspension of the exemption; or

(C) to register under Section 304.

(8) ~~[Cooperatives.]~~ a member's or owner's interest in, or a retention certificate or like security given in lieu of a cash patronage dividend issued by, a cooperative organized and operated as a nonprofit membership cooperative under the cooperative laws of a State, but not a member's or owner's interest, retention certificate, or like security sold to persons other than bona fide members of the cooperative; and

(9) ~~[Equipment trust certificates.]~~ an equipment trust certificate in respect to equipment

leased or conditionally sold to a person, if any security issued by the person would be exempt under this section or would be a federal covered security under Section 18(b)(1) of the Securities Act of 1933 (15 U.S.C. Section 77r(b)(1)).

Proposed Comments

Prior Provisions: 1956 Act Section 402(a); RUSA Section 401(b).

1. Section 201(1): United States government and municipal securities: Prior Provisions: 1956 Act Section 402(a)(1); RUSA Section 401(b)(1). This exemption generally follows the 1956 Act except that it adds securities "insured" by specified government to those "issued" or "guaranteed." RUSA, in contrast, also addressed foreign governments, which in this Act are treated separately in Section 201(2). Rule 131 issued under the Securities Act of 1933 defines securities issued under governmental obligations. Separate security means a separate security used by another person and included for no additional consideration.

2. Section 201(2): Foreign government securities: Prior Provisions: 1956 Act Section 402(a)(2); RUSA Section 401(b)(2). The 1956 Act, as amended, and RUSA both reached foreign governments as specified in Section 201(2) and separately treated "a security issued, insured, or guaranteed by Canada, a Canadian province or territory, a political subdivision of Canada or a Canadian province or territory, an agency or corporate or other instrumentality of one or more of the foregoing." The separate treatment of Canadian securities is largely redundant and has been eliminated from this Section.

3. Section 201(3): Depository institution and international banking institution securities: Prior Provision: RUSA 401(b)(3). Section 402(a)(3) of the 1956 Act exempts specified bank and similar depository institutions; Section 402(a)(4) exempts specified savings and loan and similar thrift institution securities; and Section 402(a)(6) exempts specified credit union securities. RUSA Section 401(b)(3) combines the three types of depository institutions into a common definition (see RUSA Section 101(13)) which are adopted here as Sections 102(3) and 102(5)) and a common exemption (see RUSA Section 401(b)(3)) which is adopted in this subsection.

Banks specified in Section 3(a)(2) of the Securities Act of 1933 issue federal covered securities under Section 18(b)(4)(C) of the Securities Act of 1933.

4. Section 201(4): Insurance company securities: Prior Provisions: 1956 Act Section 402(a)(5); RUSA Section 401(b)(4). The issuance, insurance, or guarantee of securities by an insurance company is extensively regulated by state insurance commissions or other state agencies.

Under this Act insurance, endowment policies, or annuity contracts under which an insurance

company promises to pay fixed sums are excluded from the definition of a security in Section 102(28)(B).

A variable annuity or other variable insurance product would be considered a security under this Act and under federal securities law. See SEC v. Variable Annuity Life Ins. Co. of Am., 359 U.S. 65 (1959); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967).

A variable annuity or other variable insurance product issued by an investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 would be a "federal covered security," see Section 102(7). See Lander v. Hartford Life & Annuity Ins. Co., 251 F.3d 101 (2d Cir. 2001).

A variable annuity or other variable insurance product not issued by a registered investment company would be exempted by Section 201(4), but would be subject to the antifraud provisions in Article 5.

5. Section 201(5): Common carrier and public utility securities: Prior Provisions: 1956 Act Section 401(a)(7); RUSA Section 401(b)(5). Both the 1956 Act and RUSA include references, omitted here, to the Interstate Commerce Commission, whose enabling legislation subsequently was repealed. Public utility holding companies covered by this exemption are subject both to the Public Utility Holding Company Act and to state utility regulation.

6. Section 201(6): Certain options and rights: No Prior Provision. The 1956 Act Section 402(a)(8) provided an exemption for securities listed on the New York, American, Midwest (now Chicago), or other designated stock exchanges, senior or substantially equal securities of the same issuer listed on the exchange and any security covered by listed or approved subscription rights or warrants, or any warrant or right to purchase or subscribe to any security exempted by Section 402(a)(8).

RUSA essentially retained this exemption in Section 401(b)(7) and added securities designated for inclusion in the National Market System by the National Association of Securities Dealers in Section 401(b)(8) and specified options issued by a clearing agency registered under the Securities Exchange Act of 1934 in Section 401(b)(9).

In 1996 Congress enacted the National Securities Markets Improvement Act and provided in Section 18(b)(1) that securities listed on the New York, American or Nasdaq Stock Exchange, or designated by rule of the Securities and Exchange Commission, as well as any security of the same issuer that is equal in seniority or senior to any of these securities will be a federal covered security. Under Rule 146 the SEC has designated as federal covered securities under Section 18(b)(1) Tier I of the Pacific Exchange; Tier I of the Philadelphia Stock Exchange; and The Chicago Board Options Exchange on condition that the relevant listing standards continue to be substantially similar to those of the New York, American, or Nasdaq stock exchanges. See Reporter's Note to Section 102(7). A federal covered security subject to Section 18(b)(1) of the

Securities Act of 1933 will not be subject to the securities registration requirements of Sections 301 and 303 through 306.

The exemption in Section 201(6) addresses specified options, warrants, and rights that are not federal covered securities under Section 18(b)(1) of the Securities Act of 1933, but generally would have been exempted under RUSA. The 1956 Act, which was narrower, was drafted before the computerized Nasdaq stock market began trading the National Market List and the development of standardized options markets.

The final clause of Section 201(6) makes clear that any offer or sale of the underlying security that occurs as a result of the offer or sale of an option or other derivative security exempted under this provision or as the result of the exercise of the option or other derivative security, is covered by the exemption if the option met the terms of the exemption at the time such derivative security was written (that is, sold) or issued. The sale of the underlying security when an option is exercised would be exempt even if the underlying security is not at that time subject to any exemption under the Act. This is consistent with existing precedent under federal law suggesting that the legality of the sale of an underlying security when exercised an option should be determined by the status of the security at the time the option was written rather than at the time of exercise. See, e.g., H. Kook & Co., Inc. v. Scheinman, Hochstin & Trotta, Inc., 414 F.2d 93 (2d Cir. 1969). Any transaction in an underlying security that results from the offer, sale, or exercise of any derivative security issued by a registered clearing agency and traded on a national securities exchange or association is exempt if the derivative security when written was exempt under Section 201(6).

The Securities and Exchange Commission has adopted Rule 9b-1 under Section 9(b).

7. Section 201(7): Nonprofit organization securities: Prior Provision: Section 3(a)(4) of the Securities Act of 1933. Section 402(a)(9) of the 1956 Act and Section 401(b)(10) of RUSA exempt specified nonprofit securities. Both are modeled on Section 3(a)(4) of the Securities Act, which was subsequently amended.

Securities issued under Section 3(a)(4) are not treated as federal covered securities in Section 18(b)(4)(C), although a separate Section 3(a)(13) exemption which addresses certain church plan securities is a federal covered security under Section 18(b)(4)(C).

RUSA included an optional notice and review requirement for nonprofit securities in Section 401(b)(10) "if at least ten days before a sale of the security the person has filed with the administrator a notice setting forth the material terms of the proposed sale and copies of any sales and advertising literature to be used and the administrator by order does not disallow the exemption within the next five full business days."

This exemption is of particular concern to state securities administrators. See, e.g., State Regulators Announce Dramatic Rise in Religious Scams; Tens of Thousands Lured, 33 Sec. Reg.

& L. Rep. (BNA) 1189 (2001).

Under Section 6 of the Philanthropy Protection Act, Congress preempted application of the registration provisions of state securities laws to issuance of securities covered by Section 3(c)(10) of the Investment Company Act of 1940 unless states acted within three years of enactment (December 1998) to pass special state legislation cancelling federal preemption. Ten states enacted such legislation. Those states may preserve this treatment of Section 3(c)(10) securities by deleting from Section 201(7) the phrase "or a security of a company that is excluded from the definition of an investment company under Section 3(c)(10) of the Investment Company Act of 1940."

Section 201(7) provides statutory authority for the states to adopt rules with respect to notes, bonds, debentures and other evidences of indebtedness issued by nonprofit organizations. Each state may adopt different rules tailored for various types of nonprofit debt offerings, (e.g., local church bond offerings, national church bond offerings, church extension funds, charitable gift annuities). For states that do not wish to provide an automatic exemption from registration for a particular type of nonprofit debt instrument or offering, Section 201(7) creates three categories of regulatory review that may be required by rule: (a) exemption by notice filing, (b) exemption by state authorization, and (c) registration by qualification. These categories are consistent with the manner in which many states currently review different types of nonprofit debt securities. See Horner & Makens, Securities Regulation of Religious and Other Nonprofit Organizations, 27 Stetson L. Rev. 473 (1997).

6. Section 201(8): Cooperatives: Prior Provision: RUSA Section 401(b)(13). Section 201(8) is derived from RUSA Section 401(b)(13) which was included in that Act after a number of states had adopted exemptions for securities issued by cooperatives. Section 201(8) is not intended to be available if securities are traded to the public generally.

The 1956 Act Section 402(a)(12) had instead provided: "insert any desired exemption for cooperatives." The Reporter of the 1956 Act had found such sharp variation among the 18 states that then had adopted a cooperative exemption that "no common pattern can be found." Louis Loss, Commentary on the Uniform Securities Act 118 (1976).

7. Section 201(9): Equipment trust certificates: Prior Provision: RUSA Section 401(b)(6). The Securities Act of 1933 Section 3(a)(6) includes a narrower exemption for railroad equipment trusts. Section 201(9) follows RUSA. The Official Comment to RUSA Section 401(b)(6) explained:

> The new paragraph (b)(6) reflects the extensive development of equipment lease financing through leveraged leases, conditional sales, and other devices. The underlying premise is that if the securities of the person using such a financing device would be exempt under some other paragraph of Section 401, the equipment trust certificate or other security issued to acquire the property in question also is exempt.

SECTION 202. EXEMPT TRANSACTIONS. The following transactions are exempt from the requirements of Sections 301 through 306 and 504:

(1) ~~[Isolated nonissuer transactions.]~~ an isolated nonissuer transaction, whether effected by or through a broker-dealer or not;

(2) ~~[Nonissuer transactions in specified outstanding securities.]~~ a nonissuer transaction by or through a broker-dealer registered, or exempt from registration under this [Act], and a resale transaction by a sponsor of a unit investment trust registered under the Investment Company Act of 1940, in a security of a class that has been outstanding in the hands of the public for at least 90 days; if, at the date of the transaction:

(A) the issuer of the security is engaged in business, the issuer is not in the organizational stage or in bankruptcy or receivership, and the issuer is not a blank check, blind pool, or shell company whose primary plan of business is to engage in a merger or combination of the business with, or an acquisition of, an unidentified person;

(B) the security is sold at a price reasonably related to its current market price;

(C) the security does not constitute the whole or part of an unsold allotment to, or a subscription or participation by, the broker-dealer as an underwriter of the security or a redistribution; and

(D) a nationally recognized securities manual or its electronic equivalent designated by rule or order under this [Act] or a record filed with the Securities and Exchange Commission that is publicly available contains:

(i) a description of the business and operations of the issuer;

(ii) the names of the issuer's executive officers and the names of the issuer's directors, if any;

(iii) an audited balance sheet of the issuer as of a date within 18 months of the date of the transaction or, in the case of a reorganization or merger, and when the parties to the reorganization or merger each had an audited balance sheet, a pro forma balance sheet for the combined entity;

(iv) an audited income statement for each of the issuer's two immediately previous fiscal years or for the period of existence of the issuer, whichever is shorter, or, in the case of a reorganization or merger when each party to the reorganization or merger had audited income statements, a pro forma income statement; or

(E) the issuer of the security has a class of equity securities listed on a national securities exchange registered under the Securities Exchange Act of 1934, or designated for trading on the National Association of Securities Dealers Automated Quotation System, unless the issuer of the security is a unit investment trust registered under the Investment Company Act of 1940; or the issuer of the security, including its predecessors, has been engaged in continuous business for at least three years; or the issuer of the security has total assets of at least $2,000,000 based on an audited balance sheet as of a date within 18 months of the time of the transaction or, in the case of a reorganization or merger when the parties to the reorganization or merger each had the audited balance sheet, a pro forma balance sheet for the combined entity;

(3) ~~[Nonissuer transactions in specified foreign securities.]~~ a nonissuer transaction by or through a broker-dealer registered or exempt from registration under this [Act] in a security of a foreign issuer that is a margin security defined in regulations or rules adopted by the Board of

Governors of the Federal Reserve System;

(4) ~~[Nonissuer transactions in securities subject to Securities Exchange Act reporting.]~~ a nonissuer transaction by or through a broker-dealer registered or exempt from registration under this [Act] in an outstanding security if the guarantor of the security files reports with the Securities and Exchange Commission under the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d));

(5) ~~[Nonissuer transactions in specified fixed income securities.]~~ a nonissuer transaction by or through a broker-dealer registered or exempt from registration under this [Act] in a security that:

(A) is rated at the time of the transaction by a nationally recognized statistical rating organization in one of its four highest rating categories; or

(B) has a fixed maturity or a fixed interest or dividend, if:

(i) a default has not occurred during the current fiscal year or within the three previous fiscal years or during the existence of the issuer and any predecessor if less than three fiscal years, in the payment of principal, interest, or dividends on the security; and

(ii) the issuer is engaged in business, is not in the organizational stage or in bankruptcy or receivership, and is not and has not been within the previous 12 months a blank check, blind pool, or shell company whose primary plan of business is to engage in a merger or combination of the business with, or an acquisition of, an unidentified person;

(6) ~~[Unsolicited brokerage transactions.]~~ a nonissuer transaction by or through a broker-dealer registered or exempt from registration under this [Act] effecting an unsolicited order or offer to purchase;

(7) ~~[Nonissuer transactions by pledgees.]~~ a nonissuer transaction executed by a bona fide pledgee without any purpose of evading this [Act];

(8) ~~[Nonissuer transactions with federal covered investment advisers.]~~ a nonissuer transaction with a federal covered investment adviser with investments under management in excess of $100,000,000 acting in the exercise of discretionary authority in a signed record for the account of others;

(9) ~~[Nonissuer transactions involving specified foreign issuers securities traded on designated security exchanges.]~~ (a) a nonissuer transaction in an outstanding security by or through a broker-dealer registered or exempt from registration under this [Act], if:

(1) The issuer is a reporting issuer in a foreign jurisdiction designated in paragraph (b), or by rule or order of the administrator, and has been subject to continuous reporting requirements in the foreign jurisdiction for not less than 180 days before the transaction; and

(2) the security is listed on the foreign jurisdiction's securities exchange that has been designated in paragraph (b), or by rule or order under this [Act], or is a security of the same issuer that is of senior or substantially equal rank to the listed security or is a warrant or right to purchase or subscribe to any of the foregoing;

(b) for purposes of paragraph (a), Canada, together with its provinces and territories, is a designated foreign jurisdiction and The Toronto Stock Exchange, Inc. is a designated securities exchange;

(c) after an administrative hearing in compliance with applicable state law, the administrator, by rule or order under this [Act], may revoke the designation of a securities exchange under this subsection if the administrator finds that revocation is necessary or

appropriate in the public interest and for the protection of investors;

(10) ~~[Underwriter transactions.]~~ a transaction between the issuer or other person on whose behalf the offering is made and an underwriter, or among underwriters;

(11) ~~[Unit secured transactions.]~~ a transaction in a note, bond, debenture, or other evidence of indebtedness secured by a mortgage or other security agreement if:

(A) the note, bond, debenture, or other evidence of indebtedness is offered and sold with a mortgage or other security agreement as a unit;

(B) a general solicitation or general advertisement of the transaction is not made; and

(C) a commission or other remuneration is not paid or given, directly or indirectly, to a person not registered under this [Act] as a broker-dealer or as an agent;

(12) ~~[Bankruptcy, guardian, or conservator transactions.]~~ a transaction by an executor, administrator of an estate, sheriff, marshal, receiver, trustee in bankruptcy, guardian, or conservator;

(13) ~~[Transactions with specified investors.]~~ a sale or offer to sell to:

(A) an institutional investor;

(B) a federal covered investment adviser; or

(C) any other person exempted by rule or order under this [Act];

(14) ~~[Limited offering transactions.]~~ a sale or an offer to sell securities of an issuer, if part of a single issue in which:

(A) there are not more than 25 purchasers in this State during any 12 consecutive months, other than those designated in paragraph (13);

(B) there is no general solicitation or general advertising used in connection with the

offer to sell or sale of the securities;

(C) a commission or other remuneration is not paid or given, directly or indirectly, to a person other than a broker-dealer registered under this [Act] or an agent registered under this [Act] for soliciting a prospective purchaser in this State; and

(D) the issuer reasonably believes that all the purchasers in this State other than those designated in paragraph (13) are purchasing for investment;

(15) ~~[Transactions with existing security holders.]~~ a transaction under an offer to existing security holders of the issuer, including persons that at the date of the transaction are holders of convertible securities, options, or warrants, if a commission or other remuneration, other than a standby commission, is not paid or given, directly or indirectly, for soliciting a security holder in this State;

(16) ~~[Offerings when registered under this [Act] and the Securities Act of 1933.]~~ an offer to sell, but not a sale, of a security not exempt from registration under the Securities Act of 1933 if:

(A) a registration or offering statement or similar record as required under the Securities Act of 1933 has been filed, but is not effective, or the offer is made in compliance with Rule 165 adopted under the Securities Act of 1933; and

(B) a stop order of which the offeror is aware has not been issued against the offeror by the administrator or the Securities and Exchange Commission, and an audit, inspection, or proceeding that is public and may culminate in a stop order is not known by the offeror to be pending;

(17) ~~[Offerings when registration has been filed, but is not effective under this [Act] and~~

~~exempt from the Securities Act of 1933.]~~ an offer to sell, but not a sale, of a security exempt from registration under the Securities Act of 1933 if:

(A) a registration statement has been filed under this [Act], but is not effective;

(B) a solicitation of interest is provided in a record to offerees in compliance with a rule adopted by the administrator under this [Act]; and

(C) a stop order of which the offeror is aware has not been issued by the administrator under this [Act], and an audit, inspection, or proceeding that may culminate in a stop order is not known by the offeror to be pending;

(18) ~~[Control transactions.]~~ a transaction involving the distribution of the securities of an issuer to the security holders of another person in connection with a merger, consolidation, exchange of securities, sale of assets, or other reorganization to which the issuer, or its parent or subsidiary, and the other person, or its parent or subsidiary, are parties;

(19) ~~[Rescission offers.]~~ a rescission offer, sale, or purchase under Section 510;

(20) ~~[Out-of-state offers or sales]~~ an offer or sale of a security to a person not resident in this State and not present in this State if the offer or sale does not constitute a violation of the laws of the state or foreign jurisdiction in which the offeree or purchaser is present and is not part of an unlawful plan or scheme to evade this [Act];

(21) ~~[Employee benefit plans.]~~ an offer or sale of a security pursuant to an employees' stock purchase, savings, option, profit-sharing, pension, or similar employees' benefit plan, including any securities, plan interests, and guarantees issued under a compensatory benefit plan or compensation contract, contained in a record, established by the issuer, its parents, its majority-owned subsidiaries, or the majority-owned subsidiaries of the issuer's parent for the participation

of their employees including:

(A) offers or sales of such securities to directors, general partners, trustees (if the issuer is a business trust), officers, or consultants and advisors;

(B) family members who acquire such securities from those persons through gifts or domestic relations orders;

(C) former employees, directors, general partners, trustees, officers, consultants and advisors if those individuals were employed by or providing services to the issuer when the securities were offered; and

(D) insurance agents who are exclusive insurance agents of the issuer, its subsidiaries or parents, or derive more than 50% of their annual income from those organizations;

(22) ~~[Specified dividends and distributions and judicially approved reorganizations.]~~ a transaction involving:

(A) a stock dividend or equivalent equity distribution, whether the corporation or other business organization distributing the dividend or equivalent equity distribution is the issuer or not, if nothing of value is given by stockholders or other equity holders for the dividend or equivalent equity distribution other than the surrender of a right to a cash or property dividend if each stockholder or other equity holder may elect to take the dividend or equivalent equity distribution in cash, property, or stock;

(B) an act incident to a judicially approved reorganization in which a security is issued in exchange for one or more outstanding securities, claims, or property interests, or partly in such exchange and partly for cash; or

(C) the solicitation of tenders of securities by an offeror in a tender offer in compliance

with Rule 162 adopted under the Securities Act of 1933; or

(23) ~~[Specified exchange transactions.]~~ a transaction in a security, whether or not the security or transaction is otherwise exempt, in exchange for one or more bona fide outstanding securities, claims, or property interests, or partly in such exchange and partly for cash, if the terms and conditions of the issuance and exchange or the delivery and exchange and the fairness of the terms and conditions have been approved by the administrator at a hearing.

Proposed Comments

Prior Provisions: 1956 Act Section 402(b); RUSA Section 402.

1. Sections 202(1)-(9) are available only for nonissuer transactions. An issuer selling securities in an initial public offering or other offering may not rely on Sections 202(1)-(9). A nonissuer, however, can rely on an applicable issuer transaction exemption such as Section 202(13). The term "nonissuer transaction or nonissuer distribution" is defined in Section 102(18); the term "issuer" is defined in Section 102(17).

2. Section 202(1): Isolated nonissuer transactions: Prior Provisions: 1956 Act Section 402(b)(1); RUSA Section 402(1). The term "isolated transaction" is not defined in this Act, but left to the states to develop. Historically under state law there has been somewhat varied case law development of the term "isolated transactions." See, e.g., Blinder, Robinson & Co., Inc. v. Goettsch, 403 N.W.2d 772 (Iowa 1987) (isolated nonissuer transaction exemption is not unconstitutionally vague); Allen v. Schauf, 449 P.2d 1010 (Kan. 1969) (regulation defined isolated transactions to not exceed four persons solicited in a 12 month period); Nelson v. State, 355 P.2d 413, 420 (Okla. Ct. Crim. App. 1960) ("[a]n isolated sale means one standing alone, disconnected from any other"); see generally 1 Louis Loss & Joel Seligman, Securities Regulation 125-130 (3d ed. rev. 1998).

In general this subsection is intended to cover the occasional sale by a person. It would not exempt multiple or successive transactions by a person or group, whether those sales and sufficient to constitute a "distribution" as that term is used for purposes of the federal securities laws, see 2 Louis Loss & Joel Seligman, Securities Regulation 1138.50-1138.52 (3d ed. rev. 1999), or merely too frequent to be considered "isolated" under the relevant state law.

Limited issuer offering transactions are separately addressed in Section 202(14).

3. Section 202(2): Nonissuer transactions in specified outstanding securities: Prior Provisions: 1956 Act Section 402(b)(2); RUSA Sections 402(3)-(4). This Section represents a

modernization of the securities manual exemption which was included in both the 1956 Act and RUSA. NASAA recommended an amendment to the 1956 Act Section 402(b) after discussion with the Securities Industry Association and others in the securities industry. This Section generally follows the NASAA amendment.

Rule 419 issued under the Securities Act of 1933 defines a "blank check company" to be a company that "is a development state company that has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person. A "blind pool" is similar and would involve an investment in a blank check or other entity with no identified business plan or purpose. A "shell company" is also similar and would involve an entity which, to date, has no significant business assets, plan, or purpose.

4. Section 202(3): Nonissuer transactions in specified foreign transactions: No Prior Provision. The NASAA recommendation that was the basis of Section 202(2) also included specified foreign nonissuer transactions subject to a manual exemption when there was disclosure of the issuer's officers and directors in the issuer's country of domicile. This subsection uses margin securities as an alternative approach to identify sufficiently seasoned foreign securities. Margin securities are required to be in compliance with Regulation T which was adopted by the Board of Governors of the Federal Reserve System.

5. Section 202(4): Nonissuer transactions in securities subject to Securities Exchange Act reporting: Prior Provision: RUSA Section 402(2). RUSA added this exemption to authorize nonissuer secondary trading in the securities of issuers that were subject to the periodic reporting requirements of the Securities Exchange Act of 1934. To bar immediate secondary trading in nonregistered initial public offerings, there was a further requirement that these securities be subject to the reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934 for not less than 90 days. Section 202(4) only covers the guarantor because if the issuer of the security is a reporting company under Sections 13 or 15(d) of the Securities Exchange Act of 1934, the transaction is preempted by Section 18(b)(4)(A) of the Securities Act of 1933.

Section 18(b)(4)(A) of the National Securities Markets Improvement Act of 1996 defines nonissuer transactions under Section 4(1) of the Securities Act of 1933 ("transactions by persons other than an issuer, underwriter, or dealer") as "federal covered securities," see Section 102(7), if the issuer files reports with the Securities and Exchange Commission under Sections 13 or 15(d) of the Securities Exchange Act of 1934. Under Section 18(a) of the Securities Act of 1933 no state statute, rule, order, or other administrative action with respect to registration of securities or reporting requirements may apply to a federal covered security. To harmonize Section 202(4) with Sections 18(a) and 18(b)(4)(A) of the Securities Act of 1933, the 90 day reporting period in RUSA Section 402(2) was not adopted.

6. Section 202(5): Nonissuer transactions in specified fixed income securities: Prior Provisions: 1956 Act Section 402(b)(2)(B); RUSA Section 402(4). The concept of a fixed

income security rated by a nationally recognized statistical rating organization in one of its four highest rating categories described in Section 202(5)(A) is well established in federal securities law in such applications as Form S-3 adopted under the Securities Act of 1933 and the net capital Rule 15c3-1(c)(2)(vi)(F) adopted under the Securities Exchange Act of 1934. See 2 Louis Loss & Joel Seligman, Securities Regulation 649-653 (3d ed. rev. 1999). Nationally recognized statistical rating organizations have been identified by the Securities and Exchange Commission and include such organizations as Moody's or Standard and Poor. Rating categories typically begin with AAA and under this Act would include BBB as the fourth highest rating category.

Section 202(5)(B) follows the 1956 Act and RUSA, but also addresses blank check and similar offerings, which became major concerns at the state and federal levels during the past two decades. Cf. Securities Act of 1933 Rule 419. See Official Comment (3).

This subsection includes both debt securities with fixed maturity or a fixed interest rate and preferred stock with fixed dividend provisions.

7. Section 202(6): Unsolicited brokerage transactions: Prior Provisions: 1956 Act Section 402(b)(3); RUSA Section 402(5). Section 18(b)(4)(B) of the Securities Act of 1933 defines transactions as federal covered securities when they are subject to Section 4(4) of the Securities Act of 1933 "brokerage transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders." Section 202(6) is intended to provide exemption for nonagency transactions by dealers not within the scope of Section 4(4).

The 1956 Act Section 402(b)(3) had provided that the administrator "may by rule require that the customer acknowledge upon a specified form that the same was unsolicited, and that a signed copy of each such form be preserved by the broker-dealer for a specified period." This type of requirement is preempted by Section 18(a) of the Securities Act of 1933 for federal covered securities and is viewed as unnecessary for the limited class of dealer nonagency transactions that will be exempted by Section 202(6).

8. Section 202(7): Nonissuer transactions by pledgees: Prior Provisions: 1956 Act Section 402(b)(7); RUSA Section 402(9). This subsection is identical to the 1956 Act and substantively identical to RUSA.

9. Section 202(8): Nonissuer transactions with federal covered investment advisers: Comment to be written.

10. Section 202(9): Nonissuer transactions involving specified foreign issuer securities traded on designated securities exchanges. Comment to be written.

11. Section 202(10): Underwriter transactions: Prior Provisions: 1956 Act Section 402(b)(4); RUSA Section 402(6). This subsection is substantively identical to the 1956 Act and RUSA.

12. Section 202(11): Unit secured transactions: Prior Provisions: 1956 Act Section 402(b)(5); RUSA Section 402(7). In recent years this exemption has been one of concern to state securities administrators. The conditions that conclude this exemption are new and are intended to address these concerns.

13. Section 202(12): Bankruptcy, guardian, or conservator transactions: Prior Provisions: 1956 Act Section 402(b)(6); RUSA Section 402(8). This subsection is identical to that in the 1956 Act and RUSA.

14. Section 202(13): Transactions with specified investors: Prior Provisions: 1956 Act Section 402(b)(8). The 1956 Act contains similar but less inclusive language in Section 402(b)(8). If the SEC adopts a rule defining "qualified purchaser" as used in Section 18(b)(3) of the Securities Act to specify certain purchasers of federal covered securities, part or all of this exemption will be redundant. As of July 2002, the Commission has proposed, but not adopted, Rule 146(c).

Section 202(13)(B) is limited to transactions for the account of a federal covered investment adviser and is not intended to reach transactions on behalf of others by such adviser.

15. Section 202(14): Limited offering transactions: Prior Provisions: 1956 Act Section 402(b)(9); USA Section 402(11). The reference in the prefatory language to "a single issue" signifies that two or more issues can be "integrated" and potentially destroy the exemption. There are two general tests for integration under the federal securities laws. First, there is a six month "buffer" before and after the issue during which no other issue can be distributed if integration automatically is to be avoided. See Rule 147(b)(2) and Rule 502(a) of the Securities Act of 1933. Second, if two issues occur within six months, integration may occur depending upon the following factors:

(i) are the offerings part of a single plan of financing;

(ii) do the offerings involve issuance of the same class of securities;

(iii) are the offerings made at or about the same time;

(iv) is the same type of consideration to be received; and

(v) are the offerings made for the same general purpose.

See generally 3 Louis Loss & Joel Seligman, Securities Regulation 1231-1248 (3d ed. rev. 1999).

Section 402(b)(9) of the 1956 Act and Section 402(11) of the 1985 Act provide alternative limited offering transaction exemptions. The 1956 Act was limited to offers to no more than ten persons (other than institutional investors specified in Section 402(b)(8)); all purchasers in the State had to purchase for investment; and no remuneration was given for soliciting prospective

purchasers in the State. RUSA, in contrast, was limited to no more than 25 purchasers (other than financial or institutional investors); no general solicitation or advertising; and no remuneration was paid to a person other than a broker-dealer for soliciting a prospective purchaser.

This Section would apply to preorganization limited offerings as well as operating company limited offerings. The Securities Act of 1933 Sections 3(b) and 4(2) also apply to both. In contrast, the 1956 Act Section 402(b)(10) and RUSA Section 402(12) used similar concepts in separate Sections to apply to preorganization limited offerings.

Section 18(b)(4)(D) of the Securities Act of 1933 defines as federal covered securities those issued under Securities and Exchange Commission rules under Section 4(2) of the Securities Act. This would include Rule 506, which uses the "accredited investor" definition in Rule 501(a). When a transaction involves Rule 506, Section 18(b)(4)(D) further provides "that this paragraph does not prohibit a state from imposing notice filing requirements that are substantially similar to those required by rule or regulation under Section 4(2) that are in effect on September 1, 1996." These notice requirements are found in Section 302(c) of this Act.

A majority of states have adopted a Uniform Limited Offering Exemption, coordinate to varying degrees with Regulation D. The authority to adopt this and other exemptive rules is provided in Section 203.

16. Section 202(15): Transactions with existing security holders: Prior Provisions: 1956 Act Section 402(b)(11); RUSA Section 402(14). Section 3(a)(9) of the Securities Act of 1933 exempts exchange offerings with existing security holders. Under Section 18(b)(4)(C) transactions subject to Section 3(a)(9) are federal covered securities. See Section 102(7). Notice requirements in the earlier 1956 Act and RUSA accordingly would be preempted by the Securities Act of 1933. See Section 18(a) of the Securities Act of 1933. Otherwise this exemption is substantively identical to the 1956 Act and RUSA.

17. Section 202(16): Offerings when registered under this [Act] and the Securities Act of 1933: Prior Provisions: 1956 Act Section 402(b)(12); RUSA Section 402(15). This exemption generally follows the 1956 Act and RUSA. Rule 165 of the Securities Act of 1933, which was adopted in 1999, allows the offeror of securities in a business combination to make written communications that offer securities for sale before a registration statement is filed as long as specified conditions are satisfied.

RUSA Section 402(15) also required that a registration statement be filed under this Act, but not yet be effective. By eliminating this filing requirement this exemption will reach the offer (but not the sale) of a security that is anticipated to be a federal covered security by applying for listing on the New York Stock Exchange or other exchange specified in Section 18(b)(1) of the Securities Act of 1933, but the listing and federal covered security status has not yet become effective.

18. Section 202(17): Offerings when registration has been filed, but is not effective under this

[Act] and exempt from the Securities Act of 1933: Prior Provisions: RUSA Section 402(16). A solicitation of interest document must accompany a registration by qualification as specified in Section 304(b)(13).

Oral offers may be made after a registration statement has been filed, both before and after a registration statement is effective.

This exemption does not operate unless the administrator adopts a rule under 202(17)(B).

19. Section 202(18): Control transactions: Prior Provision: RUSA Section 402(17). Until 1972 mergers and similar transactions were not considered to involve sales and did not have to register under the Securities Act of 1933. In 1972 the Securities and Exchange Commission adopted Rule 145 defining many mergers and similar transactions to be sales and abandoned its earlier "no sale" doctrine. See 3 Louis Loss & Joel Seligman, Securities Regulation 1262-1280 (3d ed. rev. 1999).

Because most merger and similar transactions require shareholder approval and shareholders often have appraisal rights if they choose to dissent, the potential for abuse is less than in an offering of securities for cash. When appropriate the administrator can deny, condition, limit or revoke this exemption under Section 204. Section 202(18) does not follow the requirement in RUSA Section 402(17) that written notice of the transactions and a copy of the solicitation materials be given to the administrator 10 days before the consummation of the transaction and, that the administrator is empowered to disallow the exemption within the next 10 days.

20. Section 202(19): Rescission offers: No Prior Provision. See Section 510 for discussion of rescission offers.

21. Section 202(20): Out-of-state offers or sales: Source of law: Colo. Section 11-51-102(7). Compare A.S. Goldmen & Co., Inc. v. New Jersey Bur. of Sec., 163 F.3d 780 (3d Cir. 1999), which held that under the United States Constitution's Commerce Clause a State could authorize a securities administrator to prevent a broker-dealer from selling securities from a State to purchasers in other States where purchase of the securities was authorized. The concluding phrase "and is not part of an unlawful plan or scheme to evade this [Act" is intended to preclude reliance on this exemption by boiler rooms and others engaged in illegal activities.

22. Section 202(21): Employee benefit plans: Prior Provision: RUSA Section 401(b)(12). The 1956 Act Section 402(a)(11) was limited to investment contracts issued in connection with specified employee benefit plans if the administrator was given 30 days written notice.

In 1979, the United States Supreme Court in International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979), held that a noncontributory, mandatory pension plan subject to the Employee Retirement Income Security Act of 1974 (ERISA) was not a security within the meaning of the Securities Act of 1933 or the Securities Exchange Act of 1934. The Securities and Exchange

Commission staff subsequently took the position that the interests of employees in involuntary, contributory plans are not securities. Sec. Ex. Act Rel. 6188, 19 SEC Dock. 465, 473 (1980). Both contributory and noncontributory pension or welfare plans subject to ERISA are excluded from the definition of security in Section 102(28).

In this definition, the term "advisors" does not mean "investment advisers," as defined in Section 102(15).

With respect to employee benefit plans that are securities, Section 202(21) provides an exemption, but follows RUSA in not limiting the exemption to investment contracts and not requiring 30 days notice to the administrator.

Section 202(21) is modeled, in part, on Rule 701(c) adopted under the Securities Act of 1933. Compliance with Rule 701 will provide compliance with this exemption.

Both the 1956 Act and RUSA, for unstated reasons, treated employee benefit plans as exempt securities, rather than exempt securities transactions. There appears to be no appropriate reason to do so. Resale of employee benefit plans can occur under all appropriate section 202 transaction exemptions. Section 202(21) is not intended to provide a new method of publicly issuing securities.

The administrator, when appropriate, can deny, condition, limit, or revoke an exemption under Section 202(21). See Section 204.

(22-23) Additional comments to be written about Section 202(22) and (23). Section 202(23) is based on Section 3(a)(10) of the Securities Act of 1933.

SECTION 203. ADDITIONAL EXEMPTIONS AND WAIVERS. A rule or order under this [Act] may exempt a security, transaction, or offer, or a rule under this [Act] may exempt a class of securities, transactions, or offers from any or all of the requirements of Sections 301 through 306 and 504, and, an order of the administrator under this [Act], may waive any or all of the conditions for an exemption or offers under Sections 201 and 202. The administrator may suspend an application or a rule or order under this [Act] and the administrator may revoke an exemption or waiver created under this Section, but may only do so prospectively.

Proposed Comments

Prior Provision: RUSA Section 403.

1. Under this type of authority, at least 49 of 53 jurisdictions through July 2001 had adopted the Uniform Limited Offering Exemption (ULOE) or a Regulation D exemption, and 31 jurisdictions had adopted a Rule 144A exemption. This Act does not incorporate ULOE or a Rule 144A exemption because of their complexity and the likelihood of periodic updating of their provisions. Rule 144A, and similar exemptions in ULOE, can be most effectively implemented by rule rather than statute.

2. Under Section 203 the states would also be authorized to adopt by rule or order new exemptions as circumstances warrant for new technologies such as the Internet. Cf. NASAA Resolution Regarding Securities Offered on Internet, NASAA Rep. ¶7040 (Jan. 7, 1996).

3. It is the intent of this Section that ULOE, Rule 144A, and additional exemptions or waivers be adopted uniformly by states, to the extent this is practicable.

SECTION 204. DENIAL, SUSPENSION, CONDITION OR LIMITATION OF EXEMPTIONS.

(a) **[Enforcement related powers.]** Except with respect to a federal covered security or a transaction involving a federal covered security, an order of the administrator may deny or suspend application of, condition or limit, an exemption created under Section 201(3)(C), 201(7), 201(8), or 202, or an exemption or waiver created under Section 203 with respect to a specific security, transaction, or offer. An order under this Section may only be issued pursuant to the procedures in 306(d) or 604 and may only be issued prospectively.

(b) **[Knowledge of order required.]** A person does not violate Section 301, 303 through 306, 504, or 510 by an offer to sell, offer to purchase, sale or purchase effected after the entry of an order issued under this Section if the person did not know, and in the exercise of reasonable care could not have known, of the order.

Proposed Comments

Prior Provisions: 1956 Act Section 402(c); RUSA Section 404.

1. Section 204 is potentially far reaching. The ability to deny, condition, limit, or revoke the exemptions specified in Sections 201(3)(C), 201(7), 201(8), 202, or 203 is adopted concomitant with the breadth of these exemptions. One or more than one security, transaction, or offer can be covered by a Section 204 order.

2. The courts have given a securities administrator decision to deny or revoke an exemption substantial deference when there was compliance with applicable due process and statutory requirements. See, e.g., Johnson-Bowles Co., Inc. v. Div. of Sec., 829 P.2d 101 (Utah Ct. App. 1992).

ARTICLE 3

REGISTRATION OF SECURITIES AND

NOTICE FILINGS OF FEDERAL COVERED SECURITIES

SECTION 301. SECURITIES REGISTRATION REQUIREMENT. It is unlawful for a person to offer or sell a security in this State unless:

(1) the security is a federal covered security;

(2) the security, transaction, or offer is exempted from registration under Sections 201 through 203; or

(3) the security is registered under this [Act].

Proposed Comments

Prior Provisions: 1956 Act Section 301; RUSA Section 301.

1. This Section is substantively identical to the 1956 Act and RUSA except for the addition of Section 301(1), which is necessitated by the National Securities Markets Improvement Act of 1996. See Section 102(7).

2. Except for federal covered securities or exempt securities, no sale of a security may be made in this State before the security is registered. "Sale" is defined in Section 102(26); "in this State" is addressed in Section 610; and securities registration is addressed in Sections 303 through 306.

3. The Securities Act of 1933 permits certain types of offers during the "waiting period" between the filing and effectiveness of a registration statement. The exemptive provisions of Sections 202(16)-(17) operate to permit similar offers for securities that are not federal covered securities and are in the process of registration under federal or state statutes or both.

4. Notice filings and fees applicable to federal covered securities, see Section 102(7), are addressed in Section 302.

SECTION 302. NOTICE FILINGS.

(a) **[Required filing of records.]** A rule or order under this [Act] may require the filing of any or all of the following records with respect to a security issued by an investment company that is a federal covered security as defined in Section 18(b)(2) of the Securities Act of 1933 (15 U.S.C. Section 77r(b)(2)), that is not otherwise exempt under Sections 201 through 203:

(1) before the initial offer of a federal covered security in this State, all records that are part of a federal registration statement filed with the Securities and Exchange Commission under the Securities Act of 1933 and a consent to service of process signed by the issuer [and a fee of $____];

(2) after the initial offer of the federal covered security in this State, all records that are part of an amendment to a federal registration statement filed with the Securities and Exchange Commission under the Securities Act of 1933; and

(3) to the extent necessary or appropriate to compute fees, a report of the value of the federal covered securities sold or offered to persons present in this State, if the sales data are not included in records filed with the Securities and Exchange Commission, [and a fee of $____].

(b) **[Notice filing effectiveness and renewal.]** A notice filing under subsection (a) is effective for one year commencing upon the later of the notice filing or the effectiveness of the offering filed with the Securities and Exchange Commission. On or before expiration, the issuer may renew a notice filing by filing a copy of those records filed by the issuer with the Securities and Exchange Commission that are required by rule or order under this [Act] to be filed [and a renewal fee of $ ___]. A previously filed consent to service of process may be incorporated by reference in a renewal. A renewed notice filing becomes effective upon the expiration of the filing

being renewed.

(c) **[Notice filings for federal covered securities under Section 18(b)(4)(D).]** With respect to any security that is a federal covered security under Section 18(b)(4)(D) of the Securities Act of 1933(15 U.S.C. Section 77r(b)(4)(D)), a rule under this [Act] may require a notice filing by or on behalf of an issuer to include a copy of Form D, including the Appendix, as promulgated by the Securities and Exchange Commission, and a consent to service of process signed by the issuer not later than 15 days after the first sale of the federal covered security in this State [and a fee of $____ ; and a fee of $___ for a late filing].

(d) **[Stop Orders.]** If the administrator finds that there is a failure to comply with a notice or fee requirement of this Section, the administrator may issue a stop order suspending the offer and sale of a federal covered security in this State, except a federal covered security under Section 18(b)(1) of the Securities Act of 1933 (15 U.S.C. Section 77r(b)(1)). If the deficiency is corrected, the stop order is void as of the time of its issuance and no other penalty may be imposed by the administrator.

Proposed Comments

No Prior Provision.

1. The little used "registration by notification" in the 1956 Act Section 302 or "registration by filing" in RUSA Section 302 are omitted from this Act because of the notice filing approach required by Section 18(b)(2) of the Securities Act of 1933 for federal covered securities, which, in essence, replaces the need for registration by notification.

2. For Rule 506 offerings which are addressed by Section 18(d)(4)(D) of the Securities Act of 1933, the Securities and Exchange Commission requires the filing of Form D. See Rule 503. When an issuer proceeds under Rule 506, Section 302(c) is intended to limit required state filings to no more than a requirement of filing a copy of Form D, including the Appendix, a consent to service of process, and a fee.

3. The definition of "filing" in Section 102(8) will permit states to receive electronic filing of records under this Section. An administrator may also accept under this Section a signed consent filed electronically with a designee of the administrator. See Section 104.

SECTION 303. SECURITIES REGISTRATION BY COORDINATION.

(a) **[Registration permitted.]** A security for which a registration statement has been filed under the Securities Act of 1933 in connection with the same offering may be registered by coordination under this Section.

(b) **[Required records.]** A registration statement and accompanying records under this Section must contain or be accompanied by the following records in addition to the information specified in Section 305 and a consent to service of process complying with Section 611:

(1) a copy of the latest form of prospectus filed under the Securities Act of 1933;

(2) a copy of the articles of incorporation and bylaws or their substantial equivalents currently in effect; a copy of any agreement with or among underwriters; a copy of any indenture or other instrument governing the issuance of the security to be registered; and a specimen, copy, or description of the security that is required by rule or order under this [Act];

(3) copies of any other information, or any other records filed by the issuer under the Securities Act of 1933 requested by the administrator; and

(4) an undertaking to forward each amendment to the federal prospectus, other than an amendment that delays the effective date of the registration statement, promptly after it is filed with the Securities and Exchange Commission.

(c) **[Conditions for effectiveness of registration statement.]** A registration statement under this Section becomes effective simultaneously with or subsequent to the federal registration

statement when all the following conditions are satisfied:

(1) a stop order under subsection (d) or Section 306 or issued by the Securities and Exchange Commission is not in effect and a proceeding is not pending against the issuer under Section 412; and

(2) the registration statement has been on file for at least 20 days or such shorter provided by rule or order under this [Act].

(d) **[Notice of federal registration statement effectiveness.]** The registrant shall promptly notify the administrator in a record of the date and time when the federal registration statement becomes effective and the content of a price amendment, if any, and shall promptly file a record containing the price amendment. If the notice is not timely received, the administrator may issue a stop order, without prior notice or hearing, retroactively denying effectiveness to the registration statement or suspending its effectiveness until compliance with this Section. The administrator shall promptly notify the registrant of an order by telegram, telephone or electronic means and promptly confirm this notice by a record. If the registrant subsequently complies with the notice requirements of this Section, the stop order is void as of the time of its issuance.

(e) **[Effectiveness of registration statement.]** If the federal registration statement becomes effective before each of the conditions in this Section is satisfied or is waived by the administrator, the registration statement is automatically effective under this [Act] when all the conditions are satisfied or waived. If the registrant notifies the administrator of the date when the federal registration statement is expected to become effective, the administrator shall promptly notify the registrant by telegram, telephone, or electronic means and promptly confirm this notice by a record, indicating whether all the conditions are satisfied or waived and whether the

administrator intends the institution of a proceeding under Section 306. The notice by the administrator does not preclude the institution of such a proceeding.

Proposed Comments

Prior Provisions: 1956 Act Section 303; RUSA Section 303.

1. Registration by coordination was one of the key innovations of the 1956 Act. As in the 1956 Act, Section 303 streamlines the content of the registration statement and the procedure by which a registration statement becomes effective, but not the substantive standards governing the effectiveness of a registration statement.

2. The phrase "in connection with the same offering" in Section 303 does not require that the federal and state registration statements be filed simultaneously or become effective simultaneously. A registration by coordination can be filed in a state after the effectiveness of the federal registration statement as long as the administrator does not conclude that the interval was too long to consider the state registration statement "the same offering."

3. Section 303 is similar to the 1956 Act except that these provisions have been modernized to include electronic filing and electronic notification. Cf. Sections 102(8), 102(25), 104. It is anticipated that this will facilitate simultaneous filing with the Securities and Exchange Commission and the states which is consistent with the uniformity intended by this Act. Simultaneous or sequential filing could be administered through a designee similar to the current Web-CRD or in conjunction with the Securities and Exchange Commission's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system or otherwise.

4. Section 303(b) is not intended to limit the administrator to requiring only the information and records filed with the Securities and Exchange Commission.

5. Sections 303(c)-(e) describe the conditions to be satisfied to achieve effectiveness of a coordinated filing. "Price amendment" is defined in Section 102(23). The administrator retains the right to test the registration statement by the substantive standards of Section 306(a) and may issue a stop or denial order if the administrator believes any of those provisions are applicable.

SECTION 304. SECURITIES REGISTRATION BY QUALIFICATION.

(a) **[Registration permitted.]** A security may be registered by qualification under this Section.

(b) **[Required records.]** A registration statement under this Section must contain the information specified in Section 305, a consent to service of process complying with Section 611, and, if provided by a rule under this [Act], the administrator may require the following information and the following records:

(1) with respect to the issuer and any significant subsidiary, its name, address, and form of organization; the state or foreign jurisdiction and date of its organization; the general character and location of its business; a description of its physical properties and equipment; and a statement of the general competitive conditions in the industry or business in which it is or will be engaged;

(2) with respect to each director and officer of the issuer, and other person having a similar status or performing similar functions, the person's name, address, and principal occupation for the previous five years; the amount of securities of the issuer held by the person as of the 30th day before the filing of the registration statement; the amount of the securities covered by the registration statement to which the person has indicated an intention to subscribe; and a description of any material interest of the person in any material transaction with the issuer or a significant subsidiary effected within the previous three years or proposed to be effected;

(3) with respect to persons covered by paragraph (2), the aggregate sum of the remuneration paid to those persons during the previous 12 months and estimated to be paid during the next 12 months, directly or indirectly, by the issuer, and all predecessors, parents, subsidiaries, and affiliates of the issuer;

(4) with respect to a person owning of record or owning beneficially, if known, 10 percent or more of the outstanding shares of any class of equity security of the issuer, the information specified in paragraph (2) other than the person's occupation;

(5) with respect to a promoter if the issuer was organized within the previous three years, the information specified in paragraph (2), any amount paid to the promoter within that period or intended to be paid to the promoter, and the consideration for the payment;

(6) with respect to a person on whose behalf any part of the offering is to be made in a nonissuer distribution, the person's name and address; the amount of securities of the issuer held by the person as of the date of the filing of the registration statement; a description of any material interest of the person in any material transaction with the issuer or any significant subsidiary effected within the previous three years or proposed to be effected; and a statement of the reasons for making the offering;

(7) the capitalization and long term debt, on both a current and pro forma basis, of the issuer and any significant subsidiary, including a description of each security outstanding or being registered or otherwise offered, and a statement of the amount and kind of consideration, whether in the form of cash, physical assets, services, patents, goodwill, or anything else of value, for which the issuer or any subsidiary has issued its securities within the previous two years or is obligated to issue its securities;

(8) the kind and amount of securities to be offered; the proposed offering price or the method by which it is to be computed; any variation at which a proportion of the offering is to be made to a person or class of persons other than the underwriters, with a specification of the person or class; the basis upon which the offering is to be made if otherwise than for cash; the estimated aggregate underwriting and selling discounts or commissions and finders' fees, including separately cash, securities, contracts, or anything else of value to accrue to the underwriters or finders in connection with the offering, or, if the selling discounts or commissions are variable, the

basis of determining them and their maximum and minimum amounts; the estimated amounts of other selling expenses, including legal, engineering, and accounting charges; the name and address of each underwriter and each recipient of a finder's fee; a copy of any underwriting or selling group agreement under which the distribution is to be made, or the proposed form of any such agreement whose terms have not yet been determined; and a description of the plan of distribution of any securities that are to be offered otherwise than through an underwriter;

(9) the estimated monetary proceeds to be received by the issuer from the offering; the purposes for which the proceeds are to be used by the issuer; the estimated amount to be used for each purpose; the order or priority in which the proceeds will be used for the purposes stated; the amounts of any funds to be raised from other sources to achieve the purposes stated; the sources of the funds; and, if a part of the proceeds is to be used to acquire property, including goodwill, otherwise than in the ordinary course of business, the names and addresses of the vendors, the purchase price, the names of any persons that have received commissions in connection with the acquisition, and the amounts of the commissions and other expenses in connection with the acquisition, including the cost of borrowing money to finance the acquisition;

(10) a description of any stock options or other security options outstanding, or to be created in connection with the offering, and the amount of those options held or to be held by each person required to be named in paragraph (2), (4), (5), (6), or (8), and by any person that holds or will hold 10 percent or more in the aggregate of those options;

(11) the dates of, parties to, and general effect concisely stated of each managerial or other material contract made or to be made otherwise than in the ordinary course of business to be performed in whole or in part at or after the filing of the registration statement or that was made

within the previous two years, and a copy of the contract;

(12) a description of any pending litigation, action, or proceeding to which the issuer is a party and that materially affects its business or assets, including any litigation, action, or proceeding known to be contemplated by governmental authorities;

(13) a copy of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature intended as of the effective date to be used in connection with the offering and any solicitation of interest used in compliance with Section 202(17)(B);

(14) a specimen or copy of the security being registered, unless the security is uncertificated, a copy of the issuer's articles of incorporation and bylaws, or their substantial equivalents, in effect; and a copy of any indenture or other instrument covering the security to be registered;

(15) a signed or conformed copy of an opinion of counsel concerning the legality of the security being registered, with an English translation if it is in a language other than English, which states whether the security when sold will be validly issued, fully paid, and nonassessable and, if a debt security, a binding obligation of the issuer;

(16) a signed or conformed copy of a consent of any accountant, engineer, appraiser, or other person whose profession gives authority for a statement made by the person, if the person is named as having prepared or certified a report or valuation, other than an official record, that is public, which is used in connection with the registration statement;

(17) a balance sheet of the issuer as of a date within four months before the filing of the registration statement; a statement of income and changes in financial position for each of the three fiscal years preceding the date of the balance sheet and for any period between the close of the

immediately previous fiscal year and the date of the balance sheet, or for the period of the issuer's and any predecessor's existence if less than three years; and, if any part of the proceeds of the offering is to be applied to the purchase of a business, the financial statements that would be required if that business were the registrant; and

(18) any additional information required by rule or order under this [Act].

(c) **[Conditions for effectiveness of registration statement.]** A registration statement under this Section becomes effective 30 days, or any shorter period provided by rule or order under this [Act], after the date the registration statement or the last amendment other than a price amendment is filed, if:

(1) a stop order is not in effect and a proceeding is not pending under Section 306;

(2) the administrator has not issued an order under Section 306(c) delaying effectiveness; and

(3) the applicant or registrant has not requested that effectiveness be delayed.

(d) **[Delay of effectiveness of registration statement.]** The administrator may delay effectiveness once for not more than 90 days if the administrator determines the registration statement is not complete in all material respects and promptly notifies the applicant or registrant of that determination. The administrator may also delay effectiveness for a further period of not more than 30 days if the administrator determines that the delay is necessary or appropriate.

(e) **[Prospectus distribution may be required.]** A rule or order under this [Act] may require as a condition of registration under this Section that a prospectus containing a specified part of the information specified in subsection (b) be sent or given to each person to which an offer is made, before or concurrently, with the earliest of:

(1) the first offer made in a record to the person otherwise than by means of a public advertisement, by or for the account of the issuer or another person on whose behalf the offering is being made, or by an underwriter or broker-dealer that is offering part of an unsold allotment or subscription taken by the person as a participant in the distribution;

(2) the confirmation of any sale made by or for the account of the person;

(3) payment pursuant to such a sale; or

(4) delivery of the security pursuant to such a sale.

Proposed Comments

Prior Provisions: 1956 Act Section 304; RUSA Section 304.

1. This Section generally follows the 1956 Act and RUSA. Any security may be registered by qualification, whether or not another procedure is available. Ordinarily, however, registration by qualification will only be used by an issuer when no other procedure is available.

2. Section 304(b) originally was modeled on Schedule A of the Securities Act of 1933. Section 304(b)(17) uses the same terminology as is used currently in Regulation S-X of the Securities and Exchange Commission. Under Sections 605(a) and (c) the administrator is authorized to specify the form and content of rules and forms governing registration statements and the form and content of financial statements required under this Act.

3. Under Sections 304(b)(18) and 307 the administrator may require additional information or may waive in whole or in part or conditionally any of the requirements of Section 304(b). Section 304(b)(18), for example, would authorize the administrator to require that a report by an accountant, engineer, appraiser or other professional person be filed. Section 304(b)(18) would also authorize that securities of designated classes under a trust indenture contain additional specified information.

SECTION 305. SECURITIES REGISTRATION FILINGS.

(a) [**Who may file**.] A registration statement may be filed by the issuer, a person on whose behalf the offering is to be made, or a broker-dealer registered under this [Act].

(b) [**Filing fee.**] A person filing a registration statement shall pay a filing fee of [$___]. If a registration statement is withdrawn before the effective date or a preeffective stop order is issued under Section 306, the administrator shall retain [$ ____] of the fee.

(c) [**Status of offering.**] A registration statement filed under Section 303 or 304 must specify:

(1) the amount of securities to be offered in this State;

(2) the states in which a registration statement or similar record in connection with the offering has been or is to be filed; and

(3) any adverse order, judgment, or decree issued in connection with the offering by a state securities regulator, the Securities and Exchange Commission, or a court.

(d) [**Incorporation by reference**.] A record filed under this [Act] or the predecessor act, within five years preceding the filing of a registration statement, may be incorporated by reference in the registration statement to the extent that the record is currently accurate.

(e) [**Nonissuer distribution**.] In the case of a nonissuer distribution, information may not be required under subsection (i) or Section 304, unless it is known to the person filing the registration statement or to the person on whose behalf the distribution is to be made, or unless it can be furnished by those persons without unreasonable effort or expense.

(f) [**Escrow and impoundment**.] A rule or order under this [Act], may require as a condition of registration that a security issued within the previous five years or to be issued to a promoter for a consideration substantially less than the public offering price, or to a person for a consideration other than cash, be deposited in escrow; and that the proceeds from the sale of the registered security in this State be impounded until the issuer receives a specified amount from the

sale of the security either in this State or elsewhere. The conditions of any escrow or impoundment required under this subsection may be established by rule or order under this [Act], but the administrator may not reject a depository institution solely because of its location in another State.

(g) [**Form of subscription.**] A rule or order under this [Act] may require as a condition of registration that a security registered under this [Act], be sold only on a specified form of subscription or sale contract and that a signed or conformed copy of each contract be filed under this [Act] or preserved for a period of not more than three years.

(h) [**Effective period.**] Except while a stop order is in effect under Section 306, a registration statement is effective for one year after its effective date, or for a longer period designated in an order under this [Act] during which the security is being offered or distributed in a nonexempted transaction by or for the account of the issuer or other person on whose behalf the offering is being made or by an underwriter or broker-dealer that is still offering part of an unsold allotment or subscription taken as a participant in the distribution. For the purposes of a nonissuer transaction, all outstanding securities of the same class identified in the registration statement as a security registered under this [Act] are considered to be registered while the registration statement is effective. If any securities of the same class are outstanding, a registration statement may not be withdrawn until one year after its effective date. A registration statement may be withdrawn only with the approval of the administrator.

(i) [**Periodic reports.**] While a registration statement is effective, a rule or order under this [Act] may require the person that filed the registration statement to file reports, not more often than quarterly, to keep the information or record in the registration statement reasonably current and to

disclose the progress of the offering.

(j) [**Posteffective amendments**.] A registration statement may be amended after its effective date. The posteffective amendment becomes effective when the administrator so orders. If a posteffective amendment is made to increase the number of securities specified to be offered or sold, the person filing the amendment shall pay a registration fee of [$__]. A posteffective amendment relates back to the date of the offering of the additional securities being registered, if within one year after the date of the sale, the amendment is filed and the additional registration fee is paid.

Proposed Comments

Prior Provisions: 1956 Act Section 305; RUSA Section 305.

1. Section 305 generally follows the 1956 Act and RUSA except that earlier provisions in both Acts referring to Investment Company Act of 1940 securities, which are federal covered securities, see Section 102(7), have been deleted.

2. Section 305 is applicable both to registration by coordination, see Section 303, and registration by qualification, see Section 304.

3. Section 305(a) expressly authorizes registration by "a person on whose behalf the offering is to be made." This would permit a nonissuer, cf. Section 102(18), or a broker-dealer to file a registration statement independent of the issuer.

4. This Act is intended, to the extent practicable, to be revenue neutral in its impact on existing state law, see Comment 3 to Section 608. Accordingly, Section 305(b) does not specify what fees states should provide.

5. Section 305(c), which generally follows the 1956 Act and RUSA, does not require in Section 305(c)(3) disclosure of an order permitting the withdrawal of a registration statement. The administrator may, however, require disclosure of this information in a registration by qualification under Section 304(b)(18).

6. Section 305(c), like every other provision concerned with the content of the registration statement, must be read with Section 306(a)(1) which judges the accuracy and completeness of the registration statement as of its effective date unless an order denying effectiveness had been

entered before the effective date. A registration statement must be kept current with changing developments until the effectiveness date, but a registration statement is not required to be amended after the effective date except to correct inaccuracies or deficiencies which existed as of the effective date. An administrator, however, separately may require under Section 305(i) or (j) periodic reports or amendments to keep reasonably current the information contained in the registration statement.

7. Under Section 305(d) incorporation by reference is permitted as a matter of administrative practice.

8. Section 305(e) is the substantive equivalent to provisions in the 1956 Act and RUSA. This subsection is designed to address nonissuer offerings where the seller cannot obtain certified financial statements and other normally required records. The phrase "without unreasonable effort or expense" comes from Section 10(a)(3) of the Securities Act of 1933. It is not meant to apply to expenses incidental to supplying required information required for registration in the case of a nonissuer distribution by a person in a control relationship with the issuer or otherwise having access to or contractual rights to obtain the required information. Section 305(e) only applies to registration by qualification under Section 304 and periodic reports for either registration by coordination or registration by qualification under Section 305(i).

10. Section 305(f), follows the 1956 Act and RUSA, and authorizes the administrator to require the escrow and impoundment of funds until the issuer receives a specified amount from the sale of the security in this State or elsewhere. This Section is limited to a security issued within the past five years or to be issued to a promoter for a consideration substantially different from the public offering price or to a person for a consideration other than cash. The typical distribution subject to Section 305(f) will be a relatively new promotional or speculative offering. Section 305(f) follows the 1956 Act and RUSA and provides that the administrator may not reject a depository solely because of its location in another state. Unlike the statute in Schwaemmle Const. Co. v. Michigan Dep't of Commerce, 360 N.W.2d 141 (Mich. 1984), Section 305(f) broadly provides that the administrator "may determine the conditions of any escrow or impoundment under this subsection." As in *Schwaemmle*, this power only will operate until the impounded or escrowed funds are released.

11. Section 305(g) follows the 1956 Act in authorizing the administrator to specify the form of a subscription or sale contract.

12. Section 305(h) generally follows the 1956 Act and RUSA. The term "nonissuer transaction" or "nonissuer distribution" is defined in Section 102(18). A sale by a nonissuer would have to be registered under Section 301 unless it is exempted or involves a federal covered security. Section 202(1) exempts "isolated nonissuer transactions." When a nonissuer transaction is not exempt under Section 202(1), it may still be exempted under other transaction exemptions.

If no exemption is available for a nonissuer distribution, and it does not involve a federal

covered security, the security must be registered under Article 3. Under the first sentence of Section 305(h) each registration statement remains effective for at least one year and for any longer period the administrator may determine. However, no registration statement is effective while a stop order with respect to it is in effect under Section 306.

For the purposes of a nonissuer transaction, all outstanding securities of the same class as a registered security are considered to be registered as long as the registration statement remains effective. This means that during the effective period of a registration statement under this Act all securities of the same class can be traded by anyone, including nonissuers, as if they were registered.

Section 305(h) also provides that, unless the administrator determines otherwise, a registration statement cannot be withdrawn until one year after its effective date if any securities of the same class are outstanding. This is designed to protect sellers who would be unaware of a withdrawal from being subject to civil liability.

13. Section 305(j) follows RUSA and a procedure limited to investment companies in the 1956 Act in allowing posteffective date amendments. Under Section 305(j), when a posteffective amendment increases the number of securities to be offered or sold, an additional registration fee is required.

SECTION 306. DENIAL, SUSPENSION, AND REVOCATION OF SECURITIES REGISTRATION.

(a) [**Stop orders.**] The administrator may issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, a registration statement if the administrator finds that the order is in the public interest and that:

(1) the registration statement as of its effective date or before the effective date in the case of an order denying effectiveness, an amendment under Section 305(j) as of its effective date, or a report under Section 305(i), is incomplete in a material respect or contains a statement that, in the light of the circumstances under which it was made, was false or misleading with respect to a material fact;

(2) this [Act] or a rule adopted or order issued under this [Act] or a condition imposed under this [Act] has been willfully violated, in connection with the offering, by the person filing the registration statement; by the issuer, a partner, officer, or director of the issuer or a person having a similar status or performing a similar function; a promoter of the issuer; or a person directly or indirectly controlling or controlled by the issuer; but only if the person filing the registration statement is directly or indirectly controlled by or acting for the issuer; or by an underwriter;

(3) the security registered or sought to be registered is the subject of a permanent or temporary injunction of a court of competent jurisdiction or an administrative stop order or similar order issued under any federal, foreign, or state law other than this [Act] applicable to the offering, but the administrator may not institute a proceeding against an effective registration statement under this paragraph more than one year after the date of the order or injunction on which it is based, and the administrator may not issue an order under this paragraph on the basis of an order or injunction issued under the securities act of another state unless the order or injunction was based on facts that would constitute, as of the date of the order, a ground for a stop order under this Section;

(4) the issuer's enterprise or method of business includes or would include activities that are illegal where performed;

(5) with respect to a security sought to be registered under Section 303, there has been a failure to comply with the undertaking required by Section 303(b)(4);

(6) the applicant or registrant has not paid the proper filing fee, but the administrator may issue only a stop order under this paragraph and shall void the order if the deficiency is

corrected; or

(7) the offering (A) will work or tend to work a fraud upon purchasers or would so operate; [or]

(B) has been or would be made with unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters' profits or participations, or unreasonable amounts or kinds of options[; or

(C) is being made on terms that are unfair, unjust, or inequitable].

(b) **[Enforcement of Section 306(a)(7).]** To the extent practicable, the administrator by rule or order shall publish standards that provide notice of conduct that violates subsection (a)(7).

(c) [**Institution of a stop order.**] The administrator may not institute a stop order proceeding against an effective registration statement on the basis of a fact or a transaction known to the administrator when the registration statement became effective unless the proceeding is instituted within 30 days after the registration statement became effective.

(d) [**Summary process.**] The administrator may summarily revoke, deny, postpone, or suspend the effectiveness of a registration statement pending final determination of an administrative proceeding. Upon the issuance of the order, the administrator shall promptly notify each person specified in subsection (e) that the order has been issued, the reasons for the postponement or suspension, and that within 15 days after the receipt of a request in a record from the person the matter will be scheduled for a hearing. If a hearing is not requested and none is ordered by the administrator, within 30 days after the date of service of the order, the order becomes final. If a hearing is requested or ordered, the administrator, after notice of and opportunity for hearing for each person subject to the order may modify or vacate the order or

extend the order until final determination.

(e) [**Procedural requirements for a stop order.**] A stop order may not be issued under this Section without:

(1) appropriate notice to the applicant or registrant, the issuer, and the person on whose behalf the securities are to be or have been offered;

(2) an opportunity for hearing; and

(3) findings of fact and conclusions of law in a record [in accordance with the state administrative procedure act].

(f) [**Modification or vacation of a stop order.**] The administrator may modify or vacate a stop order issued under this Section if the administrator finds that the conditions that caused its issuance have changed or that it is necessary or appropriate in the public interest or for the protection of investors.

Proposed Comments

Prior Provisions: 1956 Act Section 306; RUSA Section 306.

1. This Section generally follows the 1956 Act and RUSA and applies to both registration by coordination under Section 303 and registration by qualification under Section 304.

2. Section 306(a)(1) follows the 1956 Act and RUSA in testing in a suspension or revocation proceeding the completeness and accuracy of a registration statement as of the registration statement's effective date. A registration statement that becomes misleading because of a development that occurs after its effective date is not a ground for the issuance of a stop order under Section 306(a)(1). An administrator, however, may require periodic reports under Section 305(i) or a posteffective amendment under Section 305(j). With respect to periodic reports under Section 305(i), a misleading report would be the basis of a stop order under Section 306(a)(1) if it is materially inaccurate as of the date it was filed.

3. On the meaning of "willfully," see Comment 2 under Section 508.

4. A violation by an issuer has the same consequences whether the issuer has filed a

registration statement or has had a broker-dealer file it. But this is not the case when the registration statement is filed by a local broker-dealer acting independently.

5. The verb "is" at the beginning of Section 306(a)(3) means that a stop order or injunction that has expired or been vacated is not the ground for action under this paragraph.

6. Section 306(a)(4) applies to activity that is conducted in a state where that activity is illegal. It does not apply if the activity is not illegal under that state's law. This paragraph is not meant to apply to activity which is lawful where conducted but would be illegal if conducted in the state where the registration statement is filed.

7. Sections 306(a)(5)-(6) follow the 1956 Act and RUSA.

8. Sections 306(a)(7) and (b) address merit regulation. Sections 306(E)-(F) of the 1956 Act authorized a stop order when an "offering has worked or tended to work a fraud upon purchasers or would so operate" or "the offering has been or would be made with unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters' profits or participation, or unreasonable amounts or kinds of options." By 1985 a majority of states which had adopted the 1956 Act had adopted this approach to merit regulation rather than the earlier and broader "unfair, unjust or inequitable" standard that then applied in a minority of states.

RUSA Sections 306(a)(5)-(6) adopted provisions substantively identical to the 1956 Act and included in brackets an "unfair, unjust, or inequitable" alternative.

The National Securities Markets Improvement Act of 1996 subsequently preempted merit regulation of federal covered securities. See Section 102(7).

Sections 306(a)(7) and (b) take a different approach. Subject to the National Securities Markets Improvement Act of 1996, merit standards are retained but hortatory paragraph 306(b) encourages the administrator, to the extend practicable, to adopt, by rule or order, standards that provide notice to issuers of a state's merit standards. Notice will address one criticism of merit regulation. See generally 1 Louis Loss & Joel Seligman, Securities Regulation 111-124 (3d ed. rev. 1998). Statements of Policy of the North American Securities Administrator Association that have been adopted by a state would provide notice in compliance with Section 306(b). Similarly other state rules or orders could be adopted in the future to address new types of securities as they occur.

An order under Section 306(b) can be adopted after a securities registration statement has been filed. Under Section 306(b) an administrator, by rule or order, for example, could adopt a standard that would provide the basis for a stop order denying effectiveness to a development state company that has no specific business purpose or plan and has indicated that its business purpose or plan is to engage in a merger or acquisition with an unidentified company, entity, or person. "Blank check offerings" are subject to Rule 419 adopted under the Securities Act of 1933.

9. Section 306(c) follows the 1956 Act and RUSA and allows an administrator up to 30 days after a registration statement becomes effective to institute a stop order proceeding on the basis of a fact or transaction known when the registration statement became effective. This will avoid the necessity of an administrator issuing a stop order prematurely.

10. Sections 306(d)-(e) assure each person subject to a stop order notice, opportunity for a hearing, and written findings of fact and conclusions of law contained in a record.

11. An administrator must consider the public interest when issuing a stop order and may under Section 306(f) consider the public interest when modifying or vacating a stop order. See, e.g., TechnoMedical Lab., Inc. v. Utah Sec. Div., 744 P.2d 320, 324-325 (Utah Ct. App. 1987) (a state has a valid public interest in stopping the issuance of hundreds of thousands of public shares that did not comply with the disclosure requirements of securities registration); cf. stop orders under the Securities Act of 1933, see 1 Louis Loss & Joel Seligman, Securities Regulation 576-589 (3d ed. rev. 1998).

Reporter's Notes

As of July 2001 46 jurisdictions had adopted a form of Section 306(a)(7)(A) ("will tend to work a fraud or would so operate"); 35 jurisdictions had adopted a form of Section 306(a)(7)(B) ("unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoter profits or participations, or unreasonable amounts or kinds of options"); and 18 jurisdictions had adopted a form of bracketed Section 306(a)(7)(C) ("terms that are unfair, unjust, or inequitable").

Section 306(a)(7) - Denial, Suspension and Revocation

Jurisdiction	Sect.(7)(A) Will work or tend to work fraud	Sect.(7)(B) Unreasonable amounts	Sect.(7)(C) Unfair, unjust or Inequitable terms
Alabama Sec. 8-6-9(a)	X	X	X
Alaska Sec. 45.55.120(a)	X	X	
Arizona Sec. 44-1921	X		X[1]
Arkansas Sec. 23-42-405(a)	X	X	X
California Sec. 25410(a)	X	X	X
Colorado Sec. 11-51-306			
Connecticut 36b-20(a)	X	X	
Delaware Sec. 7308(a)	X	X	

[1] Arizona Section 44-1921(3) ". . . or would be unfair or inequitable to the purchasers."

1	District of Columbia Sec. 260	X	X		
2	Florida Sec. 517.111(1)				X
3	Georgia Sec. 10-5-7(a)	X			
4	Guam Sec. 46306(a)	X	X		
5	Hawaii Sec. 485-13(a)	X	X		
6	Idaho Sec. 30-1413	X	X		
7	Illinois Sec. 11 [5/11]	X			
8	Indiana Sec. 23-2-1-7(a)	X	X		
9	Iowa Sec. 502.209	X	X		
10	Kansas Sec. 17-1260(a)		X		X
11	Kentucky Sec. 292.390(1)	X	X		
12	Louisiana Sec. 51:707(A)	X			
13	Maine 10406(1)	X	X		X
14	Maryland ll-511(a)	X			
15	Massachusetts Sec. 305(A)	X	X		
16	Michigan Sec. 451.706(a)	X	X		X[2]
17	Minnesota Sec. 80A.13 Subd.l	X			X[3]
18	Mississippi Sec. 75-71-425	X	X		
19	Missouri Sec. 409.306(a)	X	X		X[4]
20	Montana Sec. 30-10-207(1)	X	X		
21	Nebraska Sec. 8-1109.01	X	X		X
22	Nevada Sec. 90.510(1)	X	X		
23	New Hampshire Sec. 421-B:16(b)	X	X		X[5]
24	New Jersey Sec. 49:3-64				
25	New Mexico Sec. 58-13B-25(A)	X	X		
26	New York Sec. 352(1)				

[2] Mich. Section 451.706(a)(5) concludes "or the offering is on unfair terms."

[3] Minnesota Section 80A. 13(6) - "except with respect to securities which are being registered by notification, the terms of the securities are unfair and inequitable; provided, however, that the commissioner may not determine that an offering is unfair and inequitable solely on the grounds that the securities are to be sold at an excessive price where the offering price has been determined by arms length negotiation between nonaffiliated parties. The selling price of any security being sold by a broker-dealer licensed in this state shall be presumed to have been determined by arms length negotiation;"

[4] Missouri Section 409.306(a)(E)(ii) – "any aspect of the offering is substantially unfair, unjust, unequitable or oppressive"

[5] New Hampshire Section 421-B: 16(b)(7), ". ..except with respect to securities which are being registered by notification the terms of the securities are unfair and inequitable; provided, however, that the secretary of state may not determine that an offering is unfair and inequitable solely on the grounds that the securities are to be sold at an excessive price where the offering price has been determined by arms length negotiation between nonaffiliated parties. The selling price of any security being sold by a broker-dealer licensed in this state shall be presumed to have been determined by arms length negotiation;"

North Carolina Sec. 78A-29(a)(2)	X	X		
North Dakota Sec. 10-04-09	X			X
Ohio Sec. 1707.13	X			X[6]
Oklahoma Sec. 306(a)(2)	X	X		
Oregon Sec. 59.105(1)		X		X
Pennsylvania Sec. 208(a)	X	X		
Puerto Rico Sec. 876(a)(2)	X	X		
Rhode Island Sec. 7-1 l-306(a)				
South Carolina Sec. 35-l-1010(b)	X	X		
South Dakota Sec. 47-3 IA-306(a)(2)	X	X		X
Tennessee Sec. 48-2-112(a)	X			
Texas Sec. 32[581-32]	X			
Utah Sec. 61-1-12(1)	X	X		
Vermont Sec. 4211	X			X[7]
Virginia Sec. 13.1-513(a)				
Washington Sec. 21.20.280				
West Virginia Sec. 32-3-306(a)(2)				
Wisconsin Sec. 551.28(1)				
Wyoming Sec. 17-4-112(a)				
TOTALS:	**46**	**35**		**18**

SECTION 307. WAIVERS. The administrator, may waive or modify any or all of the requirements of Sections 302, 303, and 304(b) or the requirement of any information or record in a registration statement.

Proposed Comments

Prior Provision: RUSA Section 303(h). Section 307 follows RUSA Section 303(h) and empowers the administrator to waive or modify any of the requirements of 302, 303, 304(b), or the requirement of any information or record in a registration statement. An example would be the expedited procedure several states have adopted to coordinate with shelf registration under Rule 415 of the Securities Act of 1933. In waiving or modifying requirements the administrator must make a finding satisfying the requirements of Section 605(b).

[6] Ohio Section 1707.13. ". . . that such security is being disposed of or purchased on grossly unfair terms. . ."

[7] Vermont Section 4211(5), "Is of bad business repute;"

ARTICLE 4

BROKER-DEALERS, AGENTS, INVESTMENT ADVISERS, INVESTMENT ADVISER REPRESENTATIVES, AND FEDERAL COVERED INVESTMENT ADVISERS

SECTION 401. BROKER-DEALER REGISTRATION REQUIREMENT AND EXEMPTIONS.

(a) [**Registration requirement.**] It is unlawful for a person to transact business in this State as a broker-dealer, unless the person is registered under this [Act] as a broker-dealer or is exempt from registration as a broker-dealer under subsection (b) or (d).

(b) [**Exemptions from registration.**] The following persons are exempt from the registration requirement of subsection (a):

(1) a broker-dealer without a place of business in this State if its only transactions effected in this State are with:

(A) the issuer of the securities involved in the transactions;

(B) a person registered as a broker-dealer under this [Act] or not required to be registered as a broker-dealer under this [Act];

(C) an institutional investor;

(D) a nonaffiliated federal covered investment adviser with investments under management in excess of $100 million acting for the account of others pursuant to discretionary authority in a signed record;

(E) a bona fide preexisting customer whose principal place of residence is not in this State and the person is registered as a broker-dealer under the Securities Exchange Act of

1934 or not required to be registered under the Securities Exchange Act of 1934 and is registered under the securities act of the state in which the customer maintains a principal place of residence;

(F) a bona fide preexisting customer whose principal place of residence is in this State but was not present in this State when the customer relationship was established, if:

(i) the broker-dealer is registered under the Securities Exchange Act of 1934 or not required to be registered under the Securities Exchange Act of 1934 and is registered under the securities laws of the State in which the customer relationship was established and where the customer had maintained a principal place of residence; and

(ii) within 45 days after the customer's first transaction in this State, the person files an application for registration as a broker-dealer in this State and a further transaction is not effected more than 75 days after the date on which the application is filed, or, if earlier, the date on which the administrator notifies the person that the administrator has denied the application for registration or has stayed the pendency of the application for cause;

(G) not more than three customers in this State during the previous 12 months, in addition to those specified in subparagraphs (A) through (F) and under subparagraph (H), if the broker-dealer is registered under the Securities Exchange Act of 1934 or not required to be registered under the Securities Exchange Act of 1934 and is registered under the securities act of the state in which the broker-dealer has its principal place of business; and

(H) any other person exempted by rule or order under this [Act]; and

(2) a person that deals solely in United States government securities and is supervised as a dealer in government securities by the Board of Governors of the Federal Reserve System,

the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Office of Thrift Supervision.

(c) [**Limits on employment or association.**] It is unlawful for a broker-dealer, or for an issuer engaged in offering, offering to purchase, purchasing, or selling securities in this State, directly or indirectly, to employ or associate with an individual to engage in an activity related to securities transactions in this State if the registration of the individual is suspended or revoked or the individual is barred from employment or association with a broker-dealer, an issuer, an investment adviser or a federal covered investment adviser by an order of the administrator under this [Act], the Securities and Exchange Commission, or a self-regulatory organization. A broker-dealer or issuer does not violate this subsection if the broker-dealer or issuer did not know, and in the exercise of reasonable care could not have known, of the suspension, revocation, or bar. Upon request from a broker-dealer or issuer and for good cause shown, an order under this [Act] may modify or waive the prohibitions of this subsection;

(d) **[Foreign transactions.]** A rule or order under this [Act] may permit:

(1) A broker-dealer that is registered in Canada or other foreign jurisdiction and that does not have a place of business in this State to effect transactions in securities with or for, or attempt to effect the purchase or sale of any securities by:

(A) an individual from Canada or other foreign jurisdiction that is temporarily resident in this State and with whom the broker-dealer had a bona fide client relationship before the individual entered the United States;

(B) an individual from Canada or other foreign jurisdiction who is resident in this State and whose transactions are in a self-directed tax advantaged retirement plan in that foreign

jurisdiction of which the individual is the holder or contributor; or

(C) an individual who is resident in this State, with whom the broker-dealer client relationship arose while the individual was temporarily or permanently resident in Canada or the other foreign jurisdiction, and

(2) an agent who represents a broker-dealer, that is exempt under this subsection to effect transactions in securities or attempt to effect the purchase or sale of any securities in this State as permitted for a broker-dealer described in subsection (d)(1).

Proposed Comments

Prior Provisions: 1956 Act Section 201; RUSA Sections 201-202.

1. "Broker-dealer" is defined in Section 102(4). The scope of the Section 401(a) reference "to transact business in this State" is specified in Section 610. "Transacts a business" has been held to mean "more than a trivial or *de minimis* business." United States v. Schwartz, 464 F.2d 499, 506 (2d Cir. 1972), *cert. denied,* 409 U.S. 1009 (1972).

2. Under Section 401(a) a person can be required to register as a securities broker-dealer only if the person transacts business in securities. See, e.g., AMR Realty Co. v. State, 373 A.2d 1002 (N.J. Supr. Ct. App. Div. 1977) (requirement that the transactions involve securities).

3. "Bona fide" is a much construed term particularly in the U.C.C. context. See, e.g., MCC Proceeds, Inc. v. Advest, Inc., 2002 Blue Sky L. Rep. (CCH) ¶74,267 (N.Y. A.D. 2002) (comparing bona fide to good faith standard).

4. Under 401(b)(1)(E)-(F) preexisting customers must be bona fide. A principle place of residence, for example, normally would be the residence where the customer spends a majority of time. These exemptions were intended to facilitate ongoing broker-customer relationships with customers who have established a second or other residence for such purposes as a winter home (i.e. "snowbirds").

5. Section 401(c) prohibits a broker-dealer or issuer from employing or associating with an individual in a capacity for which that individual has been suspended by the administrator. Violation of this provision does not result in strict liability. In order for a broker-dealer or issuer to be liable, the broker-dealer or issuer must have known or should have known of the administrator's order to the individual suspended or barred.

6. Section 401(d) recognizes the increasingly transnational nature of securities brokerage and permits, if the administrator adopts a rule or order, transactions by a foreign broker-dealer with a person from Canada or other foreign jurisdiction who is resident in this State. This subsection is not self-executing and is only effective if the administrator adopts a rule or order.

SECTION 402. AGENT REGISTRATION REQUIREMENT AND EXEMPTIONS.

(a) [**Registration requirement.**] It is unlawful for an individual to transact business in this State as an agent unless the individual is registered under this [Act] as an agent or is exempt from registration as an agent under subsection (b).

(b) [**Exemptions from registration.**] The following individuals are exempt from the registration requirement of subsection (a):

(1) an individual who represents a broker-dealer in effecting transactions in this State limited to those described in Section 15(h)(2) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78(o)(2));

(2) an individual who represents a broker-dealer that is exempt under Section 401(b) or (d);

(3) an individual who represents an issuer with respect to an offer or sale of the issuer's own securities or those of the issuer's parent or any of the issuer's subsidiaries, and who is not compensated in connection with the individual's participation by the payment of commissions or other remuneration based, directly or indirectly, on transactions in those securities;

(4) an individual who represents an issuer and who effects transactions in the issuer's securities exempted by Section 202, other than Sections 202(11) and (14);

(5) an individual who represents an issuer who effects transactions solely in federal covered securities of the issuer, but an individual and who effects transactions in a federal covered security under Section 18(b)(3) or 18(b)(4)(D) of the Securities Act of 1933 (15 U.S.C. Section 77r(b)(3) or 77r(b)(4)(D)) is not exempt if the individual is compensated in connection with the agent's participation by the payment of commissions or other remuneration based, directly or indirectly, on transactions in those securities;

(6) an individual who represents a broker-dealer registered in this State under Section 401(a) or exempt under Section 401(b) in the offer and sale of securities for an account of a nonaffiliated federal covered investment adviser with investments under management in excess of $100 million acting for the account of others pursuant to discretionary authority in a signed record;

(7) an individual who represents an issuer in connection with the purchase of the issuer's own securities;

(8) an individual who represents an issuer and who restricts participation to performing ministerial or clerical work; or

(9) any other individual exempted by rule or order under this [Act].

(c) [**Registration effective only while employed or associated.**] The registration of an agent is effective only while the agent is employed by or associated with a broker-dealer registered under this [Act] or an issuer that is offering or selling its securities in this State.

(d) **[Limit on employment or association.]** It is unlawful for a broker-dealer, or an issuer engaged in offering, selling, or purchasing securities in this State, to employ or associate with an agent who transacts business in this State on behalf of broker-dealers or issuer unless the

agent is registered under subsection (a) or exempt from registration under subsection (b).

(e) [**Limit on multiple affiliations**.] An individual may not act as an agent for more than one broker-dealer or more than one issuer at a time, unless the broker-dealers or the issuers for which the agent acts are affiliated by direct or indirect common control or are authorized by rule or order under this [Act].

Proposed Comments

Prior Provisions: RUSA Sections 201-202.

1. "Agent" is defined in Section 102(2). The scope of the Section 402(a) reference to "transact business in this State" is specified in Section 610. An administrator may issue an order under Section 401(d)(2) that addresses an agent.

2. An independent contractor must either be a broker-dealer or an agent if the individual transacts business as a broker-dealer or agent. There is no other category of activity permitted under this Act for securities activities.

3. A broker-dealer in violation of Section 402(a) may be disciplined under Section 412 or subject to an administrative enforcement action under Section 603 or 604.

4. Under Sections 402(b)(3) and (5) an agent may be exempt if acting for an issuer and receiving compensation (for example, to be a corporate executive), as long as the compensation is not a commission or other remuneration based on transactions in the issuer's own securities.

5. Ministerial or clerical work in Section 402(b)(8) might include preparing routine written communications or responding to inquiries.

6. Section 402(e) limits agents to a single employment or affiliation unless a rule or order of the administrator authorizes multiple affiliations. In any event an agent must be registered, see Section 402(a), or exempt from registration, see Section 402(b). Registration is only effective while an agent is employed an associated with a broker-dealer or an issuer. See Section 402(c).

SECTION 403. INVESTMENT ADVISER REGISTRATION REQUIREMENT AND EXEMPTIONS.

(a) [**Registration requirement.**] It is unlawful for a person to transact business in this State as an investment adviser unless the person is registered under this [Act] as an investment adviser or is exempt from registration as an investment adviser under subsection (b).

(b) [**Exemptions from registration.**] The following persons are exempt from the registration requirement of subsection (a):

(1) a person without a place of business in this State that is registered under the securities act of the state in that the person has its principal place of business if its only clients in this State are:

(A) federal covered investment advisers, investment advisers registered under this [Act], or broker-dealers registered under this [Act];

(B) institutional investors;

(C) bona fide preexisting clients whose principal places of residence are not in this State if the investment adviser is registered under the securities act of the state in which the clients maintain principal places of residence; or

(D) any other client exempted by rule or order under this [Act];

(2) a person without a place of business in this State if the person has had, during the preceding 12 months, not more than five clients that are residents of this State in addition to those specified under paragraph (1); or

(3) any other person exempted by rule or order under this [Act]

(c) **[Limits on employment or association.**] It is unlawful for an investment adviser,

directly or indirectly, to employ or associate with an individual to engage in an activity related to investment advice in this State if the registration of the individual is suspended or revoked, or the individual is barred from employment or association with an investment adviser, federal covered investment adviser, or broker-dealer by an order under this [Act], the Securities and Exchange Commission, or a self-regulatory organization, unless the investment adviser did not know, and in the exercise of reasonable care could not have known, of the suspension, revocation, or bar. Upon request from the investment adviser and for good cause shown, the administrator, by order, may waive the prohibitions of this subsection.

(d) [**Investment adviser representative registration required.**] It is unlawful for an investment adviser to employ or associate with an individual required to be registered under this [Act] as an investment adviser representative who transacts business in this State on behalf of the investment adviser unless the individual is registered under Section 404(a) or is exempt from registration under Section 404(b).

Proposed Comments

Prior Provisions: 1956 Act Section 201; RUSA Sections 203-204.

1. "Investment adviser" is defined in Section 102(15). The scope of the Section 403(a) reference to "transact business in this State" is specified in Section 610.

2. Excluded from the definition of investment adviser in Section 102(15)(C) is a broker-dealer who receives no special compensation for investment advisory services. Such a broker-dealer would not have to register as both a broker-dealer and investment adviser in this State. A broker-dealer that does receive special compensation, on the other hand, would also meet the statutory definition of investment adviser and would be required to register in both capacities. Cf. Section 410(f) for agents and investment adviser representatives.

3. Section 403(b)(2) is required by the National Securities Markets Improvement Act of 1996 which prohibits a state from regulating an investment adviser that does not have a place of business in this State and had fewer than six clients who are state residents during the preceding

12 months.

4. Section 403(c) prohibits an investment adviser from employing an individual who is prohibited from such employment or association by the administrator. Violation of this provision does not result in strict liability. To be liable the investment adviser must have known or should have known of the administrator's order to the individual suspended or barred.

SECTION 404. INVESTMENT ADVISER REPRESENTATIVE REGISTRATION REQUIREMENT AND EXEMPTIONS.

(a) [**Registration requirement.**] It is unlawful for an individual to transact business in this State as an investment adviser representative unless the individual is registered under this [Act] as an investment adviser representative or is exempt from registration as an investment adviser under subsection (b).

(b) [**Exemptions from registration.**] The following individuals are exempt from the registration requirement of subsection (a):

(1) an individual who is employed by or associated with an investment adviser that is exempt from registration under Section 403(b) or a federal covered investment adviser that is excluded from the notice filing requirements of Section 405; and

(2) any other individual exempted by rule or order under this [Act].

(c) [**Registration effective only while employed or associated.**] The registration of an investment adviser representative is not effective while the investment adviser representative is not employed by or associated with an investment adviser registered under this [Act] or a federal covered investment adviser that has made or is required to make a notice filing under Section 405.

(d) [**Multiple affiliations.**] An individual may transact business as an investment adviser representative for more than one investment adviser or federal covered investment adviser unless a rule or order under this [Act] prohibits or limits an individual from acting as an investment adviser representative for more than one investment adviser or federal covered investment adviser.

(e) [**Limits on employment or association.**] It is unlawful for an individual acting as an investment adviser representative, directly or indirectly, to conduct business in this State on behalf of an investment adviser or a federal covered investment adviser if the registration of the individual as an investment adviser representative is suspended or revoked or the individual is barred from employment or association with an investment adviser or a federal covered investment adviser by an order under this [Act], the Securities and Exchange Commission, or a self-regulatory organization. Upon request from a federal covered investment adviser and for good cause shown, the administrator, by order, may waive the requirements of this subsection.

(f) **[Referral Fees.]** An investment adviser registered under this [Act], a federal covered investment adviser that has filed a notice under Section 405, or a broker-dealer registered under this [Act], is not required to employ or associate with an individual as an investment adviser representative when the sole compensation paid to the individual for a referral of investment advisory clients is paid to an investment adviser registered under this [Act], a federal covered investment adviser who has filed a notice under Section 405, or a broker-dealer registered under this [Act] with which the individual is employed or associated as an investment adviser representative.

Proposed Comments

No Prior Provision.

1. "Investment adviser representative" is defined in Section 102(16). The scope of the Section 404(a) reference to "transacts business in this State" is specified in Section 610.

2. Neither the 1956 Act nor RUSA provided for the registration of investment adviser representatives. In recent years, however, the states increasingly have done so.

3. Under this Act a sole proprietor investment adviser may register both as an investment adviser and as an investment adviser representative.

4. Section 404(c) prohibits an investment adviser representative from association with a federal covered investment adviser when such association is prohibited by an order of the administrator. Unlike similar provisions in Sections 401 and 403, there is no culpability requirement that the investment adviser representative "knows or in the exercise of reasonable care should have known" of a suspension or bar because the order should be received by the investment adviser representative. As with Sections 401 and 403, the administrator may waive this prohibition.

5. The administrator may adopt rules or orders under subsection (f) in accordance with Section 605. The Securities and Exchange Commission has adopted a rule that addresses referral fees in Rule 206(4)-3 of the Investment Advisers Act of 1940.

6. For those states that intend to extend Section 404(f) to those broker-dealers and investment advisers who are not required to register and those federal covered investment advisers not required to file a notice, this subsection should read:

> (f) [**Referral Fees.**] An investment adviser registered under this [Act], a federal covered investment adviser that has filed a notice under Section 405, or a broker-dealer registered under this [Act] is not required to employ or associate with an individual as an investment adviser representative when the sole compensation paid to the individual for a referral of investment advisory clients is paid to an investment adviser registered under this [Act], or not required to register under this [Act], a federal covered investment who has filed a notice under Section or is not required to file a notice under Section 405, or a broker-dealer registered under this [Act] or not required to register under this [Act] with which the individual is employed or associated as an investment adviser representative.

SECTION 405. FEDERAL COVERED INVESTMENT ADVISER NOTICE FILING REQUIREMENT.

(a) [**Notice filing requirement.**] Except with respect to a federal covered investment adviser described in subsection (b), it is unlawful for a federal covered investment adviser to transact business in this State unless the federal covered investment adviser complies with subsection (c).

(b) [**Exclusions from notice filing requirement.**] The following federal covered investment advisers are not required to comply with subsection (c):

(1) a federal covered investment adviser without a place of business in this State if its only clients in this State are:

(A) federal covered investment advisers, investment advisers registered under this Act, and broker-dealers registered under this [Act];

(B) institutional investors;

(C) bona fide preexisting clients whose principal places of residence are not in this State; or

(D) other clients specified by rule or order under this [Act];

(2) a federal covered investment adviser without a place of business in this State if the person has had, during the preceding 12 months, not more than five clients that are residents of this State in addition to those specified under paragraph (1); and

(3) any other person excluded by rule or order under this [Act].

(c) **[Notice filing procedure.]** A person acting as a federal covered investment adviser,

not excluded under subsection (b), shall file a notice, a consent to service of process, and such records that have been filed with the Securities and Exchange Commission under the Investment Advisers Act of 1940 required by rule or order under this [Act] and pay the fees specified in Section 410(e).

(d) **[Effectiveness of filing.]** The notice becomes effective upon its filing.

Proposed Comments

No Prior Provision.

1. "Federal covered investment adviser" is defined in Section 102(6). The scope of the Section 405(a) reference to "transacts business in this State" is specified in Section 610.

2. This provision is necessitated by the National Securities Markets Improvement Act of 1996 and is intended to coordinate this Act with the Investment Advisers Act of 1940.

3. Section 404(c) provides limits on those who can be employed by or associated with a federal covered investment adviser.

4. The succession provision of Section 407(a) is available to a federal covered investment adviser who has filed a notice under Section 405.

SECTION 406. REGISTRATION BY BROKER-DEALERS, AGENTS, INVESTMENT ADVISERS, AND INVESTMENT ADVISER REPRESENTATIVES.

(a) [**Application for initial registration.**] A person shall register as a broker-dealer, agent, investment adviser, or investment adviser representative by filing an application and a consent to service of process complying with Section 611, and paying the fee specified in Section 410 and any reasonable fees charged by the designee of the administrator for processing the filing. Each application must contain:

(1) the information required for the filing of a uniform application;

(2) upon request by the administrator, any other financial or other information that the administrator determines is appropriate; and

(b) [**Amendment**] If the information contained in an application that is filed under subsection (a) is or becomes inaccurate or incomplete in any material respect, the registrant shall promptly file a correcting amendment.

(c) [**Effectiveness of registration.**] If an order is not in effect and no proceeding is pending under Section 412, registration becomes effective at noon on the 45th day after a completed application is filed unless the registration is denied. A rule or order under this [Act] may set an earlier effective date or may defer the effective date until noon on the 45th day after the filing of any amendment completing the application.

(d) [**Registration renewal.**] A registration is effective until midnight on December 31 of the year for which the application for registration is filed. Unless an order is in effect under Section 412, a registration may be automatically renewed each year by filing such records as are required by rule or order under this [Act], by paying the fee specified in Section 410, and by paying costs charged by the designee of the administrator for processing the filings.

(e) **[Additional Conditions or Waivers.]** A rule or order under this [Act] may impose such other conditions, unless inconsistent with the National Securities Markets Improvement Act of 1996, or an order under this [Act] may waive specific requirements in connection with registration as are appropriate in the public interest and for the protection of investors.

Proposed Comments

Prior Provisions: 1956 Act Section 202; RUSA Sections 205, 208.

1. Under Section 406(a), the administrator is authorized to accept standardized forms

such as Form B-D for broker-dealers; Form U-4 for agents and investment adviser representatives; and Form ADV for investment advisers, which are filed today through such designees as the Web-CRD or the Investment Adviser Registration Depository (IARD). While this Act generally encourages uniformity, Sections 401(a) and (e) are intended to give the administrator authority to augment or waive disclosure requirements in appropriate cases.

2. Section 406(a) eliminates the listing of specified information delineated in Section 202 of the 1956 Act. As with RUSA Section 205, the intent is to facilitate coordination with widely used standardized forms.

3. Under this Act a single person may act both as an agent and investment adviser representative if the person satisfies applicable requirements to be both an agent and investment adviser representative.

SECTION 407. SUCCESSION AND CHANGE IN REGISTRATION OF BROKER-DEALER OR INVESTMENT ADVISER.

(a) [**Succession.**] A broker-dealer or investment adviser may succeed to the current registration of another broker-dealer or investment adviser or a notice filing of a federal covered investment adviser, and a federal covered investment adviser may succeed to the current registration of an investment adviser or notice filing of another federal covered investment adviser, by filing as a successor an application for registration pursuant to Section 401 or 403, or a notice pursuant to Section 405, for the unexpired portion of the current registration or notice filing.

(b) [**Organizational change.**] A broker-dealer or investment adviser may change its form of organization or state of incorporation or organization, by filing an amendment to its registration if the change does not involve a material change in its financial condition or management. The amendment becomes effective when filed or upon a date designated by the registrant in its filing. The new organization is a successor to the original registrant for the

purposes of this [Act]. If there is a material change in financial condition or management, the broker-dealer or investment adviser shall file a new application for registration. Any predecessor registered under this [Act] shall stop conducting its securities business other than winding down transactions and shall file for withdrawal of broker-dealer or investment adviser registration within 45 days after filing its amendment to effect succession.

(c) [**Name change.**] A broker-dealer or investment adviser may change its name by amendment to its registration. The amendment becomes effective when filed or upon a date designated by the registrant.

(d) [**Change of control**.] A change of control of a broker-dealer or investment adviser may be made in accordance with a rule or order under this [Act].

Proposed Comments

Prior Provisions: 1956 Act Section 202(c); RUSA 210.

1. Section 408 is intended to avoid unnecessary interruptions of business by specifying procedures for a successor broker-dealer or investment adviser; a broker-dealer or investment adviser that changes its form of organization or name; or, in accordance with a rule or order adopted under this Act when there has been a change of control of a broker-dealer or investment adviser.

2. There is no filing fee under Section 407.

SECTION 408. TERMINATION OF EMPLOYMENT OR ASSOCIATION OF AGENTS AND INVESTMENT ADVISER REPRESENTATIVE AND TRANSFER OF EMPLOYMENT OR ASSOCIATION.

(a) [**Notice of Termination.**] If an agent registered under this [Act] terminates employment by or association with a broker-dealer or issuer, or if an investment adviser representative

terminates employment by or association with an investment adviser or federal covered investment adviser, or if either registrant terminates activities that require registration as an agent or investment adviser representative, the broker-dealer, investment adviser, or federal covered investment adviser shall promptly file a notice of termination. If the registrant learns that the broker-dealer, issuer, investment adviser, or federal covered investment adviser has not filed the notice, the registrant may do so.

(b) [**Transfer of employment or association.**] If an agent registered under this [Act] terminates employment by or association with a broker-dealer registered under this [Act] and begins employment by or association with another broker-dealer registered under this [Act], or if an investment adviser representative registered under this [Act] terminates employment by or association with an investment adviser registered under this [Act] or a federal covered investment adviser who has filed a notice under Section 405 and begins employment by or association with another investment adviser registered under this [Act] or a federal covered investment adviser, who has filed a notice under Section 405, upon the filing by or on behalf of the registrant, within 30 days after the termination, of an application for registration that complies with the requirement of Section 406(a), and payment of the filing fee required under Section 410, the registration of the agent or investment adviser, is:

(1) immediately effective as of the date of the completed filing if the agent's Central Registration Depository record or successor record or the investment adviser representative's Investment Adviser Registration Depository record or successor record does not contain a new or amended disciplinary disclosure within the previous 12 months; or

(2) temporarily effective as of the date the completed filing if the agent's Central

Registration Depository record or the investment adviser representative's Investment Advisor Registration Depository record contains a new or amended disciplinary disclosure within the preceding 12 months.

(c) **[Withdrawal of temporary registration**] The administrator may withdraw the temporary registration if there were grounds for discipline under Section 412 and the administrator does so within 30 days after the filing of the application. If the administrator does not withdraw the temporary registration, registration becomes automatically effective on the 31st day after filing.

(d) **[Power to prevent temporary registration.**] The administrator may prevent the effectiveness of a transfer of an agent or investment adviser representative under paragraph (b)(1) or (b)(2) based on the public interest and the protection of investors.

(e) [**Termination of registration or application for registration.**] If the administrator determines that a registrant or applicant for registration is no longer in existence or has ceased to act as a broker-dealer, agent, investment adviser, or investment adviser representative, or is the subject of an adjudication of mental incompetence or is subject to the control of a committee, conservator, or guardian, or cannot reasonably be located, a rule or order under this [Act] may require the registration be canceled or terminated or the application denied. The administrator may reinstate a canceled or terminated registration, with or without hearing, and may make the registration retroactive.

Proposed Comments

Prior Provision: 1956 Act Section 204(d).

1. Under Sections 402(c) and 404(c) registration of an agent or investment adviser representative is only effective while the agent or investment adviser representative is employed by or associated with a broker-dealer, issuer, or investment adviser. Section 408(a) specifies procedure

to inform the administrator of a notice of termination.

2. To expedite transfer to a new broker-dealer in investment adviser, Section 408(b) generally facilitates a procedure by which agents or investment adviser representative registration will be effective immediately as of the date of new employment when there is no new or added disciplinary disclosure in relevant CRD or IARD records. Both electronic systems are currently administered by the NASD. Section 408(d) is intended to ensure that the administrator has the broadest possible authority to prevent immediate effectiveness in appropriate cases.

SECTION 409. WITHDRAWAL OF REGISTRATION OF BROKER-DEALERS, AGENTS, INVESTMENT ADVISERS, AND INVESTMENT ADVISERS REPRESENTATIVES. Withdrawal of registration by a broker-dealer, agent, investment adviser, or investment adviser representative becomes effective 60 days after filing of the application to withdraw or within such shorter period as required by rule or order under this [Act] unless a revocation or suspension proceeding is pending when the application is filed. If a proceeding is pending, withdrawal becomes effective when and upon such conditions as required by rule or order under this [Act]. The administrator may institute a revocation or suspension proceeding under Section 412 within one year after the withdrawal became effective automatically and issue a revocation or suspension order as of the last date on which registration was effective if a proceeding is not pending.

Proposed Comments

Prior Provisions: 1956 Act Section 204(e); RUSA Section 214

1. This Section generally follows the 1956 Act Section 204(e) and RUSA Section 214. This Section does not affect any application's privilege of withdrawal of an application from registration before the registration becomes effective. It is simply designed to prevent withdrawal of an effective registration under fire. The last sentence preserves the ability of the administrator to initiate an action under Section 412 when the administrator does not know of a reason to object to withdrawal until after withdrawal has become effective.

2. Ordinarily today a registrant will file a standardized form such as BD-W or ADV-W to withdraw registration.

SECTION 410. FILING FEES.

(a) [**Broker-dealers.**] A person shall pay a fee of [$___] when initially filing an application as a broker-dealer for registration, and a fee of [$___] when filing a renewal of registration as a broker-dealer. If the filing results in a denial or withdrawal, the administrator shall retain [$___] of the fee.

(b) [**Agents**.] The fee for an individual is [$___] when filing an application for registration as an agent, a fee of [$___] when filing a renewal of registration as an agent, and a fee of [$____] when filing for a change of registration as an agent. If the filing results in a denial or withdrawal, the administrator shall retain [$___] of the fee.

(c) [**Investment advisers.**] A person shall pay a fee of [$___] when filing an application for registration as an investment adviser, and a fee of [$___] when filing a renewal of registration as an investment adviser. If the filing results in a denial or withdrawal, the administrator shall retain [$___] of the fee.

(d) [**Investment adviser representatives.**] The fee for an individual is [$___] when filing an application for registration as an investment adviser representative, a fee of [$___] when filing a renewal of registration as an investment adviser representative, and a fee of [$___] when filing a change of registration as an investment adviser representative. If the filing results in a denial or withdrawal, the administrator shall retain [$___] of the fee.

(e) **[Federal covered investment advisers.]** A federal covered investment adviser required

to file a notice under Section 405, shall pay an initial and annual notice fee of [$___].

(f) [**Payment.**] A person required to pay a filing or notice fee under this Section may transmit the fee through or to a designee as a rule or order requires under this [Act].

[(g) [**Dual agent/investment adviser representative.**] An investment adviser representative who is registered as an agent under Section 402 and who represents a person that is both registered as a broker-dealer under Section 401 and registered as an investment adviser under Section 403 or required as a federal covered investment adviser to make a notice filing under Section 405 shall not be required to pay an initial or annual registration fee for registration as an investment adviser representative.]

Proposed Comments

Prior Provisions: 1956 Act Section 202(b); RUSA Section 206.

Each state should determine the appropriate fees for each type of registration and for each type of renewal, denial, or withdrawal of a registration.

SECTION 411. POSTREGISTRATION REQUIREMENTS.

(a) **[Financial requirements.]** Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22), a rule or order under this [Act] may establish minimum financial requirements for broker-dealers registered or required to be registered under this [Act] and investment advisers registered or required to be registered under this [Act].

(b) [**Financial reports.**] Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222(b) of the Investment Advisers Act of 1940 (15 U.S.C.

Section 80b-22), a broker-dealer registered or required to be registered under this [Act] and an investment adviser registered or required to be registered under this [Act] shall file such financial reports as are required by rule or order under this [Act]. If the information contained in a record filed under this subsection is or becomes inaccurate or incomplete in any material respect, the registrant shall promptly file a correcting amendment.

(c) [**Recordkeeping**.] Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22):

(1) a broker-dealer registered or required to be registered under this [Act] and an investment adviser registered or required to be registered under this [Act] shall make and maintain the accounts, correspondence, memoranda, papers, books, and other records as required by the administrator;

(2) broker-dealer records required to be maintained under paragraph (1) may be maintained in any form of data storage acceptable under Section 17(a) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78q(a)) if they are readily accessible to the administrator; and

(3) investment adviser records required to be maintained under paragraph (1) may be maintained in any form of data storage required by rule or order under this [Act].

(d) **[Audits or Inspections.]** The records of a broker-dealer registered or required to be registered under this [Act] and an investment adviser registered or required to be registered under this [Act] are subject to such reasonable periodic, special, or other audits or inspections by a representative of the administrator, within or without this State, as the administrator considers necessary or appropriate in the public interest and for the protection of investors. An audit or

inspection may be made at any time and without prior notice. The administrator may copy and remove for audit or inspection, copies of all records the administrator reasonably considers necessary or appropriate to conduct the audit or inspection. The administrator may assess a reasonable charge for conducting an audit or inspection under this subsection.

(e) **[Custody and discretionary authority bond or insurance.]** Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22), a rule or order under this [Act] may require each broker-dealer and investment adviser that has custody of or discretionary authority over funds or securities of a client to obtain insurance, or post a bond or other satisfactory form of security in an amount not to exceed [$____]. The administrator may determine the requirements of the insurance, bond, or other satisfactory form of security. Insurance or a bond or other satisfactory form of security may not be required of a broker-dealer registered under this [Act] whose net capital exceeds or, of an investment adviser registered under this [Act] whose minimum financial requirements exceed, the amounts required by rule or order under this [Act]. The insurance, bond, or other satisfactory form of security must permit an action by a person to enforce any liability on the insurance, bond, or other satisfactory form of security if commenced within the time limitations in Section 509(j)(2).

(f) [**Requirements for custody.**] Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22), an agent may not have custody of funds or securities of a customer except under the supervision of a broker-dealer and an investment adviser representative may not have custody over funds or securities of a client except under the supervision of an investment adviser or federal

covered investment adviser. A rule or order under this [Act] may prohibit, limit, or impose conditions on a broker-dealer regarding custody of funds or securities of a customer and on an investment adviser regarding custody of securities or funds of a client.

(g) [**Investment adviser brochure rule.**] With respect to an investment adviser registered or required to be registered under this [Act], a rule or order under this [Act] may require that information be furnished or disseminated to clients or prospective clients in this State as necessary or appropriate in the public interest and for the protection of investors and advisory clients.

(h) **[Continuing education.]** A rule or order under this [Act] may require any individual registered under Section 402 or 404 to participate in a continuing education program which is approved by the Securities and Exchange Commission and administered by a self-regulatory organization or, in the absence of such a program, a rule or order under this [Act] may require continuing education for an individual registered under Section 404.

Proposed Comments

Prior Provisions: 1956 Act Sections 102(c), 202(d)-(e) and 203; RUSA Sections 209, 211 and 215.

1. Sections 411(a)-(c) and (e)-(f) refer to "capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements." Under the National Securities Markets Improvement Act of 1996, states may not impose such requirements to covered individuals greater than those specified in Section 15(h) of the Securities Exchange Act of 1934 and Section 222 of the Investment Advisors Act of 1940.

2. Minimum financial requirements must be maintained during the entire time a person is registered and not merely at the time of the registration. See, e.g., National Grange Mut. Ins. Co. v. Prioleau, 236 S.E.2d 808 (S.C. 1977) (continuing bond requirement); Ridgeway, McLeod & Assoc., 281 A.2d 390 (N.J. Super. Ct. App. Div. 1971) (continuing minimum capital requirement).

3. The duty in Section 411(b) to correct or update information is limited to material information which a reasonable investor would continue to consider important in deciding whether to purchase or sell securities. Cf. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 444-450 (1970);

Securities Act Release No. 6084, 17 SEC Dock. 1048, 1054 (1979) ("persons are continuing to rely on all or any material portion of the statements").

4. Section 411(c)(1) authorizes the administrator to require all records to be preserved for the period the administrator prescribes by rule or order.

5. Rule 17a-4 is the current Rule under Section 17(a) of the Securities Exchange Act referred to in Section 411(c)(2) that addresses acceptable forms of data storage.

6. The administrator's power to copy and examine records in Section 411(d) is subject to all applicable privileges. See, e.g., 10 Louis Loss & Joel Seligman, Securities Regulation 4921-4925 n.69 (3d ed. rev. 1996). The power in Section 411(d) to conduct audits or inspections is distinguishable from the administrator's enforcement powers under Section 602. No subpoena is necessary under Section 411(d). Failure to submit to a reasonable audit or inspection is a violation of this Act which may result in an action by the administrator under Section 412(d)(14) or a criminal prosecution under Section 508.

7. Section 411(f) broadens 1956 Act Section 102(c) and RUSA Section 215 to apply to agents as well as investment adviser representatives. Subject to Section 15(h) of the Securities Exchange Act of 1934 and Section 222 of the Investment Adviser Act of 1940, the administrator is given broad authority to prohibit, limit, or condition custody arrangements.

8. Section 411 (g) parallels Rule 204-3, adopted under the Investment Advisers Act of 1940, popularly known as the brochure rule, which authorizes the SEC to require dissemination to investment adviser clients of specified information about the investment adviser and investment advice.

SECTION 412. DENIAL, REVOCATION, SUSPENSION, CANCELLATION, WITHDRAWAL, RESTRICTION, CONDITION, OR LIMITATION OF REGISTRATION.

(a) [**Disciplinary conditions-applicants.**] An order under this [Act] may deny an application, or condition or limit registration of an applicant to be a broker-dealer, agent, investment adviser, or investment adviser representative and if the applicant is a broker-dealer or investment adviser, any partner, officer, or director, any person having a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser, if

the administrator finds that the order is in the public interest and subsection (d) authorizes the action.

(b) **[Disciplinary conditions – registrants.]** An order under this [Act] may revoke, suspend, condition, or limit the registration of a current registrant and if the registrant is a broker-dealer or investment adviser, any partner, officer, or director, any person having a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser, if the administrator finds that the order is in the public interest and subsection (d) authorizes the action, but:

(1) The administrator may not institute a revocation or suspension proceeding under this subsection based on an order issued by another state that is reported to the administrator or designee later than one year after the date of the order on which it is based; and

(2) under subsection (d)(5)(A) through (B) the administrator may not issue an order on the basis of an order under the state securities act of another state unless the other order was based on conduct for which subsection (d) would authorize the action had the conduct occurred in this State.

(c) **[Disciplinary penalties – registrants.]** An order under this [Act] may censure, impose a bar, or impose a civil penalty in an amount not to exceed a maximum of [$___] for a single violation or [$___] for several violations on a registrant and if the registrant is a broker-dealer or investment adviser, any partner, officer, or director, any person having a similar functions or any person directly or indirectly controlling the broker-dealer or investment adviser, if the administrator finds that the order is in the public interest and subsection (d)(1)-(6), (9)-(10) or (12)-(14) authorize the action.

(d) **[Grounds for discipline]** A person may be disciplined under subsections (a) through (c) if the person:

(1) has filed an application for registration under this [Act] or the predecessor act within the previous 10 years in this State, which, as of the effective date of registration or as of any date after filing in the case of an order denying effectiveness, was incomplete in any material respect or contained a statement that, in light of the circumstances under which it was made, was false or misleading with respect to a material fact;

(2) willfully violated or willfully failed to comply with this [Act] or the predecessor act or a rule adopted or order issued under this [Act] or the predecessor act within the previous 10 years;

(3) has been convicted of any felony or within the previous 10 years has been convicted of a misdemeanor involving a security, a commodity futures or option contract, or an aspect of a business involving securities, commodities, investments, franchises, insurance, banking, or finance;

(4) is enjoined or restrained by a court of competent jurisdiction in an action instituted by the administrator under this [Act] or a predecessor act, a State, the Securities and Exchange Commission, or the United States from engaging in or continuing an act, practice, or course of business involving an aspect of a business involving securities, commodities, investments, franchises, insurance, banking, or finance;

(5) is the subject of an order, issued after notice and opportunity for hearing:

(A) by the securities, depository institution, insurance or other financial services regulator of a State, or by the Securities and Exchange Commission or other federal agency denying, revoking, barring, or suspending registration as a broker-dealer, agent, investment adviser, federal

covered investment adviser, or investment adviser representative;

(B) by the securities regulator of a State or by the Securities and Exchange Commission against a broker-dealer, agent, investment adviser, investment adviser representative, or federal covered investment adviser;

(C) by the Securities and Exchange Commission or by a self-regulatory organization suspending or expelling the registrant from membership in a self-regulatory organization;

(D) by a court adjudicating a United States Postal Service fraud;

(E) by the insurance regulator of a state denying, suspending, or revoking the registration of an insurance agent; or

(F) by a depository institution regulator suspending or barring a person from the banking or depository institution business;

(6) is the subject of an adjudication or determination, after notice and opportunity for hearing, by the Securities and Exchange Commission; the Commodity Futures Trading Commission, the Federal Trade Commission; a federal depository institution regulator, depository institution, insurance, or other financial services regulator of a State, that the person willfully violated the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, or the Commodity Exchange Act, the securities or commodities law of a State, or a federal or state law under which a business involving investments, franchises, insurance, banking, or finance is regulated;

(7) is insolvent, either in the sense that the person's liabilities exceed the person's assets or in the sense that the person cannot meet the person's obligations as they mature, but the administrator may not enter an order against an applicant or registrant under this paragraph without

a finding of insolvency as to the applicant or registrant;

(8) is not qualified on the basis of factors such as training, experience, and knowledge of the securities business, but in the case of an application by an agent for a broker-dealer that is a member of a self-regulatory organization or by an individual for registration as an investment adviser representative, a denial order may not be based on this paragraph if the individual has successfully completed all examinations required by subsection (e); but the administrator may require an applicant for registration under Section 402 or 404 who has not been registered in any state within the two years preceding the filing of an application in this State to successfully complete an examination;

(9) has failed to reasonably supervise an agent, investment adviser representative, or other individual, if the agent, investment adviser representative, or other individual was subject to the person's supervision and committed a violation of this [Act] or the predecessor act or a rule adopted or order issued under this [Act] or the predecessor act within the previous 10 years;

(10) has not paid the proper filing fee within 30 days after having been notified by the administrator of a deficiency, but the administrator shall vacate an order under this paragraph when the deficiency is corrected;

(11) after notice and opportunity for a hearing, has been found within the previous 10 years:

(A) by a court of competent jurisdiction to have willfully violated the laws of a foreign jurisdiction under which the business of securities, commodities, investment, franchises, insurance, banking or finance is regulated;

(B) to have been the subject of an order of a securities regulator of a foreign

jurisdiction denying, revoking, or suspending the right to engage in the business of securities as a broker-dealer, agent, investment adviser, investment adviser representative or similar person; or

(C) to have been suspended or expelled from membership by or participation in a securities exchange or securities association operating under the securities laws of a foreign jurisdiction;

(12) is the subject of a cease and desist order issued by the Securities and Exchange Commission or issued under the securities, franchise, or commodities laws of a state;

(13) has engaged in dishonest or unethical practices in the securities, banking, insurance, or commodities business within the previous 10 years; or

(14) refuses to allow or otherwise impedes the administrator from conducting an audit or inspection under Section 411(d) or refuses access to any registrant's office to conduct an audit or inspection.

(e) [**Examinations.**] A rule or order under this [Act] may require an examination, including an examination developed or approved by an organization of securities regulators, be successfully completed by a class of individuals or all individuals. An order under this [Act] may waive an examination as to an individual and a rule under this [Act] may waive an examination as to a class of individuals if the administrator determines that the examination is not necessary or appropriate in the public interest and for the protection of investors.

(f) [**Summary Process**.] The administrator may suspend or deny an application summarily, or restrict, condition, limit or suspend a registration, or censure, bar, or impose a civil penalty on a registrant pending final determination of an administrative proceeding. Upon the issuance of the order, the administrator shall promptly notify each person subject to the order that the order has

been issued, the reasons for the action, and that within 15 days after the receipt of a request in a record from the person, the matter will be scheduled for a hearing. If a hearing is not requested and none is ordered by the administrator, within 30 days after the date of service of the order, the order becomes final by operation of law. If a hearing is requested or ordered, the administrator, after notice of and opportunity for hearing to each person subject to the order, may modify or vacate the order or extend the order until final determination.

(g) [**Procedural requirements.**] An order may not be issued under this Section, except under subsection (f), without:

(1) appropriate notice to the applicant or registrant;

(2) opportunity for hearing; and

(3) findings of fact and conclusions of law in a record [in accordance with the state administrative procedure act].

(h) [**Control person liability.**] A person who controls, directly or indirectly, a person not in compliance with this Section may be disciplined by order of the administrator under subsections (a) through (c) to the same extent as the noncomplying person, unless the controlling person did not know, and in the exercise of reasonable care could not have known, of the existence of conduct that is the basis for discipline under this Section.

(i) **[Limit on investigation or proceeding.]** The administrator may not institute a proceeding under subsection(a), (b), or (c) solely based on material facts actually known by the administrator unless an investigation or the proceeding is instituted within one year after the administrator actually knew the material facts.

Proposed Comments

Prior Provisions: 1956 Act Section 204; RUSA Sections 207, 212-213.

1. Section 412 generally follows Section 204 of the 1956 Act and Sections 207 and 212-213 of RUSA, but has been modified to reflect subsequent developments that have broadened the scope and remedies of counterpart federal and state statutes.

2. Section 412 authorizes the administrator to seek a sanction based on the seriousness of the misconduct. Under Section 412 the administrator must prove that the denial, revocation, suspension, cancellation, withdrawal, restriction, condition, or limitation both is (1) in the public interest and (2) involves one of the enumerated grounds in Section 412(d). See, e.g., Mayflower Sec. Co., Inc. v. Bureau of Sec., 312 A.2d 497 (N.J. 1973). The "public interest" is a much litigated concept that has come to have settled meanings. See generally 6 L. Loss & J. Seligman, Securities Regulation 3056-3057 (3d ed. 1990) (under federal securities laws). The public interest will not require imposition of a sanction for every minor or technical violation of subsection (d).

3. The term "foreign" means a jurisdiction outside of the United States, not a different state within the United States.

4. Section 412(a)-(c) authorizes the administrator to proceed against an entire firm when an individual partner, officer, or director or person occupying a similar status or performing similar functions, or a controlling person is disciplined under subsection (d), but only if proceeding against the entire firm is in the public interest. The discipline of such an individual may not automatically be used against a broker-dealer or investment adviser. When, however, there is a failure to reasonably supervise, see Section 412(d)(9) or control person liability, see Section 412(h), the administrator is empowered to proceed against a firm in an appropriate case. In Section 412, "any partner, officer, or director, any person occupying a similar status or performing similar function." can include a branch manager, assistant branch manager, or other supervisor.

5. In Section 412(d)(1) the completeness and accuracy of an effective application for registration is tested as of the appropriate effective date. An application that becomes incomplete or inaccurate after its effective date is not a ground for discipline under paragraph (d)(1). On the other hand, in a proceeding to deny effectiveness to a pending application for registration, the completeness and accuracy of the application is not limited to the effective date and can be judged on any date after filing.

6. The term "willfully" in Section 412(d)(2)(11)(A) is discussed in Comment 2 to Section 508.

7. There is no time limit or statute of limitations on felony convictions in Section 412(d)(3) as a ground for disciplinary action.

8. The present tense of the verb "is" in Sections 412(d)(4)-(6) and (12) means that an

injunction, order, adjudication, or determination that has expired or been vacated is no longer a ground for discipline.

9. In Sections 412(d)(5) and (6) the administrator is not required to prove the validity of the ground which led to the earlier disciplinary order.

10. Under Section 412(d)(7) the administrator may not proceed against a broker-dealer or investment advisory firm on the basis of the insolvency of a partner, officer, director, controlling person or other person specified in subsection (b), unless it is a sole proprietorship.

11. Under the counterparts to Section 412(d)(8) and (e) applicants to become agents of broker-dealers typically take standardized tests administered by the National Securities of Securities Dealers.

12. The term "failed to supervise reasonably" in Section 412(d)(9) includes having reasonable supervisory procedures in place as well as a proper system of supervision and internal control. Cf. Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990), *cert. denied*, 499 U.S. 976 (1991). Section 15(b)(4)(E) of the Securities Exchange Act of 1934 similarly addresses "failure to supervise reasonably." See 6 Louis Loss & Joel Seligman, Securities Regulation 3097-3101 (3d ed. rev. 2002).

13. The term "dishonest and unethical practices" in Section 412(d)(13) has been held not to be unconstitutionally vague. See, e.g., Brewster v. Maryland Sec. Comm'n, 548 A.2d 157, 160 (M.D. Ct. Spec. App. 1988) ("a broad statutory standard is not vague if it has a meaningful referent in business practice, custom or usage"); Johnson-Bowles Co. v. Division of Sec., 829 P.2d 101, 114 (Utah Ct. App. 1992) (such legislative language bespeaks a legislative intent to delegate the interpretation of what constitutes "dishonest and unethical practices" in the securities industry to the administrator). Ministerial or clerical violations of a statute or rule, if immaterial and occurring without intent or recklessness, typically would not constitute dishonest or unethical practices.

14. Section 412(d)(14) can be violated by a refusal to cooperate with an administrator's reasonable audit, inspection, or investigation, including by withholding or concealing records, refusing to furnish required records, or refusing the administrator reasonable access to any office or location within an office to conduct an audit, inspection or investigation under this Act. However, a request by a person subject to an audit, examination, inspection, or investigation for a reasonable delay to obtain assistance of counsel does not constitute a violation of Section 412(d)(14).

15. Sections 412(f) and (g) amplify the earlier procedures found in Section 204(f) of the 1956 Act and are intended to facilitate summary disciplinary proceedings, when these are appropriate.

16. "Actually known" in Section 412(i) would not be satisfied solely by material facts communicated in the Central Registration Depository or Investment Advisory Registration Depository systems.

ARTICLE 5

FRAUD AND LIABILITIES

SECTION 501. GENERAL FRAUD. It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly:

(1) to employ a device, scheme, or artifice to defraud;

(2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it is made, not misleading; or

(3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.

Proposed Comments

Prior Provisions: 1956 Act Section 101; RUSA Section 501.

1. Section 501, which was Section 101 in the 1956 Act, was modeled after Rule 10b-5 adopted under the Securities Exchange Act of 1934 and on Section 17(a) of the Securities Act of 1933, except that Rule 10b-5 was expanded to cover the purchase as well as the sale of any security. There has been significant later case development interpreting Rule 10b-5, Section 17(a), and Section 101 of the 1956 Act. Section 101 is not identical to either Rule 10b-5 or Section 17(a).

2. There are no exemptions from Section 501.

3. Section 501 applies to any securities transaction. This would include registered, exempt, or federal covered securities. It would also include a rescission offer under Section 510.

4. The possible consequences of violating Section 501 are many. These include denial, suspension, or revocation of securities registration under Section 306; denial, revocation, suspension, cancellation, withdrawal, restriction, condition or limitation of a broker-dealer, agent, investment adviser, or investment adviser representative registration under Section 412; criminal prosecution under Section 508; or administrative proceedings under Sections 603 and 604.

5. Because Section 501, like Rule 10b-5, reaches market manipulation, see 8 Louis Loss & Joel Seligman, Securities Regulation Ch.10.D (3d ed. 1991), this Act does not include the RUSA market manipulation Section 502, which had no counterpart in the 1956 Act.

6. The culpability required to be pled or proved under Section 501 is addressed in the relevant enforcement context. See, e.g., Section 508, criminal penalties, where "willfulness" must be proven; Section 509, civil liabilities, which includes a reasonable care defense.

7. There is no private cause of action, express or implied, under Section 501. Section 509(m) expressly provides that only Section 509 provides a private cause of action for conduct that could violate Section 501.

SECTION 502. PROHIBITED CONDUCT IN PROVIDING INVESTMENT ADVICE.

(a) [**Fraud in providing investment advice.**] It is unlawful for a person that advises others, for compensation, either directly or indirectly, or through publications or writings, as to the value of securities or the advisability of investing in, purchasing or selling securities, or that, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities:

(1) to employ a device, scheme, or artifice to defraud another person; or

(2) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.

(b) [**Rulemaking.**] (1) A rule under this [Act] may define an act, practice, or course of business of an investment adviser or an investment adviser representative, other than a supervised person of a federal covered investment adviser, as fraudulent, deceptive or manipulative, and prescribe means reasonably designed to prevent investment advisers and investment adviser representatives, other than supervised persons of a federal covered investment adviser, from engaging in acts, practices, and courses of business defined as fraudulent, deceptive, or

manipulative.

(2) A rule under this [Act] may specify the contents of an investment advisory contract entered into, extended, or renewed by an investment adviser.

Proposed Comments

Prior Provisions: 1956 Act Section 102(a); RUSA Section 503.

1. Section 502 is not limited to registered investment advisers or investment advisers representatives.

2. A person can both violate Section 501 and Section 502 if the person violates Section 502 in connection with the offer, purchase, or sale of a security.

3. The rulemaking authority under Rule 502(b) would provide the basis for existing NASAA rules concerning investment advisers, to the extent these rules are not preempted by the National Securities Markets Improvement Act of 1996.

4. Under Section 203A(b)(2) of the Investment Advisers Act states retain their authority to investigate and bring enforcement actions with respect to fraud or deceit against a federal covered investment adviser or a person associated with a federal covered investment adviser. Under Section 502(a), which applies to any person, a state could bring an enforcement action against a federal covered investment adviser, including a federal covered investment adviser excluded from the definition of investment adviser in Section 102(15)(E).

5. There is no private cause of action, express or implied, under Section 502. Section 509(m) expressly provides that only Section 509 provides for a private cause of action for prohibited conduct in providing investment advice that could violate Section 502.

SECTION 503. EVIDENTIARY BURDEN.

(a) [**Civil.**] In a civil action or administrative proceeding under this [Act], a person claiming an exemption, exception, preemption, or exclusion has the burden to prove the applicability of the exemption, exception, preemption, or exclusion.

(b) [**Criminal.**] In a criminal proceeding under this [Act], a person claiming an exemption,

exception, preemption, or exclusion has the burden of going forward with evidence of the claim.

Proposed Comment

Prior Provisions: 1956 Act Section 402(d); RUSA Section 608.

1. As specified in Section 503(a), in a civil action, the person claiming an exemption, exception, preemption, or exclusion has the burden of persuasion.

2. In contrast, in a criminal action under Section 503(b), the prosecutor is required to prove each element of a crime "beyond a reasonable doubt." The defendant only has the burden of producing evidence of an exemption, exception, preemption, or exclusion. Some court decisions have characterized this burden as an affirmative defense. See, e.g., United States ex. rel. Schott v. Tehan, 365 F.2d 191, 195 (6th Cir. 1966) (Ohio blue sky law constitutionally shifts burden of production to defendant); Commonwealth v. David, 309 N.E.2d 484, 488 (Mass. 1974) (exemption is an affirmative defense); State v. Frost, 387 N.E.2d 235, 238-239 (Ohio 1979) (it is not unconstitutional to require the burden of proof as an affirmative defense to prove a securities law exemption); State v. Andersen, 773 A.2d 328 (Conn. 2001) (an exemption from registration is an affirmative defense to the charge of selling unregistered securities).

SECTION 504. FILING OF SALES AND ADVERTISING LITERATURE.

(a) [**Filing requirement.**] Except as otherwise provided in subsection (b), a rule or order under this [Act] may require the filing of a prospectus, pamphlet, circular, form letter, advertisement, sales literature, or other advertising communication relating to a security or investment advice, addressed or intended for distribution to prospective investors, including clients or prospective clients of a person registered or required to be registered as an investment adviser under this [Act].

(b) [**Scope limitations.**] This Section does not apply to sales and advertising literature specified in subsection (a) relating to a federal covered security, a federal covered investment adviser, or a security or transaction exempted by Section 201, 202, or 203 except as may be required pursuant to Section 201(7).

Proposed Comments

Prior Provisions: 1956 Act Section 403; RUSA Section 405.

1. The prospectuses, pamphlets, circulars, form letters, advertisements, sales literature or advertising communications, includes material disseminated electronically or available on a web site.

2. The administrator may bring a civil enforcement action in a court under Section 603 or institute administrative enforcement under Section 604 to prevent publication, circulation or use of any materials required by the administrator to be filed under Section 504 that have not been filed.

3. Section 504(b) is meant to refer to the communications described in Section 504(a).

SECTION 505. MISLEADING FILINGS. It is unlawful for a person to make or cause to be made, in a record that is used in an action or proceeding or filed under this [Act], a statement that, at the time and in the light of the circumstances under which it is made, is false or misleading in a material respect, or, in connection with the statement, to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it was made, not false or misleading.

Proposed Comment

Prior Provisions: 1956 Act Section 404; RUSA Section 504.

The definition of "materiality" in TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) ("an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote") has generally been followed in both federal and state securities law. See 4 Louis Loss & Joel Seligman, Securities Regulation 2071-2105 (3d ed. rev. 2000).

SECTION 506. MISREPRESENTATIONS CONCERNING REGISTRATION OR EXEMPTION. The filing of an application for registration, a registration statement, a notice filing under this [Act], or the registration of a person, the notice filing by a person, or the registration of a security under this [Act] does not constitute a finding by the administrator that a record filed under this [Act] is true, complete, and not misleading. The filing or registration or the availability of an exemption, exception, preemption, or exclusion for a security or a transaction does not mean that the administrator has passed upon the merits or qualifications of, or recommended or given approval to, a person, security, or transaction. It is unlawful to make, or cause to be made, to a purchaser, customer, client, or prospective customer or client, a representation inconsistent with this Section.

Proposed Comment

Prior Provisions: 1956 Act Section 405; RUSA Section 505.

This Section follows the 1956 Act and RUSA, as well as state securities statutes generally, in providing that a misrepresentation concerning registration or an exemption is unlawful.

SECTION 507. QUALIFIED IMMUNITY. A broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative is not liable to another broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative for defamation relating to an alleged untrue statement that is contained in a record required by the administrator, or designee of the administrator, the Securities and Exchange Commission, or a self-regulatory organization, unless it is proven that the person knew, or should have known at the time that the statement was made, that it was false in a material respect or the person acted in reckless disregard of the statement's truth or falsity.

Proposed Comments

Source of Law: National Association of Securities Dealers, Inc. Proposal Relating to Qualified Immunity in Arbitration Proceedings for Statements Made in Forms U-4 and U-5.

1. The National Association of Securities Dealers proposal was reprinted in Securities Exchange Release 39,892, 66 SEC Dock. 2473 (1998). This proposal was limited to arbitration proceedings. It has not been approved by the Securities and Exchange Commission.

2. An alternative approach would be a standard providing for absolute immunity. See generally Anne Wright, Form U-5 Defamation, 52 Wash. & Lee L. Rev. 1299 (1995); Acciardo v. Millennium Sec. Corp., 83 F. Supp. 2d 413 (S.D.N.Y. 2000) (discussing both New York qualified and absolute immunity cases).

3. Securities administrators or self-regulatory organizations generally are subject to absolute or qualified immunity for actions of their employees within the course of their official duties. See 10 Louis Loss & Joel Seligman, Securities Regulation 4818-4821 (3d ed. rev. 1996).

4. As is generally the law "truth is a complete defense to a defamation action." Andrews v. Prudential Sec., Inc., 160 F.3d 304, 308 (6th Cir. 1998).

5. An agent who has been the subject of a Form U-5, Uniform Termination Notice for Securities Industry Registration, may respond to specified adverse disclosures and have their responses reprinted on the published version of Form U-5.

Reporter's Notes

Through June 2001 no state had adopted an immunity provision in its securities statute. No state has rejected immunity in this context by judicial decision. A number of states have adopted qualified immunity by judicial decision. See, e.g., Eaton Vance Distrib., Inc. v. Ulrich, 692 So.2d 915 (Fla. Dist. Ct. App. 1997); Bavarati v. Josephal, Lyon & Ross, Inc., 28 F.3d 704 (7th Cir. 1994) (Illinois); Andrews v. Prudential Sec., Inc., 160 F.3d 304 (6th Cir. 1998) (Michigan); Prudential Sec., Inc. v. Dalton, 929 F. Supp. 1411 (N.D. Okla. 1996) (Oklahoma); Glennon v. Dean Witter Reynolds Inc., 83 F.3d 132 (6th Cir. 1996) (Tennessee).

SECTION 508. CRIMINAL PENALTIES.

(a) [**Criminal penalties.**] A person that willfully violates this [Act], or a rule adopted or order issued under this [Act], except Section 504 or the notice filing requirements of Section 302 or

405, or that willfully violates Section 505 knowing the statement made to be false or misleading in a material respect, upon conviction, shall be fined not more than [$___] or imprisoned not more than [___] years, or both. An individual convicted of violating a rule or order under this [Act] may be fined, but may not be imprisoned, if the individual did not have knowledge of the rule or order.

(b) [**Criminal reference not required.**] The [Attorney General or the proper prosecuting attorney] with or without a reference from the administrator, may institute appropriate criminal proceedings under this [Act].

(c) [**No limitation on other criminal enforcement**.] This [Act] does not limit the power of this State to punish a person for conduct that constitutes a crime under other laws of this State.

Proposed Comments

Prior Provisions: 1956 Act Section 409; RUSA Section 604; Securities Exchange Act of 1934 Section 32(a).

1. This Section follows the 1956 Act and the federal securities laws in imposing criminal penalties for any willful violation of the Act. RUSA Section 604 distinguished between felonies and misdemeanors, limiting willful violations of cease and desist orders to a misdemeanor.

2. The term "willfully" has the same meaning in Section 508 as it did in the 1956 Act. All that is required is proof that a person acted intentionally in the sense that the person was aware of what he or she was doing. Proof of evil motive or intent to violate the law or knowledge that the law was being violated is not required.

3. The final sentence of Section 508(a) is based on Section 32(a) of the Securities Exchange Act of 1934, which provides: "[N]o person shall be subject to imprisonment under this section in violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation." The "no knowledge" clause in Section 508(a) is only relevant to sentencing. The person convicted has the burden of persuasion to prove no knowledge at sentencing. Because this does not impose a burden on the defendant to disprove the elements of a crime, Section 32(a) of the Securities Exchange Act of 1934 has been held not to raise a constitutional problem. United States v. Mandel, 296 F. Supp. 1038, 1040 (S.D.N.Y. 1969).

4. The appropriate state prosecutor under Section 508(b) may decide whether to bring a criminal action under this statute, another statute, or, when applicable, common law. In certain

states the administrator has full or limited criminal enforcement powers.

5. This Section does not specify maximum dollar amounts for criminal fines, maximum terms for imprisonment, nor the years of limitation, but does provide for each state to specify appropriate magnitudes for criminal fines, maximum terms for imprisonment, and a statute of limitations.

Reporter's Notes

1. The definition of willfulness in Section 508 has been followed by most courts. See, e.g., State v. Hodge, 460 P.2d 596, 604 (Kan. 1969) ("No specific intent is necessary to constitute the offense where one violates the securities act except the intent to do the act denounced by the statute"); State v. Nagel, 279 N.W.2d 911, 915 (S.D. 1979) ("[I]t is widely understood that the legislature may forbid the doing of an act and make its commission a crime without regard to the intent or knowledge of the doer"); State v. Fries, 337 N.W.2d 398, 405 (Neb. 1983) (proof of a specific intent, evil motive, or knowledge that the law was being violated is not required to sustain a criminal conviction under a state's blue sky law); People v. Riley, 708 P.2d 1359, 1362 (Colo. 1985) ("A person acts 'knowingly' or 'willfully' with respect to conduct . . . when he is aware that his conduct . . . exists"); State v. Larsen, 865 P.2d 1355, 1358 (Utah 1993) (willful implies a willingness to commit the act, not an intent to violate the law or to injure another or acquire any advantage); State v . Montgomery, 17 P.3d 292, 294 (Idaho 2001) (bad faith is not required for a violation of a state securities act; willful implies "simply a purpose or willingness to commit the act or make the omission referred to"); State v. Dumke, 901 S.W.2d 100, 102 (Mo. Ct. App. 1995) (*mens rea* not required); State v. Mueller, 549 N.W.2d 455, 460 (Wis. Ct. App. 1996) (willfulness does not require proof that the defendant acted with intent to defraud or knowledge that the law was violated).

2. The "no knowledge" clause was interpreted in the United States v. Lilley, 291 F. Supp. 989, 993 (S.D. Tex. 1968) to mean that

> Congress intended to charge every man with knowledge of the standards prescribed in the securities acts themselves. It would frustrate the intent of Congress to permit a person whose conduct is expressly prohibited by statute to attempt to prove no knowledge of a parallel rule provision. Allowing these defendants to invoke the "no knowledge" clause would have precisely this effect. It was not intended by the Congress that the "no knowledge" clause of the penalty statute should be available to persons who were charged with knowing their conduct to be in violation of a particular rule or regulation of the SEC such as Rule 10b-5. . . .
>
> . . . Proof of no knowledge cannot mean proof that defendants did not know, for example, the precise number or common name of the rule, the book and page where it was to be found, or the date upon which it was promulgated. It does not even mean proof of a lack of knowledge that their conduct was proscribed by rule rather than by statute. Proof of "no knowledge" of the rule can only mean proof of an

ignorance of the substance of the rule, proof that they did not know that their conduct was contrary to law.

SECTION 509. CIVIL LIABILITY.

(a) [**Securities Litigation Uniform Standards Act.**] Enforcement of civil liability under this Section is subject to the Securities Litigation Uniform Standards Act of 1998.

(b) [**Liability of seller to purchaser.**] A person is liable to the purchaser if the person sells a security in violation of Section 301, or by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statement made, in light of the circumstances under which it is made, not misleading, the purchaser not knowing the untruth or omission, and the seller not sustaining the burden of proof that the seller did not know and, in the exercise of reasonable care, could not have known of the untruth or omission. An action under this subsection is governed by the following:

(1) The purchaser may maintain an action at law or in equity to recover the consideration paid for the security, less the amount of any income received on the security, and interest [at the legal rate of interest] per year from the date of the purchase, costs, and reasonable attorneys' fees determined by the court, upon the tender of the security, or for actual damages as provided in paragraph (3).

(2) The tender referred to in paragraph (1) may be made any time before entry of judgment. Tender requires only notice in a record of ownership of the security and willingness to exchange the security for the amount specified. A purchaser that no longer owns the security may recover actual damages.

(3) Actual damages in an action arising under this subsection are the amount that would be recoverable upon a tender less the value of the security when the purchaser disposed of it, and interest [at the legal rate of interest] from the date of purchase, costs, and reasonable attorneys' fees determined by the court.

(c) [**Liability of purchaser to seller.**] A person is liable to the seller if the person buys a security by means of an untrue statement of a material fact or omission to state a material fact necessary in order to make the statement made, in light of the circumstances under which it is made, not misleading, the seller not knowing of the untruth or omission, and the purchaser not sustaining the burden of proof that the purchaser did not know, and in the exercise of reasonable care, could not have known of the untruth or omission. An action under this subsection is governed by the following:

(1) The seller may maintain an action at law or in equity to recover the security, and any income received on the security, costs, and reasonable attorney's fees determined by the court, upon the tender of the purchase price, or for actual damages as provided in paragraph (3).

(2) The tender referred to in paragraph (1) may be made any time before entry of judgment. Tender requires only notice in a record of the present ability to pay the amount tendered and willingness to take delivery of the security for the amount specified. If the purchaser no longer owns the security, the seller may recover actual damages.

(3) Actual damages in an action arising under this subsection are the difference between the price at which the security was sold and the value the security would have had at the time of the sale in the absence of the purchaser's conduct causing liability, and interest [at the legal rate of interest] from the date of sale of the security, costs, and reasonable attorneys' fees

determined by, the court.

(d) [**Liability of unregistered broker-dealer and agent.**] A person acting as a broker-dealer or agent that sells or buys a security in violation of Section 401(a), 402(a), or 506 is liable to the customer. The customer, if a purchaser, may maintain an action at law or in equity for recovery of actual damages as specified in subsections (b)(1) through (3); or, if a seller, a remedy as specified in subsections (c)(1) through (3).

(e) **[Liability of unregistered investment adviser and investment adviser representative.]** A person acting as an investment adviser or investment adviser representative that provides investment advice for a fee in violation of Section 403(a), 404(a), or 506 is liable to the client. The client may maintain an action at law or in equity to recover the consideration paid for the advice, interest [at the legal rate of interest] from the date of payment, costs, and reasonable attorney's fees determined by the court.

(f) [**Liability for investment advice**]. (1) A person that receives directly or indirectly any consideration for providing investment advice to another person and that employs a device, scheme, or artifice to defraud the other person or engages in an act, practice, or course of business that operates or would operate as a fraud or deceit on the other person, is liable to the other person.

(2) The other person specified in paragraph (1) may maintain an action at law or in equity to recover the consideration paid for the advice and the amount of any actual damages caused by the conduct specified in paragraph (1), interest [at the legal rate of interest] from the date of the conduct causing liability, costs, and reasonable attorneys' fees determined by the court, less the amount of any income received as a result of the conduct specified in paragraph (1).

(3) This subsection does not apply to a broker-dealer or its agents, whose providing of

investment advice is solely incidental to the conduct of business as a broker-dealer and that does not receive special compensation for the investment advice.

(g) [**Joint and several liability**.] The following persons are liable jointly and severally with and to the same extent as persons liable under subsections (b) through (f):

(1) a person that directly or indirectly controls a person liable under subsections (b) through (f), unless the person sustains the burden of proof that the controlling person did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist;

(2) an individual who is a managing partner, executive officer, or director of a person liable under subsections (b) through (f), including each individual having a similar status or performing similar functions, unless the individual sustains the burden of proof that the individual did not know and, in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist;

(3) an individual who is an employee of or associated with a person liable under subsections (b) through (f) and who materially aids the conduct giving rise to the liability, unless the individual sustains the burden of proof that the individual did not know and, in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist; and

(4) a person that is a broker-dealer, agent, investment adviser, or investment adviser representative that materially aids the conduct giving rise to the liability under subsections (b) through (f), unless the person sustains the burden of proof that the person did not know and, in the exercise of reasonable care could not have known, of the existence of the facts by reason of which

liability is alleged to exist.

(h) [**Right of contribution.**] A person liable under this Section has a right of contribution as in cases of contract against any other person liable under this Section for the same conduct.

(i) [**Survival of cause of action.**] A cause of action under this Section survives the death of an individual who might have been a plaintiff or defendant.

(j) **[Statute of limitations.]** A person may not obtain relief:

(1) under subsection (b) for violation of Section 301, or under subsection (d) or (e), unless the action is commenced within one year after the violation occurred; or

(2) under subsection (b), other than for violation of Section 301, or under subsection (c) or (f), unless the action is commenced within the earlier of one year after discovery of the facts constituting the violation and three years after such violation.

(k) [**No enforcement of violative contract.**] A person that has made or engaged in the performance of a contract in violation of this [Act] or a rule adopted or order issued under this [Act], or that has acquired a purported right under the contract with knowledge of the facts by reason of which its making or performance was in violation of the [Act], may not base an action on the contract.

(l) [**No contractual waiver.**] A condition, stipulation, or provision binding a person purchasing or selling a security or receiving investment advice to waive compliance with this [Act] or a rule adopted or order issued under this [Act] is void.

(m) [**Survival of other rights or remedies.**] The rights and remedies provided by this [Act] are in addition to any other rights or remedies that may exist, but this [Act] does not create a cause of action not specified in this Section or Section 411(e).

Proposed Comments

Prior Provisions: 1956 Act Section 410; RUSA Sections 605-607, 609, 802.

1. Under Section 509 violations of two or more sections can be proven, but the remedy is limited either to rescission or actual damages. Actual damages means compensatory damages. Punitive or "double" damages are prohibited by this section which also is the standard under Section 28(a) of the Securities Exchange Act of 1934. See 9 Louis Loss & Joel Seligman, Securities Regulation 4408-4427 (3d ed. rev. 1992).

2. The Securities Litigation Uniform Standards Act of 1998 cited in Section 509(a) modifies the entire Section 509.

3. As with Section 12(a)(2) of the Securities Act of 1933, Section 509(b) contains a type of privity requirement in that the purchaser is required to bring an action against the seller. Section 509(b) is broader than Section 12(a)(2) in that it will reach all sales in violation of Section 301, not just sales "by means of a prospectus" as is the law under Section 12(a)(2). See Gustafson v. Alloyd Co., Inc., 513 U.S. 561 (1995).

4. Neither causation nor reliance has been held to be an element of a private cause of action under the precursor to Section 509(b). See Gerhard W. Gohler, IRA v. Wood, 919 P.2d 561 (Utah 1996); Ritch v. Robinson-Humprhey Co., 748 So. 2d 861 (Ala. 1999); Kaufman v. i-Stat Corp., 754 A.2d 1188 (N.J. 2000).

5. The measure of damages in Section 509(b)(3) is that contemplated by Section 12 of the Securities of 1933. See 9 Louis Loss and Joel Seligman, Securities Regulations 4242-4246 (3d ed. 1992). The measure of damages in Section 509(c)(3), however, is that contemplated by Rule 10b-5. Sec. 9 id. 4408-4427. In providing for damages as an alternative to rescission, Section 509(b)(3) follows the 1956 Act and is an improvement upon many earlier state provisions, which conditioned the plaintiff's right of recovery on his or her being in a position to make a good tender. A plaintiff is not given the right under this type of statutory formula to retain stock and also seek damages.

6. Sections 509(e)-(f) are based on a proposed 1981 NASAA amendment to the Uniform Securities Act adopted in order "to establish civil liability for individuals who willfully violate Section 102 dealing with fraudulent practices pertaining to advisory activities." Neither provision is intended to limit other state law claims for providing investment advice.

7. Broker-dealer employees, including research analysts, who receive no special compensation from third parties for investment advice would not be liable under Section 509(f)(3).

8. The control liability provision in Section 509(g)(1) is modeled on that in the 1956 Act. On the meaning of "control," see 4 Louis Loss & Joel Seligman, Securities Regulations 1703-1727 (3d ed. rev. 2000).

9. The defense of lack of knowledge in Sections 509(g)(1)-(2) is also modeled on the 1956 Act.

10. Under Section 509(g)(2) partners, officers, and directors are liable, subject to the defense afforded by that subsection, without proof that they aided in the sale. In Section 509(g)(2), the term "partner" is intended to be limited to partners with management responsibilities, rather than a partner with a passive investment.

11. Under 509(g)(4), the performance by a clearing broker of the clearing broker's contractual functions – even though necessary to the processing of a transaction – without more would not constitute material aid or result in liability under this subsection. See, e.g., Ross v. Bolton, 904 F.2d 819 (2d Cir. 1990).

12. The "reasonable attorneys' fees" specified in Section 509 are permissive, not mandatory. See, e.g., Andrews v. Blue, 489 F.2d 367, 377 (10th Cir. 1973), (Colorado Statute).

13. The contribution provision in Section 509(h) is a safeguard to avoid the common law principle that prohibited contribution among joint tortfeasors.

14. The statute of limitations in Section 509(j) is a hybrid of the 1956 Act and federal securities law approaches. The 1956 Act Section 410(p) provided that: "No person may sue under this section more than two years after the contract of sale." Under this provision, the state courts generally decline to extend a statute of limitations period on grounds of fraudulent concealment or equitable tolling.

Rule 10b-5 of the Securities Exchange Act, in contrast, as construed by the United States Supreme Court in Lampf, Pleva, Lipkind, Prepis & Petigrew v. Gilbertson, 501 U.S. 350 (1991), prohibits equitable tolling under the federal securities law one year after discovery and three years after the act formula. See generally 10 Louis Loss & Joel Seligman, Securities Regulation 4505-4525 (3d. ed. rev. 1996).

Section 509(j)(1), as with the 1956 Act, is a unitary statute of repose, requiring an action to be commenced within one year after a violation occurred. It is not intended that equitable tolling be permitted.

Section 509(j)(2), in contrast, generally follows the federal securities law model. An action must be brought within the earlier of one year after discovery or three years after the violation. As with federal courts construing the statute of limitations under Rule 10b-5, it is intended that the plaintiff's right to proceed is limited to one year after actual discovery "or after such discovery should have been made by the exercise of reasonable diligence" (inquiry notice), see, e.g., Law v. Media Research, Inc., 113 F.3d 781 (7th Cir. 1997), or three years after the violation.

The rationale for replicating the basic federal statute of limitations in this Act is to discourage

forum shopping. If the statute of limitations applicable to Rule 10b-5 were to be lengthened in the future, identical changes should be made in Section 509(j)(2).

15. Section 509(k) is similar to Section 29(b) of the Securities Exchange Act and is intended only to apply to actions to enforce illegal contracts. See Louis Loss, Commentary on the Uniform Securities Act 150 (1976).

16. Section 509(m) follows the 1956 Act.

17. Section 509 and Section 411(e) provide the exclusive private causes of action under this Act.

Reporter's Notes

1. In Zack Co. v. Sims, 438 N.E. 2d 663 (Ill. App. Ct. 1982), the court held in construing the equivalent to Section 509(b) that a party who provides financing for the purchase of stock without becoming involved in the actual contract negotiations is not a "purchaser" and not entitled to invoke the statutory remedies. However a financing party may assume a variety of legal roles such as donor, lender, or beneficiary of a resulting trust, with regard to the benefitted party, that have no relationship whatsoever to the agreement between the contracting parties. A purchaser's wife providing financing to the purchaser without participating in the purchase transaction would not be entitled to relief as a "purchaser" and is not entitled to relief, but she could be recognized as the beneficiary of a resulting trust with a one half interest in designated stock. See also Space v. E. F. Hutton Co., Inc., 544 N.E.2d 67 (Ill. App. 1989), appeal denied, 548 N.E.2d 1078 (Ill. 1989) (the remedies under the Illinois blue sky law §13(A) are available only to purchasers of securities).

2. State court decisions typically follow analogous federal law in deciding whether a person may be deemed a control person. See, e.g., Hines v. Data Line Sys., Inc., 787 P.2d 8, 13-16 (Wash. 1990).

3. Washington's Supreme Court contrasts the defense in Section 509(g)(1)-(2) with the corporate law business judgment rule and "requires affirmative action on the part of a director who wished to avail himself of this defense." Hines v. Data Line Sys., Inc., 787 P.2d 8, 17-19 (Wash. 1990). Several jurisdictions have interpreted the provision to Section 509(g) to impose strict liability on partners, officers, and directors unless the statutory defense of lack of knowledge is proven. See, e.g., Taylor v. Perdition Minerals Group, Ltd., 766 P.2d 805, 809 (Kan. 1988), citing cases; Hines v. Data Line Sys., Inc., 787 P.2d at 17. The plaintiff obviously does not have to allege a defendant's scienter to deprive the defendant of the reasonable care defense. See Currie v. Cayman Resources Corp., 595 F. Supp. 1364, 1374 (N.D. Ga. 1984) (Texas statute).

4. Under Section 509(g)(2), an outside director may be held liable without actively participating

in any of the illegal transactions. See Hines v. Data Line Sys. Inc. 787 P.2d 8, 16-18 (Wash. 1990). The Michigan precursor to Section 509(g)(2) imposes liability on directors of corporations offering securities who know or reasonably should have known of the presence of information that was false and misleading. There was no requirement that the plaintiff prove a specific intent to defraud. Molecular Technology Corp. v. Valentine, 925 F.2d 910, 920 & n.7 (6th Cir. 1991).

5. On the interpretation of "material aids" in Section 509(g)(3)-(4), see Quick v. Woody, 747 S.W.2d 108 (Ark. 1988); Connecticut Nat'l Bank v. Giacomi, 699 A.2d 101 (Conn. 1997); State v. Diacide Distrib., Inc., 596 N.W.2d 532 (Iowa 1991). In Metal Tech Corp. v. Metal Teckniques Co., Inc. 703 P.2d 237, 245-246 (Or. App Ct. 1985) the court observed that merely acting as a scrivener or otherwise merely preparing and executing documents would not involve material aid.

6. In Black & Co., Inc. v. Nova-Tech, Inc., 333 F. Supp. 468, 471 (D. Or. 1971), the court held under the Oregon provision that is the counterpart to Section 509(h) that, since indemnification was a traditional remedy for one who paid a loss caused by another, the legislature did not intend by including a right of contribution to exclude the right of indemnity. In Hainbuchner v. Miner, 509 N.E. 2d 424, 426 (Ohio 1987), the court held under the Ohio provision that the liability of a director in contribution is coextensive with his liability for securities fraud in the underlying action.

7. With respect to state securities statutes interpreting Section 410(p) of the 1956 Act as not permitting extension by fraudulent concealment or equitable tolling, see e.g., Martin v. Pacific Ins. Co. of N.Y., 431 S.W.2d 239,240 (Ark. 1968); Norden v. Friedman, 756 S.W.2d 158, 163 (Mo 1988); Weisz v. Spindletop Oil & Gas Co. 664 S.W.2d 423, 425-426 (Tex. Ct. App. 1983); McCullough v. Leede Oil & Gas, Inc., 617 F. Supp. 384, 390-391 (W.D. Okla. 1985) (Alabama statute); Reshal Assoc., Inc. v. Long Grove Trading Co., 754 F. Supp. 1226, 1242-1243 (N.D. Ill. 1990). But some state statutes expressly provided, or have been construed to provide, for tolling. See, e.g., Platsis v. E. F. Hutton & Co., Inc. 642 F. Supp. 1277, 1305 (W.D. Mich. 1986), aff'd per curiam, 829 F.2d 13 (6th Cir. 1987), *cert denied*, 485 U.S. 962 (Michigan statute); Barton v. Peterson, 733 F. Supp. 1482, 1492-1493 (N.D. Ga. 1990) (Georgia).

8. At least one court has read the provision that is the counterpart to Section 509(k) as barring an action for rescission by a purchaser with knowledge, allegedly, of the failure to register the securities. Hayden v. McDonald, 742 F.2d 423, 435-436 (8th Cir. 1984) (Unif. Sec. Act); cf. Dunn v. Bemor Petroleum, Inc., 680 S.W.2d 304, 306 (Mo Ct. App. 1984) (recognition of defenses of estoppel and in parti delicto "would defeat the purpose of our blue sky laws"). See also Brannan v. Eisenstein, 804 F.2d 1041-1045 (8th Cir. 1986).

9. With respect to Section 509(m), cf. State ex rel. Corbin v. Pickrell, 667 P.2d 1304 (Ariz. 1983) (securities violations may be basis of Consumer Fraud Act complaint); Knoell v. Huff, 395 N.W.2d 749, 754 (Neb. 1986) (Nebraska blue sky law is not exclusive remedy under state law for cases involving the sale of securities); Campbell v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 1984-1985 Fed. Sec. L. Rep. (CCH) ¶92,082 at 91,416-91,417 (N.D. Ill. 1985) (Illinois blue sky law does not preempt application of the state's Consumer Fraud Act to securities transactions).

SECTION 510. RESCISSION OFFERS. A purchaser, seller, or recipient of investment advice may not maintain an action under Section 509 if:

(1) the purchaser, seller, or recipient of investment advice receives in a record, before the action is commenced, an offer:

(A) stating the respect in which liability under Section 509 may have arisen and fairly advising the purchaser, seller, or recipient of investment advice of that person's rights in connection with the offer, including financial or other information necessary to correct all material misstatements or omissions in the information that was required by this [Act] to be furnished to that person at the time of the purchase, sale, or investment advice;

(B) if the basis for relief under this Section may have been a violation of Section 509(b), offering to repurchase the security for cash, payable on delivery of the security, equal to the consideration paid, and interest [at the legal rate of interest] per year from the date of purchase, less the amount of any income received on the security, or, if the purchaser no longer owns the security, offering to pay the purchaser upon acceptance of the offer damages in an amount that would be recoverable upon a tender, less the value of the security when the purchaser disposed of it, and interest [at the legal rate of interest] from the date of purchase in cash equal to the damages computed in the manner provided in this subsection;

(C) if the basis for relief under this Section may have been a violation of Section 509(c), offering to tender the security, on payment by the seller of an amount equal to the purchase price paid, less income received on the security by the purchaser and interest [at the legal rate of interest]

from the date of the sale, or if the purchaser no longer owns the security, offering to pay the seller upon acceptance of the offer, in cash, damages in the amount of the difference between the price at which the security was purchased and the value the security would have had at the time of the purchase in the absence of the purchaser's conduct that may have caused liability and interest [at the legal rate of interest] from the date of the sale;

(D) if the basis for relief under this Section may have been a violation of Section 509(d), and if the customer is a purchaser, offering to pay as specified in subparagraph (1)(B); or, if the customer is a seller, offering to tender or to pay as specified in subparagraph (1)(C);

(E) if the basis for relief under this Section may have been a violation of Section 509(e), offering to reimburse in cash the consideration paid for the advice. and interest [at the legal rate of interest] from the date of payment;

(F) if the basis for relief under this Section may have been a violation of Section 509(f), offering to reimburse in cash the consideration paid for the advice and the amount of any actual damages that may have been caused by the conduct, and interest [at the legal rate of interest] from the date of the violation causing the loss; and

(G) stating that the offer must be accepted by the purchaser, seller, or recipient of investment advice within 30 days after the date of its receipt by the purchaser, seller, or recipient of investment advice, or any shorter period, of not less than three days, that the administrator, by order, specifies;

(2) the offeror has the present ability to pay the amount offered or to tender the security under paragraph (1);

(3) the offer under paragraph (1) is delivered to the purchaser seller, or recipient of

investment advice, or sent in a manner that ensures receipt by the purchaser, seller, or recipient of investment advice; and,

(4) the purchaser, seller, or recipient of investment advice that accepts the offer under paragraph (1), in a record within the period specified under paragraph (1)(G) is paid in accordance with the terms of the offer.

Proposed Comments

Prior Provisions: 1956 Act Section 410(e); RUSA Section 607.

1. A rescission offer must meet the specific requirements of Section 510 for civil liability under Section 509 to be extinguished. Cf. Binder v. Gordian Sec., Inc., 742 F. Supp. 663, 666 (N.D. Ga. 1990). See generally Rowe, Rescission Offers under Federal and State Securities Law, 12 J. Corp. L. 383 (1987).

2. A rescission offer that does not comply with Section 510 is subject to civil liability, administrative enforcement, or criminal penalties under this Act. A rescission offer, for example, could violate Section 501, the general fraud provision.

3. The administrator may publish a form that would comply with Section 510, but the form would not be the only one that could be used by the parties.

4. A valid rescission offer will be exempt from securities registration. See Section 202(19).

5. If a state chooses to add a notice or filing provision, it could provide this provision in Section 510(5), which would state:

> (5) The offer [or a notice] is required to be filed with the administrator 10 business days before the offering and conform in form and content with a rule prescribed by the administrator.

ARTICLE 6

ADMINISTRATION AND JUDICIAL REVIEW

Proposed Comment

Each state, the District of Columbia, Guam, and Puerto Rico today have enacted an administrative procedure act. It is the assumption of this Act that a person against whom an order may be issued or a sanction imposed is entitled to an administrative proceeding that affords procedural due process including notice and an opportunity for a hearing. It is similarly the assumption of this Act that rules adopted or orders issued under this Act are subject to judicial review. The procedural provisions of this Article are intended to augment the state administrative procedure act.

SECTION 601. ADMINISTRATION OF [ACT].

(a) **[Administration.]** The administrator shall administer this [Act] [insert any related provisions on such matters as method of selection, salary, term of office, selection and remuneration of personnel, and annual reports to the legislature or governor that are appropriate to the particular State].

(b) **[Unlawful use of records or information.]** It is unlawful for the administrator or officer, employee or designee of the administrator to use for personal benefit or the benefit of others records or other information obtained by or filed with the administrator that are not public under Section 607(b). This [Act] does not authorize the administrator or an officer, employee or designee of the administrator to disclose the record or information, except in accordance with Section 602, 607(c), or 608.

(c) **[No common law privilege or exemption created or diminished.]** This [Act] does not create or diminish any privilege or exemption that exists at common law, by statute, rule or

otherwise.

(d) **[Investor education.]** The administrator may develop and implement investor education initiatives to inform the public about investing in securities, with particular emphasis on the prevention and detection of securities fraud. In developing and implementing these initiatives, the administrator may collaborate with public and nonprofit organizations with an interest in investor education. The administrator may accept grants or donations from a person that is not affiliated with the securities industry or from a nonprofit organization, regardless of whether or not the organization is affiliated with the securities industry, to develop and implement investor education initiatives. This subsection does not authorize the administrator to require participation or monetary contributions of a registrant in an investor education program.

(e) **[The Securities Investor Education and Training Fund.]** There is created a Fund known as the Securities Investor Education and Training Fund to provide funds for the purposes specified in paragraph (d)(1). [All monies received by the State by reason of civil penalties pursuant to this [Act] shall be deposited in the Securities Investor Education and Training Fund. The state can insert any other provision concerning appropriations to support this Fund as well as procedures for its operations.]

Proposed Comments

Prior Provisions: 1956 Act Section 406; RUSA Sections 701-702.

1. Section 601(b) should be read with Section 607. Section 601(b) prohibits the administrator or the administrator's officers and employees from using for personal benefit records or information that Section 607(b) specifies do not constitute public records. Section 601(b) is not intended to limit the operation of Section 607(a). Neither Section 601(b) nor 607(b) is intended to impede the ability of the agencies specified in Section 608(a) from sharing records or other information in connection with an examination or an investigation.

2. Section 601(c) makes clear that nothing in this Act alters the availability of evidentiary privileges. That question is left to the general law of the particular state.

SECTION 602. INVESTIGATIONS AND SUBPOENAS.

(a) **[Authority to investigate.]** The administrator may:

(1) conduct public or private investigations within or outside of this State that the administrator considers necessary or appropriate to determine whether any person has violated, is violating, or is about to violate this [Act] or a rule adopted or order issued under this [Act], or to aid in the enforcement of this [Act] or in the adoption of rules and forms under this [Act];

(2) require or permit a person to testify, file a statement, or produce a record, under oath or otherwise as the administrator determines, as to all the facts and circumstances concerning a matter to be investigated or about which an action or proceeding is to be commenced; and

(3) publish information concerning an action, proceeding, or an investigation under, or a violation of, this [Act] or a rule adopted or order issued under this [Act] if the administrator determines it is necessary or appropriate in the public interest and for the protection of investors.

(b) **[Administrator powers to investigate.]** For the purpose of an investigation under this [Act], the administrator or a designated officer may administer oaths and affirmations, subpoena witnesses, seek compulsion of attendance, take evidence, require the filing of a statement, and require the production of any records that the administrator considers relevant or material to the investigation.

(c) **[Procedure and remedies for noncompliance.]** If a person fails to appear or refuses to testify, file a statement, produce records, or otherwise fails to obey a subpoena as required by the

administrator under this [Act], the administrator [may refer the matter to the Attorney General or the proper attorney, who] may apply to [insert name of the appropriate court] or a court of another state to enforce compliance. The court may:

(1) hold the person in contempt;

(2) order the person to appear before the administrator;

(3) order the person to testify about the matter under investigation or in question;

(4) order the production of records;

(5) grant injunctive relief, including restricting or prohibiting the offer or sale of securities or the providing of investment advice;

(6) order a civil penalty of not less than [$__] and not greater than [$__] for each violation; and

(7) grant any other necessary or appropriate relief.

(d) **[Application for relief.]** This Section does not preclude a person from applying to [insert name of appropriate court] or a court of another State for appropriate relief from a request to appear, testify, file a statement, produce records, or obey a subpoena.

(e) **[Use immunity procedure.]** An individual is not excused from attending, testifying, filing a statement, producing a record or other evidence, or obeying a subpoena of the administrator under this [Act] or in an action commenced or proceeding instituted by the administrator under this [Act] on the ground that the required testimony, statement, record, or other evidence, directly or indirectly, may tend to incriminate the individual or subject the individual to a criminal fine, penalty or forfeiture. If the individual refuses to testify or file a statement, produce a record or other evidence on the basis of the individual's privilege against self-incrimination, the administrator may

apply [to the name of the appropriate court] to compel the testimony, the filing of the statement, the production of the record or the giving of other evidence. The testimony, record, or other information compelled under such an order may not be used, directly or indirectly, against the individual in a criminal case, except in a prosecution for perjury or contempt or otherwise failing to comply with the order.

(f) **[Assistance to securities regulator of another state.]** At the request of the securities regulator of another state or a foreign jurisdiction, the administrator may provide assistance if the requesting regulator states that it is conducting an investigation to determine whether a person has violated, is violating, or is about to violate a law or rule of the other state or foreign jurisdiction relating to securities matters which the requesting regulator administers or enforces. The administrator may provide the assistance by using the authority to investigate and the powers conferred by this Section as the administrator determines is necessary or appropriate. The assistance may be provided without regard to whether the facts stated in the request would also constitute a violation of this [Act] or other law of this State if occurring in this State. In deciding whether to provide the assistance, the administrator may consider whether the requesting regulator is permitted and has agreed to provide assistance reciprocally within its state or foreign jurisdiction to the administrator on securities matters when requested; whether compliance with the request would violate or prejudice the public policy of this State; and the availability of resources and employees of the administrator to carry out the request for assistance.

Proposed Comments

Prior Provisions: 1956 Act Section 407; RUSA Section 601.

1. Sections 602 (a)-(b) follow the 1956 Act, which was modeled generally on Sections 21(a)-(d) of the Securities Exchange Act of 1934 as it then read.

2. Standards for issuance of subpoenas have been generally established in federal and state securities law. See, e.g., 10 Louis Loss & Joel Seligman, Securities Regulation 4917-4937 (3d ed. rev. 1996) (discussing Oklahoma Press Pub. Co. v. Walling, 327 U.S. 186 (1946) and other cases). The scope of subpoena enforcement in each state is a general matter for judicial determination. Under Section 602, an individual subpoenaed to testify by the administrator is not compelled to testify within the meaning of these sections simply by service of a subpoena. Under Section 602(b) the individual can be subpoenaed and compelled to attend. Once in attendance an individual can assert an evidentiary privilege or exemption, see Section 601(c), including the Fifth Amendment privilege against self-incrimination. If an individual refuses to testify or give evidence, the administrator may apply (or have the appropriate state attorney apply) to the appropriate court for the relief specified in Section 602(c). If the individual invokes the privilege against self-incrimination, Section 602(d) allows the administrator to apply to the appropriate court to compel testimony under a "use immunity" provision barring the record compelled or other evidence obtained from being used in a criminal case. See People v. District Co. of Arapahoe County, 894 P.2d 739 (Colo. 1995). The phrase "directly or indirectly" in Section 602(d) is intended to include testimony, other evidence, or other information derived from immunized testimony, statements, records, or evidence.

3. Section 602 is intended to apply generally to securities offers and sales under Article 3 and broker-dealer and investment adviser activity under Article 4, when there is noncompliance with the first sentence of Section 602(c). This subsection does not limit the powers of an administrator under other provisions of this Act.

4. Where appropriate under Section 602(e), an administrator could move to authorize admission of a requesting state's attorney under existing *pro hac vice* rules.

5. Section 602(e) is consistent with the Securities Litigation Uniform Standard Act of 1998 which provides in Section 102(e):

> The Securities and Exchange Commission, in consultation with State securities commissions (or any agencies or offices performing like functions), shall seek to encourage the adoption of State laws providing for reciprocal enforcement by State securities commissions of subpoenas issued by another State securities commission seeking to compel persons to attend, testify in, or produce documents or records in connection with an action or investigation by a State securities commission of an alleged violation of State securities laws.

SECTION 603. CIVIL ENFORCEMENT.

(a) **[Civil action instituted by administrator.]** If it appears to the administrator that a person whose securities are not registered under Article 3 or that is not registered under Article 4 has engaged, is engaging, or is about to engage in an act, practice, or course of business constituting a violation of this [Act] or a rule adopted or order issued under this [Act], or that a person has, is, or is about to engage in an act, practice, or course of business that materially aids a violation of this [Act] or a rule adopted or order issued under this [Act], the administrator may maintain an action in the [insert name of court] to enjoin the act, practice, or course or business and to enforce compliance with this [Act] or a rule adopted or order issued under this [Act].

(b) **[Relief available]** In an action under this Section and upon a proper showing, the court may:

(1) grant or require a permanent or temporary injunction, restraining order or a declaratory judgment;

(2) issue an order for other appropriate or ancillary relief, to include:

(A) an asset freeze, accounting, writ of attachment, writ of general or specific execution, and an appointment of a receiver or conservator, that may be the administrator, for the defendant or the defendant's assets;

(B) an order to the administrator to take charge and control of a defendant's property, including investment accounts and accounts in a depository institution, rents, and profits; to collect debts; and to acquire and dispose of property;

(C) the imposition of a civil penalty up to a maximum of [$__] for a single violation or of [$__] for several violations; an order of rescission, restitution, or disgorgement directed to a

person that has engaged in an act, practice, or course of business constituting a violation of this [Act] or the predecessor act or an rule adopted or order issued under this [Act] or the predecessor act; and

(D) an order for the payment of prejudgment and postjudgment interest; or

(3) granting other relief that the court considers appropriate.

(c) **[No bond requirement.]** The administrator may not be required to post a bond.

Proposed Comments

Prior Provisions: 1956 Act Section 408; RUSA Section 603

1. Section 408 of the 1956 Act was limited to injunctions. This Section follows RUSA in broadening the administrative remedies available when the administrator believes that a violation has occurred. A primary purpose of a broad range of potential sanctions is to enable administrators to better tailor appropriate sanctions to particular misconduct.

2. The administrator alternatively may proceed to seek administrative enforcement under Section 604; a denial, suspension, or revocation of securities registration under Section 306; or a denial, revocation, suspension, cancellation, withdrawal, restriction, condition, or limitation of broker-dealer, agent, investment adviser, or investment adviser representative registration under Section 412.

3. Constitutional due process considerations can also be addressed by rulemaking or incorporation of the applicable administrative procedure act provisions of each jurisdiction. The term "upon a proper showing" has a settled meaning in the federal securities laws. See, e.g., Securities Act of 1933 Section 20(b).

4. As with Sections 509(g)(3)-(4), material aid does not include ministerial or clerical acts.

SECTION 604. ADMINISTRATIVE ENFORCEMENT.

(a) **[Issuance of an order or notice.]** If the administrator determines that a person has engaged, is engaging, or is about to engage, in an act, practice, or course of business constituting a violation of this [Act] or a rule adopted or order issued under this [Act], or that a person has, is, or

is about to materially aid an act, practice, or course of business constituting a violation of this [Act] or a rule adopted or order issued under this [Act], the administrator may:

(1) issue an order directing the person to cease and desist from engaging in the act, practice, or course of business or to take other action necessary or appropriate to comply with this [Act];

(2) issue an order denying, suspending, revoking or conditioning the exemptions for a broker-dealer under Section 401(b)(1)(D) or (F) or an investment adviser under Section 403(b)(1)(C); or

(3) issue an order under Section 204.

(b) **[Summary process.]** An order under subsection (a) is effective on the date of issuance. Upon issuance of the order, the administrator shall promptly serve each person subject to the order with a copy of the order and a notice that the order has been entered. The order shall include a statement whether the adminstrator will seek a civil penalty or costs of the investigation, a statement of the reasons for the order, and notice that, within 15 days after receipt of a request in a record from the person, the matter will be scheduled for a hearing. If a person subject to the order does not request a hearing and none is ordered by the administrator within 30 days after the date of service of the order, the order becomes final as to that person. If a hearing is requested or ordered, the administrator, after notice of and opportunity for hearing to each person subject to the order, may modify or vacate the order or extend it until final determination.

(c) **[Procedure for final order.]** If a hearing is requested or ordered pursuant to subsection (b), a hearing shall be held [pursuant to the state administrative procedure act]. A final order may not be issued unless the administrator makes findings of fact and conclusions of law in a record [in

accordance with the state administrative procedure act]. The final order may make final, vacate, or modify the order issued under subsection (a).

(d) **[Civil penalty.]** In a final order, the administrator may impose a civil penalty up to a maximum of [$] for a single violation or [$] for several violations.

(e) **[Costs.]** In a final order, the administrator may charge the actual cost of an investigation or proceeding for a violation of this [Act] or a rule adopted or order issued under this [Act].

(f) **[Filing of certified final order with court; effect of filing.]** If a petition for judicial review of a final order is not filed in accordance with Section 609, the administrator may file a certified copy of the final order with the clerk of a court of competent jurisdiction. The order so filed shall have the same effect as a judgment of the court and may be recorded, enforced, or satisfied in the same manner as a judgment of the court.

(g) **[Enforcement by court; further civil penalty.]** If a person fails to comply with an order under this Section, the administrator may petition a court of competent jurisdiction to enforce the order. The court may not require the administrator to post a bond. If the court finds, after service and opportunity for hearing, that the person is not in compliance with the order, the court may adjudge the person in civil contempt of the order. The court may impose a further civil penalty against the person for contempt in an amount not less than [$] but not greater than [$] for each violation, and may grant any other relief the court determines is just and proper in the circumstances.

Proposed Comments

Prior Provisions: RUSA Sections 602, 712.

1. Section 604, unlike Section 603, may be initiated by the administrator without prior judicial process or a prior hearing. The Section, among other matters, empowers the administrator to act

summarily in emergency circumstances.

2. Sections 603 and 604 are intended to be available to the administrator against persons not subject to stop orders under Section 306 or proceedings against registered broker-dealers, agents, investment advisers, or investment adviser representatives under Section 412. All persons or securities not subject to Section 306 or 412 will be subject to Sections 603 and 604. A person must be covered by either (1) Sections 306 or 412 or (2) Sections 603 or 604.

3. Service of an order or notice under this Section is not effective unless made in accordance with Section 611.

SECTION 605. RULES, FORMS, ORDERS, INTERPRETATIVE OPINIONS, AND HEARINGS.

(a) **[Issuance and adoption of forms, orders, and rules.]** The administrator may:

(1) issue forms and orders, and after notice and comment, may adopt and amend rules necessary or appropriate to carry out this [Act], and may repeal rules, including rules and forms governing registration statements, applications, notice filings, reports, and other records;

(2) by rule, define terms, whether or not used in this [Act], when those definitions are not inconsistent with this [Act]; and

(3) by rule, classify securities, persons, and transactions and adopt different requirements for different classes.

(b) **[Findings and cooperation.]** A rule or form may not be adopted or amended, or an order issued or amended under this [Act], unless the administrator finds that the rule, form, or order is necessary or appropriate in the public interest or for the protection of investors and is consistent with the purposes intended by this [Act]. In adopting, amending, and repealing rules and forms, the administrator may cooperate under Section 608 in order to achieve uniformity among the States and coordination with federal laws in the form and content of registration statements, applications,

reports, and other records, including in the adoption of uniform rules, forms, and procedures.

(c) **[Financial statements.]** Subject to Section 15(h) of the Securities Exchange Act and Section 222 of the Investment Advisers Act of 1940, the administrator may require that a financial statement filed under this [Act] be prepared in accordance with generally accepted accounting principles in the United States and comply with other requirements specified by rule or order under this [Act]. A rule or order under this [Act] may establish:

(1) subject to Section 15(h) of the Securities Exchange Act and Section 222 of the Investment Advisors Act of 1940, the form and content of financial statements required under this [Act];

(2) whether unconsolidated financial statements must be filed; and

(3) whether required financial statements must be audited by an independent certified public accountant.

(d) **[Interpretative opinions.]** The administrator may provide interpretative opinions or may issue determinations that the administrator will not institute an enforcement proceeding or commence an action under this [Act] against a specified person for engaging in a specified act, practice, or course of business if the determination is consistent with the purposes intended by this [Act]. A rule or order under this [Act] may assess a reasonable charge for interpretative opinions or determinations that the administrator will not commence an action or institute an enforcement proceeding under this [Act].

(e) **[Effect of compliance.]** A penalty under this [Act] may not be imposed and liability does not arise for conduct that is engaged in or omitted in good faith conformity with a rule, form, or order of the administrator under this [Act].

(f) **[Presumption for public hearings.]** A hearing in an administrative proceeding under this [Act] must be conducted in public unless the administrator for good cause consistent with the purposes intended by this [Act] determines that the hearing shall not be so conducted.

Proposed Comments

Prior Provisions: 1956 Act Section 412; RUSA Sections 705, 707.

1. It is anticipated that the administrator will propose amendments or make rules under Section 605(a) to remain coordinate with relevant federal law, as well as appropriate rules of the National Association of Securities Dealers, and to achieve uniformity among the States.

2. Uniform forms such as Form B-D, U-4, U-5, and NF are today common in the securities industry and are authorized by Section 605(b).

3. Section 605(c) refers to generally accepted accounting principles in the United States which currently are promulgated by the Financial Accounting Standards Board and the Securities and Exchange Commission.

4. It is anticipated that the states will employ websites, e-mail or other electronic means to provide notice of proposed rulemaking or adoption of new rules, rule amendments, forms or form amendments, statements of policy or interpretations adopted by the administrator, and issuance of orders to registrants and others who have provided a current e-mail or similar address and expressed an interest in receiving such notice.

5. Section 605(e) does not apply to staff no action or interpretative opinions, but does apply to rules, forms, orders, statements of policy or interpretations adopted by the administrator.

SECTION 606. ADMINISTRATIVE FILES AND OPINIONS.

(a) **[Public register of filings.]** The administrator shall maintain, or designate a person to maintain, a register of all applications for registration of securities; registration statements; notice filings, applications for registration of broker-dealers, agents, investment advisers, and investment adviser representatives; notice filings by federal covered investment advisers that are or have been

effective under this [Act] or the predecessor act; notices of claims of exemption from registration or notice filing requirements contained in a record; orders issued under this [Act] or the predecessor act; and interpretative opinions or no-action determinations issued under this [Act].

(b) **[Public availability.]** The administrator shall make all rules, forms, interpretative opinions, and orders available to the public.

(c) **[Copies of public records.]** Upon request, the administrator shall furnish to a person a copy of a record that is a public record or a certification that the public record does not exist. A rule under this [Act] may establish a reasonable charge for furnishing the record. A copy of the record certified or a certificate of its nonexistence by the administrator is prima facie evidence.

Proposed Comments

Prior Provisions: 1956 Act Section 413; RUSA Section 709.

1. "Record" is defined in Section 102(25).

2. Compliance with a state records law will typically satisfy the requirements of Section 606(a).

SECTION 607. PUBLIC RECORDS; CONFIDENTIALITY.

(a) **[Presumption of public records.]** Except as otherwise provided in subsection (b), records obtained by the administrator or filed under this [Act], including a record contained in or filed with any registration statement, application, notice filing, or report, are public records and are available for public examination.

(b) **[Nonpublic records.]** The following records are not public records and are not available for public examination under subsection (a):

(1) a record obtained by the administrator in connection with an examination under

Section 411(c) or an investigation under Section 602;

(2) a part of a record filed in connection with a registration statement under Sections 301 and 303 through 305 or a record under Section 411(d), that contains trade secrets or confidential information when the person filing the registration statement or report has asserted a claim of confidentiality or privilege that is authorized by law;

(3) a record that is not required to be provided to the administrator or filed under this [Act] and is provided to the administrator only on the condition that the information will not be subject to public examination or disclosure;

(4) a nonpublic record received from a person specified in section 608;

(5) any social security number, residential address, and residential telephone number contained in a record that is filed; and

[(6) a record obtained by the administrator through a designee of the administrator that a rule or order under this [Act] determines:

(A) has been appropriately expunged from the administrator's records by that designee, or

(B) appropriately determined to be nonpublic or nondisclosable by that designee if the administrator finds that this is in the public interest and for the protection of investors.]

(c) **[Administrator discretion to disclose.]** The administrator may disclose a record obtained in connection with an audit or inspection under Section 411(d) or a record obtained in connection with an investigation under Section 602 if disclosure is for the purpose of a civil, administrative, or criminal investigation, action, or proceeding or to a person specified in Section 608(a).

Proposed Comments

Prior Provisions: RUSA Section 703; SEC Rule Section 200.80(b)(4); Securities Exchange Act of 1934 Sections 24(d)-(e).

1. Section 607(a) reflects the extensive development of freedom of information and open records laws since the 1956 Act was adopted.

2. Section 607(b) may insulate from public disclosure records or other information that may be available under a state freedom of information or open records act. Unless the state freedom of information or open records act implements a constitutional provision, this Act as the later and more specific enactment should control as a matter of statutory construction. A state may amend its freedom of information act, open records act or this Section to eliminate any inconsistencies.

3. Records and other information obtained by an administrator in connection with an audit or inspection under subsection 411(d) or an investigation under Section 602 may be made public in the enforcement action, even if records and other information would otherwise be subject to subsection 607(b)(1).

SECTION 608. UNIFORMITY AND COOPERATION WITH OTHER AGENCIES.

(a) [**Objective of uniformity.]** The administrator shall, in its discretion, cooperate, coordinate, consult, and, subject to Section 607, share records and information with the securities regulators of one or more States, Canada or one or more of its provinces or territories, one or more foreign countries; the Securities and Exchange Commission, the United States Department of Justice, the Commodity Futures Trading Commission, the Federal Trade Commission, the Securities Investor Protection Corporation, a self-regulatory organization, a national or international organization of securities regulators, federal or state banking and insurance regulators, and any governmental law enforcement agency, in order to effectuate greater uniformity in securities matters among the federal government, self-regulatory organizations and state and foreign governments.

(b) **[Balancing of policies.]** In cooperating under this Section and in acting by rule, order, or waiver under this [Act], the administrator shall, in the discretion of the administrator, take into

consideration in carrying out the public interest the following general policies:

(1) maximizing effectiveness of regulation for the protection of investors;

(2) maximizing uniformity in federal and state regulatory standards; and

(3) minimizing burdens on the business of capital formation, without adversely affecting essentials of investor protection.

(c) **[Subjects for cooperation.]** The cooperation authorized by this Section includes:

(1) establishing or employing one or more designees as a central depository for registration and notice filings under this [Act] and for records required or allowed to be maintained under this [Act];

(2) developing and maintaining uniform forms;

(3) conducting a joint examination or investigation;

(4) holding a joint administrative hearing;

(5) instituting and prosecuting a joint civil or administrative proceeding;

(6) sharing and exchanging personnel;

(7) coordinating registrations under Sections 301 and 401 through 404 and exemptions under Section 203;

(8) sharing and exchanging records;

(9) formulating rules, statements of policy, guidelines, forms, and interpretative opinions and releases;

(10) formulating common systems and procedures;

(11) notifying the public of proposed rules, forms, statements of policy, and guidelines;

(12) attending conferences and other meetings among securities regulators, which may

include representatives of governmental and private organizations involved in capital formation, deemed necessary or appropriate to promote or achieve uniformity; and

(13) developing and maintaining a uniform exemption from registration for small issuers, and taking other steps to reduce the burden of raising investment capital by small businesses.

Proposed Comments

Prior Provisions: 1956 Act Section 415; RUSA Sections 704 and 803; 19(c) of the Securities Act of 1933.

1. Uniformity of regulation among the states and coordination with the Securities and Exchange Commission is a principal objective of this Act. Section 608 is intended to encourage such cooperation to the maximum extent appropriate.

2. The goals of uniformity among the states and coordination with related federal regulation, including self regulatory organizations, may be enhanced by greater use of information technology systems such as the Web-CRD, the Investment Adviser Registration Depository (IARD), or the Securities and Exchange Commission Electronic Data Gathering, Analysis and Retrieval System (EDGAR). These types of techniques are consistent with a potential system of "one stop filing" of all federal and state forms that is encouraged by this Act.

3. This Act is intended, to the extent practicable, to be revenue neutral in its impact on existing state laws.

4. Section 608(c) lists some joint or coordinated efforts which might be undertaken. Other appropriate cooperative activities are also encouraged.

5. Add comment on construction of Act in cases to achieve remedial purposes of the Act.

SECTION 609. JUDICIAL REVIEW.

(a) **[Judicial review of orders.]** Final orders issued by the administrator under this [Act] are subject to judicial review in accordance with [the State's administrative procedure act].

[(b) **[Judicial review of rules.]** Rules adopted under this [Act] are subject to judicial

review in accordance with [the State's administrative procedure act.]

Proposed Comments

Prior Provisions: 1956 Act Section 411; RUSA Section 711(b).

1. The 1956 Act Section 411 specified procedures for judicial review of orders, in part modeled on Section 12 of the Model Administrative Procedure Act, 54 Handbook of National Conference of Commissioners on Uniform State Laws 334 (1944) and partly on Section 25 of the Securities Exchange Act.

2. A rule adopted under this Act may be subject to judicial review in accordance with the state administrative procedure act.

3. In those states in which judicial review of rules is permitted, a state may choose to add Section 609(b).

SECTION 610. JURISDICTION.

(a) **[Sales and offers to sell.]** Sections 301, 302, 401(a), 402(a), 403(a), 404(a), 501, 506, 509 and 510 apply to a person that sells or offers to sell a security if the offer to sell or the sale is made in this State, or the offer to purchase or the purchase is made and accepted in this State.

(b) **[Purchases and offers to purchase.]** Sections 401(a), 402(a), 403(a), 404(a), 501, 506, 509, and 510 apply to a person that purchases or offers to purchase a security if the offer to purchase or the purchase is made in this State, or the offer to sell or the sale is made and accepted in this State.

(c) **[Offers in this State.]** For the purpose of this Section, an offer to sell or to purchase a security is made in this State, whether or not either party is then present in this State, if the offer:

(1) originates from this State; or

(2) is directed by the offeror to a place in this State and received at the place to which it is directed.

(d) **[Acceptances in this State.]** For the purpose of this Section, an offer to purchase or to sell is accepted in this State, whether or not either party is then present in this State, if the acceptance:

(1) is communicated to the offeror in this State and the offeree reasonably believes the offeror to be present in this State and the acceptance is received at the place in this State to which it is directed, and

(2) has not previously been communicated to the offeror, orally or in a record, outside this State.

(e) **[Publications, radio, television, or electronic communication.]** An offer to sell or to purchase is not made in this State when a publisher circulates or there is circulated on the publisher's behalf in this State a bona fide newspaper or other publication of general, regular, and paid circulation that is not published in this State, or that is published in this State but has had more than two-thirds of its circulation outside this State during the previous 12 months, or when a radio or television program or other electronic communication originating outside this State is received in this State. A radio, television program, or other electronic communication is considered as having originated in this State if either the broadcast studio or the originating source of transmission is located in this State, unless:

(1) the program or communication is syndicated and distributed from outside this State for redistribution to the general public in this State;

(2) the program or communication is supplied by a radio, television, or other electronic network with the electronic signal originating from outside this State for redistribution to the general public in this State;

(3) the program or communication is an electronic communication that originates outside this State and is captured for redistribution to the general public in this State by a community antenna or cable, radio, cable television, or other electronic system; or

(4) the program or communication consists of an electronic communication that originates in this State, but which is not intended for distribution to the general public in this State.

(f) **[Investment advice and misrepresentations.]** Sections 403(a), 404(a), 405(a), 502, 505, and 506 apply to a person if an act, practice, or course of business instrumental in effecting prohibited or actionable conduct is engaged in this State, whether or not either party is then present in this State.

Proposed Comments

Source of Law: 1956 Act Section 414; RUSA Section 801.

1. Section 610 defines the application of the Act to interstate or international transactions when only some of the elements of a violation occur in this State. This Section applies to all types of proceedings specified by the Act – administrative, civil, and criminal. The law is now settled that a person may violate the law of a particular state without ever being within the state or performing each act necessary to violate the law within that state.

2. Section 610 generally follows Section 414 of the 1956 Act, but has been modernized to reflect the development of the internet and other electronic communications after 1956.

3. Section 610 can be illustrated in the context of a civil action under Section 509(b) by a purchaser in State A against a seller in State B:

Section 610(a) would apply when an "offer to sell is made in this State."

Section 610(c) provides that an offer which originates in State B and is directed to State A is made in both states. The securities act of State A would apply under Section 610(c)(2). The act of State B would apply also under Section 610(c)(1). The intent is to prevent a seller in State B from using that state as a base of operations for defrauding person in other states.

Section 610(e) addresses offers made through publications, radio, television, or electronic communications. The subsection provides a series of safe harbors for advertisements in newspapers, magazines, radio, television, or electronic media that either originate outside State A or

that originate in State A but are directed outside the state to the general public. With respect to bona fide newspapers or other publications of general, regular, and paid circulation, the safe harbor requires that more than two-thirds of its circulation be outside State A. With respect to radio, television, or other electronic communications, safe harbors are specified in Sections 610(e)(1)-(4).

Section 610(d), however, provides that a person in State A who makes an offer to purchase as a result of communication described in Section 610(e) may cause the Act to be applicable if the offeror accepts the offer "in this State." Section 610(d) defines when an offer is accepted "in this State."

If a selling broker-dealer in State B solely sends a confirmation into State A, or the purchaser in State A sends a check from within State A, the Act will not apply unless, under Section 610(d), the confirmation or delivery constitutes the seller's acceptance of the purchaser's offer to buy in State A.

The applicability of the Act to purchaser is addressed by Section 610(b) which is the converse of Section 610(a). Under Section 509(c) there can be liability of purchasers to sellers.

Section 610(f) is a new provision that specifies jurisdictions in cases involving investment advice and misrepresentations.

4. Under subsection 202(20) certain out-of-state offers or sales are exempt from securities registration.

5. The phrase "other electronic means" is coextensive with computer or other information technology permitted by subsections 102(8), 102(25).

6. Under Section 610 the administrator may adopt interpretative rules or orders to specify when particular uses of new electronic communications, including the Internet, involve an offer to sell or to purchase a security, acceptance of an order to purchase or sell a security, or an act or practice involving prohibited conduct, within a State, whether or not a purchaser, seller, or other party is then present in the State. The NASAA Interpretive Order Concerning Broker-Dealers, Agents, and Investment Adviser Representatives Using the Internet for General Dissemination of Information for Products and Services (Apr. 23, 1997) is an illustration of an order that would be in compliance with the administrator's authority under Section 610. Under this Order, broker-dealers, agents, investment advisers, and investment adviser representatives who distribute information on available products and services through communications on the internet generally to anyone having access to the internet such as postings on a bulletin board or home page shall not be deemed to be transacting business in a State if specified conditions are satisfied including a legend clearly stating that the broker-dealer, agent, investment adviser, or investment adviser representative may only transact business in that State if first registered, excluded or exempted from applicable registration requirements.

Reporter's Notes

1. Courts have interpreted the precursor to Section 610(a) as applicable if there was a physical nexus between the sale or offer to sell and a specific state. See, e.g. Ah Moo v. A. G. Becker Paribas, Inc., 857 F.2d 615, 620 (9th Cir. 1988). In Shappley v. State, 520 S.W.2d 766, 768 (Tex. Crim. App. 1974), the court held: "If the offer was made within the state, it would be immaterial whether it was intended that the sale would be finally consummated in another state." Similarly it is immaterial that a solicitation originated outside the forum state if the solicitation was received within the forum state. See, e.g., DuPont v. Becker, 375 F. Supp. 959, 962 n.2 (D. Mass. 1974) *aff'd without pub. op.*, 508 F.2d 834 (1st Cir. 1974). See also Parvin v. Davis Oil Co., 524 F.2d 112, 117 (9th Cir. 1975); Petrites v. J.C. Brandford & Co., 646 F.2d 1033, 1036-1037 (5th Cir. 1981); Stimmel v. Shearson, Hammill & Co., 411 F. Supp. 345, 348-349 (D. Or. 1976); Oil Resources, Inc. v. State of Fla. Dep't of Banking & Fin., Div. of Sec., 583 F. Supp. 1027, 1030 (S.D. Fla. 1984), *aff'd without pub. op.* 746 F.2d 814 (11th Cir. 1984).

In Booth v. Verity, 124 F. Supp. 2d 452, 459 (W.D. Ky. 2000) (Kentucky law), the court held that the mere ability to view a passive web page or mass media report was an insufficient contact with a state to render an out-of-state defendant subject to that state's jurisdiction.

2. The Section 610(c)(2) "place to which it is directed" would include a post office box at which a person receives mail. Application of the Section 610(c)(2) formula has been held to afford due process of law. Green v. Weis, Voison, Cannon, Inc. 479 F.2d 462 (7th Cir. 1973).

In Newsome ex rel. Oklahoma Sec. Comm. v. Diamond Oil Producers, Inc., 1982-1984 Blue Sky L. Rep. (CCH) ¶71,869 (Okla. Dist. Ct. 1983), the court applied the precursor to Section 610(c)(1) even though the offer in the state to which it was directed had been made in accordance with the laws of that state. It would be incompatible with the purposes of the Act to exclude such sales from regulation, the court said, because that would create a "safe harbor" from which a promoter could operate with impunity so long as he or she never ventured into the states in which the purchasers resided.

In Haberman v. Washington Pub. Power Supply Sys., 109 Wash. 2d 107, 134-136, 744 P.2d 1032, 1053-1054 (en banc 1987), *appeal dismissed sub nom*. American Express Related Serv. Co. v. Washington Pub. Power Sys., 488 U.S. 805, which grew out of a bond issue by the System to finance two nuclear power plants, the court applied the "most significant relationship" standard to conclude that Washington was clearly the state with the most substantial contracts with the subject matter of the case. Cf. Singer v. Magnavox Co., 380 A.2d 969, 981 (Del. 1977), where the Delaware Supreme Court refused to apply the Delaware Blue Sky Law "simply because the company is incorporated here." Cf. also State of Wis. v. Mattes, 175 Wis. 2d 572, 499 N.W.2d 711 (Wis. Ct. App. 1993) (establishing venue in the county in which defendant accepted and negotiated checks).

3. With respect to Section 610(d), see Cody v. Ward, 954 F. Supp. 43 (D. Conn. 1997), where a federal district court concluded that Connecticut could extend its version of the Uniform Securities Act to a non-resident who sent oral and written misrepresentations into the state.

4. With respect to Section 610(e), cf. Martin v. Steubner, 652 F.2d 652 (6th Cir. 1981), where an advertisement of a Minnesota real estate limited partnership was placed in the Wall Street Journal and read by the plaintiff in Ohio. This alone would not establish Ohio as a forum state. But the plaintiff also wrote from and received a written reply in Ohio, in addition to causing $100,000 to be transferred from an Ohio broker to the defendant's bank in Minnesota, and was mailed a subscription agreement in Ohio which was signed in that state. On these latter bases the court concluded that there were sufficient contacts with Ohio. Id. at 653.

5. The Internet raises new jurisdictional issues, as one commentator theorizes because application of state blue sky laws to securities transactions has traditionally been based on location, i.e., the laws of a given state seek to regulate transactions occurring within the state's boundaries. Rice, The Regulatory Response to the New World of Cybersecurities, 51 Admin. L. Rev. 901, 930-931 (1999). It is uncertain whether the existing statutory approach will remain adequate. "Despite the additional complexities, existing principles can be used to view e-mail over the Internet as similar to traditional postal mail and phone calls in providing a basis for jurisdiction." Id. at 933. See also id. at 944-945; ABA Global Cyberspace Jurisdiction Project, 55 Bus. Law. 1801, 1931-1937 (2000).

SECTION 611. SERVICE OF PROCESS.

(a) **[Signed consent to service of process.]** A consent to service of process required by this [Act] must be signed and filed in the form required by the administrator. A consent appointing the administrator the person's agent for service of process in a noncriminal action or proceeding against the person, or the person's successor, or personal representative under this [Act] or a rule adopted or order issued by the administrator under this [Act] after the consent is filed, has the same force and validity as if the service were made personally on the person filing the consent. A person that has filed a consent complying with this subsection in connection with a previous application for registration or notice filing need not file an additional consent.

(b) **[Conduct constituting appointment of agent for service.]** If a person, including a nonresident of this State, engages in an act, practice, or course of business prohibited or made actionable by this [Act] or a rule adopted or order issued by the administrator under this [Act] and

the person has not filed a consent to service of process under subsection (a), that act, practice, or course of business constitutes the appointment of the administrator as the person's agent for service of process in a noncriminal action or proceeding against the person, the person's successor, or personal representative.

(c) **[Procedure for service of process.]** Service under subsection (a) or (b) may be made by providing a copy of the process to the office of the administrator, but it is not effective unless:

(1) the plaintiff, which may be the administrator, promptly sends notice of the service and a copy of the process, return receipt requested, to the defendant or respondent at the address set forth in the consent to service of process or, if a consent to service of process has not been filed, at the last known address, or takes other reasonable steps to give notice; and

(2) the plaintiff files an affidavit of compliance with this subsection in the action or proceeding on or before the return day of the process, if any, or within the time that the court, or the administrator in a proceeding before the administrator, allows.

(d) **[Use in administrative proceedings]** Service as provided in subsection (c) may be used in a proceeding before the administrator or by the administrator in a civil action in which the administrator is the moving party.

(e) **[Provision of opportunity to defend.]** If the process is served under subsection (c), the court, or the administrator in a proceeding before the administrator, shall order continuances as are necessary or appropriate to afford the defendant or respondent reasonable opportunity to defend.

Proposed Comments

Prior Provisions: 1956 Act Sections 414(g)-(h); RUSA Section 708.

1. Section 611 follows the 1956 Act and RUSA in providing for a signed consent to service of process in Section 611(a); a substituted service of process in Section 611(b); and process and

opportunity to defend in Sections 611(c)-(e).

2. An issuer is not required to file a consent to service of process unless it proposes to offer a security in this State through someone acting on an agency basis. Since the civil liability provisions of Section 509(b) only apply in a suit by a purchaser against a seller, the issuer in a firm commitment underwriting is civilly liable only to the underwriter, who, in turn, may be liable to the dealer, who, in turn, may be liable to the purchaser. In contrast, in a best efforts underwriting, when the security is sold on an agency basis and title passes directly to the purchaser, the issuer can be liable to the purchaser.

3. Section 611(b) generally follows Section 414(h) of the 1956 Act and Section 708(c) of RUSA. The intent is to provide for substituted service of process when a seller in one state directs an offer into a second state either in violation of the laws of the second state or fraudulently. Under Section 611(b) the purchaser may sue the seller in the purchaser's state and then bring an action on the judgment in the seller's state. The constitutionality of this type of statute has long been sustained.

Reporter's Notes

1. This Section was originally based on the type of nonresident motorist statute whose constitutionality was sustained in Hess v. Pawlowski, 274 U.S. 352 (1927) and subsequently in other contexts. See, e.g., International Shoe Co. v. State of Wash., 326 U.S. 310 (1945); Travelers Health Ass'n v. Commonwealth of Va., 339 U.S. 643 (1950).

2. In Piantes v. Hayden-Stone, Inc., 514 P.2d 529 (Utah 1973), the court held that jurisdiction could be based either on a state blue sky provision like Section 611(b) or on a state's long arm statute. Cf. Paquinelli v. Wilson, 365 S.E.2d 702 (N.C. App. 1988), where the defendants, both directors of a North Carolina corporation though residents of other states, were held to be subject to personal jurisdiction under a North Carolina statute applicable to nonresident directors "in all actions. . . .on behalf of, or against said corporation in which said director is a necessary or party." Id. at 730. See also Illinois Nat'l Bank & Trust Co. of Rockford, Ill. v. Gulf States Energy Corp., 429 N.E.2d 1301 (Ill. App. 1981) (Illinois long arm statue applied to securities transactions). But see Ek v. Nationwide Candy Div., Ltd., 403 So. 2d 780, 784 (La. App. 1981), *cert denied*, 407 So.2d 732 La. (1981) (long arm statute did not make nonresident amenable to jurisdiction when he was never physically present in the forum state and the only contacts with that state were two telephone calls and a letter).

SECTION 612. SEVERABILITY CLAUSE. If any provision of this [Act] or its application to any person or circumstances is held invalid, the invalidity does not affect other provisions or applications of this [Act] that can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

Proposed Comments

Prior Provisions: 1956 Act Section 417; RUSA Section 805.

ARTICLE 7

TRANSITION

SECTION 701. EFFECTIVE DATE. This [Act] takes effect on [insert date, which should be at least 60 days after enactment].

SECTION 702. REPEALS. The following act is repealed:

[Insert name of former State securities act].

SECTION 703. APPLICATION TO EXISTING PROCEEDING.

(a) **[Applicability of predecessor act to pending proceedings.]** The predecessor act exclusively governs all actions, prosecutions, or proceedings that are pending or may be maintained or instituted on the basis of facts or circumstances occurring before the effective date of this [Act], but a civil action may not be maintained to enforce any liability under the predecessor act unless commenced within any period of limitation that applied when the cause of action accrued or within three years after the effective date of this [Act], whichever is earlier.

(b) **[Transition.]** All effective registrations under the predecessor act, all administrative orders relating to the registrations, statements of policy, interpretative opinions, declaratory rulings, no action determinations, and all conditions imposed upon the registrations under the predecessor act remain in effect while they would have remained in effect if this [Act] had not been enacted. They are considered to have been filed, issued, or imposed under this [Act], but are exclusively governed by the predecessor act.

(c) **[Applicability of predecessor act to offers or sales]** The predecessor act exclusively governs any offer or sale made within one year after the effective date of this [Act] except with respect to a federal covered security under an offering begun before the effective date of this [Act] using an exemption available under the predecessor act.

Proposed Comments

Prior Provisions: 1956 Act Section 418; RUSA Section 807.

1. Prior law governs all suits, actions, prosecutions, or proceedings which are pending or may be initiated on the basis of facts or circumstances occurring before the effective date of a State blue sky statute. See Hilton v. Mumaw, 522 F.2d 588, 600 (9th Cir. 1975).

2. Case law construing provisions of prior securities statutes that are identical or substantively similar may be relevant to construction of this Act.