**DRAFT**

**FOR DISCUSSION ONLY**

# UNIFORM SECURITIES ACT (2001)

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## NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

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## MARCH 2001

*WITH PREFATORY NOTE AND REPORTER'S NOTES*



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*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.*

## REPORTER'S PREFACE

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 ("NSMIA") 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 trading.

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, when appropriate, RUSA, federal preemptive legislation, and the other developments described in the comments.

The attached draft has been reorganized to follow 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 Drafting Committee's determination to seek enactment in all State jurisdictions of the new Uniform Securities Act after it is adopted by the National Conference.

The attached draft is solely a new Uniform Securities Act. It does not codify or append related regulations or guidelines. This Act also authorizes State Administrators to adopt further exemptions without statutory amendment (See, e.g., Section 203).

The Drafting Committee reviewed several drafts during meetings between 1998 and 2001. The Committee had the assistance of advisors and observers from several interested groups, including, alphabetically, the American Bar Association, the Certified Financial Planners, the Financial Planning Association, the Investment Company Institute, the Investment Counsel Association of America, the National Association of Securities Dealers, Inc., 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 or other groups.

This draft of the Uniform Securities Act (2001) should be read as a discussion draft. Comments or proposals for change in this draft can be forwarded to:

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# UNIFORM SECURITIES ACT (2001)

## ARTICLE 1:
## DEFINITIONS

**SECTION 101. SHORT TITLE.** This [Act] may be cited as the Uniform Securities Act (2001).

### OFFICIAL COMMENT

Prior Provision: 1956 Act Section 416; RUSA Section 804.

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

(1) "Administrator" means the [insert name 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 own securities, except that a partner, officer, or director of a broker-dealer or issuer, or an individual occupying a similar status or performing similar functions, is an agent only if the individual otherwise comes within the term. The term does not include:

(A) 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;

(B) an individual acting for an issuer with respect to an offering or purchase of the issuer's own securities or those of the issuer's parent or any of the issuer's subsidiaries if:

(i) the individual primarily performs, or is intended primarily to perform upon completion of the offering, substantial duties for or on behalf of the issuer, the issuer's

parent, or any of the issuer's subsidiaries otherwise than in connection with transactions in the issuer's own securities; and

(ii) the individual's compensation is not based, in whole or in part, upon the amount of purchases or sales of the issuer's own securities; or

(C) an individual the administrator, by rule or order, specifies.

(3) "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 [acting on behalf of the broker-dealer];

(B) an issuer;

(C) an international bank; or

(D) a person the administrator, by rule or order, specifies.

[(4) "Depository institution" means a bank, savings institution, or trust company that is organized or chartered under the laws of a State or of the United States, authorized to and receives 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 also includes a credit union organized and supervised under the laws of this State. The term does not include:

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

(B) a Morris Plan bank;

(C) an industrial loan company; or

(D) a similar bank or company unless its deposits are insured by a federal agency.]

(5) "Federal covered investment adviser" means a person registered under Section 203 of the Investment Advisers Act of 1940.

(6) "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 or rules or regulations adopted under Section 18(b).

(7) "Filing" means the receipt of a record by the administrator or designee of the administrator.

(8) "Fraud," "deceit," and "defraud" are not limited to common law deceit.

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

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

(A) a depository institution or international bank;

(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 $25,000,000 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, political subdivisions, 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 $25,000,000 or its investment decisions are made by a [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 $25,000,000, its trustee is a depository institution, 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, 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 $25,000,000;

(J) a small business investment company licensed by the Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958 with total assets in excess of $25,000,000;

(K) a private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940 with total assets in excess of $25,000,000;

[(L) an investment adviser registered under the Investment Advisers Act of 1940 with investments under management in excess of $100 million, whether acting for its own account or for the account of others on a discretionary basis;]

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

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

(O) any other institutional buyer; or

(P) any other person the administrator, by rule or order, specifies.

**REPORTER'S COMMENT**

Source of Law: RUSA Section 101(5); Securities Act Rules 144A and 501(a).

1. Section 102(10)(H) concludes with an except clause meant to exclude self-directed plans for individuals from this definition.

2. Section 102(10)(P) is meant to reach institutional buyers similar to those listed in Sections 102(10)(A)-(O), but not otherwise listed.

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

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

(13) "International bank" means an international banking institution of which the United States is a member and whose securities are exempt from the Securities Act of 1933.

(14) "Investment adviser" means a person who, 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 who, 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 who, as an integral component of other financially related services, provides investment advisory services to others for compensation as part of a business or who holds itself out as providing investment advisory services 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 advisory services is solely incidental to the practice of the person's profession;

(C) a broker-dealer or its agents whose performance of investment advisory services is solely incidental to the conduct of business as a broker-dealer and who receives no special compensation for the investment advisory services;

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

(E) a federal covered investment adviser;

(F) any other person who is excepted from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act; or

(G) any other person the administrator, by rule or order, specifies.

(15) "Investment adviser representative" means an individual, other than an investment adviser, who represents an investment adviser or a federal covered investment adviser in making any recommendations or otherwise rendering investment advice regarding securities, except that a

partner, officer, director or individual occupying a similar status or performing similar functions is an investment adviser representative only if the individual otherwise comes within the term. The term does not include an individual:

(1) whose performance of these services is solely incidental to conduct as an agent of a broker-dealer and who receives no special compensation for these services;

(2) whose functions are clerical or ministerial;

(3) who is an "investment adviser representative," as defined under Section 203A of the Investment Advisers Act of 1940, of a federal covered investment adviser without a place of business in this state;

(4) who is not a "supervised person" of a federal covered investment adviser, as that term is defined in Section 202(a)(25) of the Investment Advisers Act of 1940, and who solicits, offers, or negotiates for the sale of or sells investment advisory services on behalf of the federal covered investment adviser; or

(5) the administrator, by rule or order, specifies.

**REPORTER'S COMMENT**

Source of Law: NASAA 1997 Amendment.

1. Investment adviser representatives were not required to register under the federal Investment Advisers Act, before or after the National Securities Markets Improvement Act.

2. Investment adviser representative is defined under Section 203A of the Investment Advisers Act of 1940 in Rule 203A-3(a).

3. In Sections 102 (14) and (15) investment advisory services may include, depending on relevant facts and circumstances:

(1) managing securities accounts or portfolios of clients;

(2) determining which service recommendations or advice should be given to a customer;

(3) receiving compensation to solicit, offer to negotiate for the sale or, sell investment advisory services; and

(4) supervising employees or individuals who provide any of these services.

4. The FPA questions the wisdom of the exemption in Section 102(15)(A)(1) for investment advisers. The FPA does favor retention of solicitor within the definition of investment advisor representative.

5. The ICAA proposes a revision of Section 102(15) to read:

> (15)(A) "Investment adviser representative" means any partner, officer, director, or individual occupying a similar status or performing similar functions, or any other individual, except clerical or ministerial personnel, who is employed by or associated with an investment adviser and who does any of the following:
>
> 1. makes any recommendations or otherwise renders investment advice regarding securities;
> 2. manages accounts or portfolios of clients;
> 3. determines which recommendation or advice regarding securities should be given;
> 4. [receives compensation to solicit, offer or negotiate for the sale or sells investment advisory services,] or
> 5. supervises employees who perform any of the foregoing.
>
> (B) "Investment adviser representative" of a federal covered adviser means an individual with a place of business in this State as "place of business" is defined by the Securities and Exchange Commission under Section 203A of the Investment Advisers Act and who is an "investment adviser representative" as defined in Section 203A of the Investment Advisers Act of 1940.
>
> (C) [The term "investment adviser representative" also includes any individual who solicits, offers, or negotiates for the sale or sells investment advisory services on behalf of a federal covered investment adviser, but is not a "supervised person" of the federal covered investment adviser, as that term is defined in Section 202(a)(25) of the Investment Advisers Act of 1940.]
>
> (D) The term "investment adviser representative" does not included any individual the administrator, by rule or order, specifies.

(16) "Issuer" means a person or group of persons that issues or proposes to issue its own securities, subject to the following:

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

(B) The issuer of an equipment trust certificate, including a conditional sales contract or similar security serving the same purpose, is the person or the person's parent to whom the equipment or property is or is to be leased or conditionally sold.

(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, who creates fractional interests for the purpose of sale.

**REPORTER'S COMMENT**

Source of Law: 1956 Act Section 401(g); RUSA Section 101(8).

1. The definition in Section 102(16) includes Section 102(16)(B) that did not appear in the 1956 Act but was added by RUSA.

2. Pennsylvania has suggested adding to the end of this definition, "or an affiliate of the issuer."

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

**REPORTER'S COMMENT**

The Pennsylvania Securities Commission has suggested adding to the end of this definition "or an affiliate of the issuer."

(18) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government; governmental subdivision, agency, or instrumentality, public corporation; or any other legal or commercial entity.

(19) "Place of business" of a broker-dealer or an investment adviser means:

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

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

**REPORTER'S COMMENT**

Source of Law: Rules 203A-3(b) and 222-1 of the Investment Advisers Act of 1940.

(20) "Predecessor act" means an Act repealed under Section 705.

(21) "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.

**REPORTER'S COMMENT**

Source of Law: Rule 222-1(b) of the Investment Advisers Act of 1940.

(22) "Price amendment" means the amendment to a registration statement filed under the Securities Act of 1933 or, if no amendment is filed, the prospectus or prospectus supplement filed under the Securities Act of 1933 which 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.

(23) "Record," except in "of 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.

**REPORTER'S COMMENT**

Source of Law: New.

(24) "Sale" includes every contract of sale, contract to sell, or disposition of, a security or interest in a security for value.

"Offer to sell" includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.

"Offer to purchase" includes every attempt to offer to obtain, or solicitation of an offer to sell, a security or interest in a security for value, but the term does not include a transaction that is subject to Section 14(d) of the Securities Exchange Act of 1934.

(A) Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing constitutes part of the subject of the purchase and to have been offered and sold for value.

(B) A gift of assessable stock involves an offer and sale.

(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 into another security of the same or another issuer, includes an offer of the other security.

(D) The term does not include:

(i) the creation of a security interest in conjunction with a loan;

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

(iii) 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

(iv) the solicitation of tenders of securities by an offeror in a stock tender offer in compliance with Rule 162 issued under the Securities Act of 1933.

**REPORTER'S COMMENT**

Source of Law: 1956 Act Section 401(j); RUSA Section 101(13).

1. Both the 1956 Act and RUSA definition of "sale" are modeled on Section 2(a)(3) of the Securities Act of 1933.

2. 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(24), but may be exempted from the securities registration requirements by Section 202(16).

3. Securities Act Rule 162 allows the offeror in a stock exchange offer to solicit tenders of securities before a registration statement is effective as long as no securities are purchased until the registration statement is effective and the tender offer has expired.

4. Should Section 102(24)(D)(i) be clarified to refer to bona fide commercial loans given the Reves case holding that some notes are securities.

(25) "Securities Act of 1933" (15 U.S.C.A. Section 77a et seq.), "Securities Exchange Act of 1934" (15 U.S.C. Section 78a et seq.), "Public Utility Holding Company Act of 1935," "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," "National Housing Act," "Commodity Exchange Act" (7 U.S.C. Section 1 et seq.), "National Securities Markets Improvement Act of 1996," "Securities Litigation Uniform Standards Act of 1998," and "Electronic Signatures in Global and National Commerce Act (2000)," mean the federal statutes of those names, the rules and regulations under these statutes, as in effect on the effective date of this [Act], [or as later amended].

**REPORTER'S COMMENT**

Source of Law: 1956 Act Section 401(k); RUSA Section 101(15).

1. This Section is intended at least to refer to specified federal statutes, their rules and regulations and amendments adopted before the effective date of this Act in this State. Cf. National Conference of Commissioners on Uniform State Laws, Uniform Statute and Rule Construction Act Section 12(d) (1995), which 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."

2. Many, but not all states, permit after adopted amendments to become automatically effective.

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

(27) "Security" means a note; stock; treasury stock; 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 an oil, gas, or other mineral lease or in payments out of production under a lease, right, or royalty; a put, call, straddle, or option entered into on a national securities exchange relating to foreign currency; a put, call, straddle, or option on a security, certificate of deposit, or group or index of securities, including an interest in or based on the value of any of the foregoing; 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, whole or partial guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. The term does not include:

(A) 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; or

(B) an interest in a contributory or noncontributory pension or welfare plan subject to the Employee Retirement Income Security Act of 1974.

**REPORTER'S COMMENT**

This term is intended to apply whether or not a security is evidenced by a writing. To save states the need to litigate this point, see Thomas v. State, 3 S.W.3d 89 (Tex. Ct. App. 1999), *petition for review granted*, the Pennsylvania Securities Commission proposes elevating this point to statutory text.

(28) "Self-regulatory organization" means a national securities exchange registered under Section 6 of the Securities Exchange Act of 1934, a national securities association of brokers and dealers registered under Section 15A of the Securities Exchange Act of 1934, a clearing agency

registered under Section 17A of the Securities Exchange Act of 1934, or the Municipal Securities Rulemaking Board established under Section 15B(b)(1) of the Securities Exchange Act of 1934.

(29) "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.

(30) "Underwriter" means a person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security; participates or has a direct or indirect participation in an undertaking; or participates or has a participation in the direct or indirect underwriting of an undertaking. The term does not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission.

**OFFICIAL COMMENT**

Prior Provisions: 1956 Act Section 401; RUSA 101.

1. Under Section 604(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: "When used in this Act, unless the context otherwise requires:" Prior Provisions: 1956 Act Section 401 Preface; RUSA Section 101 Preface. This prefatory phrase which begins 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 L. Loss & J. Seligman, Securities Regulation 927-929 (3d ed. rev. 1999), and will allow the courts to harmonize these 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 TSC v. Northway 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(1): Administrator: Prior Provisions: 1956 Act Section 401(a); RUSA Section 101(1).

5. Section 102(2): Agent: Prior Provisions: 1956 Act Section 401(b); RUSA Section 101(14).

Section (102)(2)(A), in part, follows the 1956 Act definitions. 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, 346 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) (unlicensed 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. 1992) (attorney-client relationship is generally one of agency, but that alone does not bring attorneys within securities act definition of agent).

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.

The term "individual" is limited to human beings and does not include juridical "persons" such as a corporation. Cf. definition of "person" in Section 102(18). The 1956 Act Section 401(b) similarly was limited to individuals and did not reach juridical persons such as corporations or partnerships. See Connecticut Nat'l Bank v. Giacomi, 699 A.2d 101 (Conn. 1997) ("agent" only includes natural persons when it used the term individual); Schpok v. Fodale, 236 N.W.2d 97 (Mich. Ct. App. 1975) (agent defined to be individual which did not under the statute include a corporation).

An individual will not be considered to be an agent under Section 102(2)(A) 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, for example, because of a managerial role. See, e.g., Abell v. Potomac Ins. Co., 858 F.2d 1104 (5th Cir.

1988). See also Norwest Bank Hastins v. Clapp, 394 N.W.2d 176, 178-179 (Minn. Ct. App. 1986) (lender was not an agent). Cf. Quick v. Woody, 747 S.W.2d 108 (Ark. 1988).

Section 102(2)(B) further provides with respect to individuals acting for an issuer, a parent of the issuer, or subsidiary of the issuer, including a partner, officer, or director, that such individual will not be an "agent" when such an individual acts for an issuer with respect to an offering or sale of the issuer's securities, a parent, or subsidiary when (1) such an individual primarily performs duties other than in connection with transactions in the issuer's own securities and (2) the individual does not receive compensation based, in whole or in part, upon sales of the issuer's own securities. Similar provisions exist in some states today. See, e.g., Colorado Section 201(14); Illinois Securities Act Section 2.9.

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

6. Section 102(3): 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 or selling from its own inventory).

The distinction between "a person engaged in the business" of effecting securities transactions 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 L. Loss & J. 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 exemption of banks from the definition of broker and dealer in Sections 3(a)(4) and (5) of the Securities Exchange Act of 1934. Under Section 102(3)(D), a securities administrator can exclude banks and other depository institutions, in whole or in part. There is also an exemption in Section 401(b) for bank registration as a broker-dealer for specified activities.

Section 15(h)(1) of the Securities Exchange Act of 1934, as ordered 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, Sections 401-402, 406-408.

7. Section 102(5): 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.

8. Section 102(6): 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 shareholder reporting areas. Under Section 18(a) of the federal 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) 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 Commission 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,

NASDAQ National Market System list, or other applicable securities exchange;

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

(3) Securities offered or sold to "qualified purchasers." This category of covered securities will become operational only when the SEC defines the term "qualified purchaser" as used in Section 18(b)(3) of the Securities Act of 1933, by rule, which to date it has not done; 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 covered securities. The Act does not diminish state authority to investigate and bring enforcement actions generally with respect to securities transactions.

The states are also 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.

9. Section 102(7): 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 Central Registration Depository (CRD) or Investor Advisor Registration Depository (IARD) or successor institutions or the Securities and Exchange Commission's Electronic Data Gathering 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(23) 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).

10. Section 102(8): Fraud, Deceit and Defraud: Prior Provisions: 1956 Act Section 401(d); RUSA Section 101(6). This definition, which is 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 L. Loss & J. Seligman, Securities Regulation 3421-3448 (3d ed. 1991).

11. Section 102(9): 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(9) 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 Section 101(27).

12. Section 102(11): Insurance Company: No Prior Provision. This definition is based on Securities Act of 1933 Section 2(a)(13).

13. Section 102(12): 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(12) is applicable generally but is limited to "payment of all principal and all interest."

14. Section 102(13): International Bank: No Prior Provision.

Securities issued or guaranteed by the Internal 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 within the meaning of Section 3(a)(2) of the Securities Act of 1933, see generally 3 L. Loss & J. Seligman, Securities Regulation 1191-1194 (3d ed. rev. 1999), and are within this term.

15. Section 102(14): Investment Adviser: Prior Provisions: 1956 Act Section 401(f); RUSA Section 101(7).

This term generally follows the definition in the 1956 Act and RUSA, both of which, in turn, generally followed the definition in Section 202(a)(11) of the Investment Advisers Act of 1940.

The first sentence in Section 102(14) 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(14) because of the intention that this definition be construed uniformly with the definition in the Investment Advisers Act of 1940. See Section 701.

The second sentence in the term addressing financial planners is new. The purpose of this sentence is to achieve functional regulation of those financial planners who, in fact, 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 some form of 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 alone does not require registration of the financial planner as an investment adviser.

Sections 102(14)(A)-(G) 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 Article 4 registration and regulatory provisions.

Sections 102(14)(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(5) and 102(15); registration and exemptions in Sections 404-405.

Sections 102(14)(A), (C), and (G) are substantively identical to the 1956 Act, RUSA, and the Investment Advisers Act of 1940. The Official Comment to 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":

> [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 [(3)] 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.

Section 102(14)(D) is identical to the 1956 Act definition but adds 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 drafted 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 RUSA approach may be too broad. The retention of the 1956 Act and 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(14)(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, regular, and paid 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(14)(F) is required by the National Securities Markets Improvement Act of 1996. This exclusion will also reach banks and bank holding companies as described in Investment Advisers Act Section 202(a)(11)(A) and persons whose advice solely address United States government securities as described in Section 202(a)(11)(E).

16. Section 102(17): 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)-(7).

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).

17. Section 102(18): 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. 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.

18. Section 102(22): Price Amendment: Prior Provision: RUSA Section 101(11). This concept concerns only the registration by coordination with the Securities and Exchange Commission procedure in Section 303(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 L. Loss & J. Seligman, Securities Regulation 542-550 (3d ed. rev. 1998).

19. Section 102(23): Record: No Prior Provision. The term record includes, but is not limited to documents, books, publications, accounts, correspondence, memoranda, agreements, computer files, film, microfilm, photographs, and audio and visual tapes. It is intended to embrace new forms of records that are created or popularized in the future.

20. Section 102(27): Security: Prior Provisions: 1956 Act Section 401(1); RUSA Section 101(16).

Much of the definition in Section 102(27), like the definitions in the 1956 Act Section 401(l) and RUSA Section 101(16), is identical or virtually 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 L. Loss & J. Seligman, Security Regulation 923-1138.19 (3d ed. rev. 1999).

Section 102(27) adds two provisions from RUSA to the 1956 definition: (a) "a put, call, straddle, or option entered into on a national securities exchange relating to foreign currency; a put, call, straddle or option on a security, certificate of deposit, or group or index of securities, including an interest in or based on the value of any of the foregoing"; and (b) the exception for "an interest in a contributory or noncontributory pension or welfare plan subject to the Employee Retirement Income Security Act of 1974."

Section 102(27) also 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 interests to be investment contracts. 2 L. Loss & J. Seligman, Securities Regulation 979-982 (3d ed. rev. 1999).

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

Under federal securities law limited liability companies and limited partnerships have been held to be investment contracts and accordingly "securities" within the meaning of Section 2(a)(1) of the Securities Act of 1933. See 2 L. Loss & J. Seligman, Securities Regulation 1028-1031 (3d ed. rev. 1999). In addition, 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), such instruments as limited liability partnerships or viatical settlements could also be statutory securities. But 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).

Insurance or endowment policies or endowments 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 exempted from securities registration under Section 201(4). This will allow state securities administrators to bring enforcement actions concerning variable insurance sales practices. Some states have taken a different approach and excluded variable insurance products from the definition of a security. In those states variable insurance product sales practices would not be subject to the securities fraud provisions.

This definition is intended to apply whether or not a security is evidenced by a writing.

21. Section 102(28): Self-regulatory Organization: Prior Provision: RUSA Section 101(17). This definition was added by RUSA and based on a counterpart provision in the Federal Securities Code.

22. Section 102(29): 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.

23. Section 102(30): Underwriter: No Prior Provision. The definition in Section 102(30) is intended to be construed consistently with the definition of underwriter in Section 2(a)(11) of the Securities Act of 1933.

## ARTICLE 2:
## EXEMPTIONS

### OFFICIAL COMMENT

Section 201 includes exempt securities and Section 202 includes exempt transactions. Both exempt securities and exempt transactions are exempt from the securities registration and the filing of sales literature sections of this Act. Neither Section 201 nor Section 202 provide an exemption from the Act's antifraud provisions in Article 5.

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.

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

(1) [United States Governments and Municipals] a security, including a revenue obligation or a separate security as defined in a rule under the Securities Act of 1933, issued, insured, or guaranteed by the United States; by a State, or by a political subdivision of a State; or by a public authority, agency, instrumentality of one or more States, or political subdivisions 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 Governments] 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 Institutions and International Banks] a security issued by and representing

or that will represent an interest in or a direct obligation of, or be guaranteed by, a depository institution or by an international bank;

**REPORTER'S COMMENT**

Source of Law: RUSA Section 401(b)(3).

1. 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 is adopted here as Section 102(4)) and a common exemption (see RUSA Section 401(a)(3) which is adopted in this Section).

2. 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) [Insurance Companies] 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) [Public Utilities] a security issued or guaranteed by a railroad, other common carrier, public utility, or holding company that is:

(A) a registered holding company under the Public Utility Holding Company Act of 1935 or a subsidiary of a registered holding company within the meaning of that act;

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

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

(6) [Certain Options and Rights] a put or call option contract, warrant, or subscription right on or with respect to a federal covered security specified in Section 18(b)(1) of the Securities Act of 1933 or by rule under that Section or any security listed or approved for listing

on another appropriate securities markets specified by rule by the administrator; or an option 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;

(7) [Nonprofit Organizations] 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 person, or a security of a fund that is excluded from the definition of an investment company under Section 3(c)(10) of the Investment Company Act of 1940, but not including a note, bond, debenture, or evidence of indebtedness unless the administrator so specifies, by rule or order, under Section 203;

**REPORTER'S COMMENT**

Source of Law: Sec. Act Section 3(a)(4).

1. 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.

2. Section 3(a)(4) is not treated as a federal covered security 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).

3. RUSA also 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 Act instead relies exclusively on the antifraud provisions to address whatever abuses might occur with these securities.

4. This exemption is of particular concern to state securities administrators. Robert M. Lam, Chairman of the Pennsylvania Securities Commission, wrote the Reporter on November 30, 1999:

> Of all the changes that have occurred at the State level, the rise of the market of debt securities of non-profit organizations has been the most significant and troublesome. . . .

(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 does not include a member's or owner's interest, retention certificate, or like security sold to persons other than bona fide members of the cooperative unless the administrator adopts a rule or issues an order under Section 203;

(9) [Employee Benefit Plans] a security issued in connection with 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 its majority owned subsidiaries of the issuer's parent for the participation of their employees; directors; general partners; and trustees if the issuer is a business trust; or officers; or consultants and advisors; and their family members who acquire the securities from such persons by gift or pursuant to a domestic relations order; securities issued in connection with the employee benefit plans to former employees, directors, general partners, trustees, officers, consultants, and advisors are also exempt, but only if these persons were employed by or providing services to the issuer at the time the securities were offered; in this paragraph, the term

"employee" includes an insurance agent who is the exclusive agent of the issuer, its subsidiaries or parents, or who derives more than 50 percent of the agent's annual income from those entities; and

**REPORTER'S COMMENT**

The Pennsylvania Securities Commission has expressed concerns that this exemption, unlike Rule 701 of the Securities Act of 1933, does not provide for (1) resale restrictions; (2) limits on the amounts that may be sold; and (3) mandatory delivery of a disclosure document by the issuer.

(10) [Equipment Trust Certificates] an equipment trust certificate in respect to equipment leased or conditionally sold to a person, if securities issued by the person would be exempt under this subsection or would be federal covered securities under Section 18(b)(1) of the Securities Act of 1933.

**OFFICIAL COMMENT**

1. Section 201(1): United States Governments and Municipals: 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 a relevant 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 and is referenced by the phrase, "[a] security, including a reserve obligation or a separate security as that form is defined in a rule under the Securities Act of 1933."

2. Section 201(2): Foreign Governments: 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(4): Insurance Companies: 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 or 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(27).

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(6), and subject to the notice filing requirements of Section 302.

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.

4. Section 201(5): Public Utilities: 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 utilities covered by this exemption are subject both to the federal Public Utility Holding Company Act and to state utility regulation.

5. 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 stock exchanges, senior or substantially equal securities of the same issuer, and any security called for 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 or American Stock Exchanges or the National Market System of the National Association of Securities Dealers Stock Markets 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. See Comment to Section 102(6).

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 and American Stock Exchanges and the National Market System of the National Association of Securities Dealers Stock Exchange.

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 Securities Market of the National Association of Securities Dealers began trading the National Market List and the development of standardized options markets.

5. 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. As with the RUSA version of this exemption, it is not intended to be available if securities are traded to the public generally.

The 1956 Act Section 402(a)(12) had instead merely 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." L. Loss, Commentary on the Uniform Securities Act 118 (1976).

6. Section 201(9): 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, after the 1956 Act was drafted, the United States Supreme Court in International Brotherhood 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 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." Both contributory and noncontributory pension or welfare plans subject to the Employee Retirement Income Security Act of 1974 are excluded from the definition of security in Section 102(27).

In this definition, the term "advisors" does not refer to "investment advisers," as defined in Section 102(14).

With respect to employee benefit plans that are securities, Section 201(9) provides an exemption, but follows RUSA in not limiting the exemption to investment contracts and not requiring 30 days notice to the administrator. The administrator, however, does retain the power under Section 204, if necessary or appropriate, to deny, condition, limit, or revoke this and other specified exemptions.

The conclusion of Section 201(9) is derived from Rule 701(c) issued under the Securities Act of 1933. Compliance with Rule 701 is intended also to provide compliance with this exemption.

7. Section 201(10): 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.

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 Sections 301 through 306, and 504:

(1) [Isolated Nonissuer Transactions] an isolated nonissuer transaction, whether effected through a broker-dealer or not;

(2) [Specified Nonissuer Transactions] a nonissuer transaction by a registered agent of a

registered broker-dealer, and any 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 time of the transaction:

(A) The issuer of the security is engaged in business, is not in the organization stage or in bankruptcy or receivership, and 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 the current market price of the security;

(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 of the administrator under this [Act] or a record filed with the Securities and Exchange Commission which is publicly available through the Securities and Exchange Commission's Electronic Data Gathering and Retrieval System 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, or, in the case of a foreign issuer, the corporate equivalents of those persons in the issuer's country of domicile;

(iii) an audited balance sheet of the issuer as of a date within 18 months or, in the case of a reorganization or merger where the parties to the reorganization or merger had

the audited balance sheet, a pro forma balance sheet;

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

(v) 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:

(A) the issuer of the security is a unit investment trust registered under the Investment Company Act of 1940;

(B) the issuer of the security has been engaged in continuous business (including predecessors) for at least three years; or

(C) 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 or, in the case of a reorganization or merger where the parties to the reorganization or merger had the audited balance sheet, a pro forma balance sheet;

**REPORTER'S COMMENT**

QUERY: The SIA has proposed adding an exemption for: "Any security rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories." The Pennsylvania Securities Commission does not object to the SIA proposal as a nonissuer exemption, but would object if it were an issuer exemption.

(3) [Foreign Nonissuer Transactions] a nonissuer transaction involving a foreign equity

security that is a margin security defined in rules or regulations 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 in an outstanding security if the issuer or 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;

(5) [Nonissuer Transactions in Specified Securities with Fixed Maturity, Interest or Dividend] a nonissuer transaction in a security that has a fixed maturity or a fixed interest or dividend, if:

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

(B) the issuer is engaged in business, is not in the organization stage or in bankruptcy or receivership, and 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 or persons;

(6) [Unsolicited Brokerage Transactions] a nonissuer transaction by or through a broker-dealer registered under this [Act] effecting an unsolicited order or offer to purchase;

(7) [Pledges] a nonissuer transaction executed by a bona fide pledgee without any purpose of evading this [Act];

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

(9) [Unit Secured Transactions] a transaction in a note, bond, debenture, or other evidence of indebtedness secured by a real or chattel mortgage or deed of trust or by an agreement for the sale of real estate or chattels, if each mortgage, deed of trust or agreement, together with all the notes, bonds, debentures, or other evidences of indebtedness secured thereby, is offered and sold as a unit, and there is no general solicitation or general advertisement of the transaction and sales compensation is not paid to any person not registered under this [Act] as a broker-dealer or as an agent;

(10) [Bankruptcy, Guardian, or Conservator Transactions] a transaction by an executor, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian, or conservator;

(11) [Institutional Investors] an offer or sale to one or more of the following:

(A) an institutional investor;

[(B) an investment adviser registered under the Investment Advisers Act of 1940 acting for its own account]; or

(C) any other person the administrator, by rule or order, specifies;

**REPORTER'S COMMENT**

Source of Law: New.

1. The 1956 Act contains similar but less inclusive language in Section 402(b)(8).

2. When the SEC adopts a rule defining "qualified purchaser" as used in Section 18(b) of the Securities Act as purchasers of federal covered securities, part or all of this exemption may prove redundant.

(12) [Limited Offering Transactions] a transaction under an offer to sell securities of an issuer, if the transaction is part of an issue in which:

(A) there are no more than 10 purchasers in this State during any 12 consecutive months, other than those designated in Rule 501(a) under the Securities Act of 1933 and in paragraph 11;

(B) general solicitation or general advertising is not used in connection with the offer to sell or sale of the securities;

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

(D) either the seller reasonably believes that all the purchasers in this State other than those designated in Rule 501(a) of the Securities Act of 1933 and in paragraph 11 are purchasing for investment or, immediately before and immediately after the transaction, the issuer reasonably believes that the equity securities of the issuer are held by a total of 50 or fewer beneficial owners, wherever located, other than those designated in Rule 501(a) under the Securities Act of 1933 and in paragraph 11 and the transaction is part of an aggregate offering that does not exceed [$1,000,000] during any 12 consecutive months;

**REPORTER'S COMMENT**

Source of Law: RUSA Section 402(11); 1956 Act Section 402(b)(9).

1. 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 buyers in the State had to purchase for investment; and no remuneration was given for soliciting prospective buyers in the State. The 1985 Act, 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.

2. 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, both the 1956 Act Section 402(b)(10) and RUSA Section 402(12) use similar concepts in separate Sections to apply to preorganization limited offerings.

3. 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 integrates 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.

4. 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.

(13) [Transactions with Existing Security Holders] a transaction under an offer to existing security holders of the issuer, including persons who at the time 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;

(14) [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 under the Securities Act of 1933; and

(B) no stop order of which the offeror is aware has been entered against the offeror by the administrator or the Securities and Exchange Commission, and no examination or

public proceeding that may culminate in a stop order is known by the offeror to be pending;

(15) [Offerings When Registered 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; and

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

(C) no stop order of which the offeror is aware has been entered by the administrator, and no examination or public proceeding that may culminate in that kind of order is known by the offeror to be pending; and

**REPORTER'S COMMENT**

Source of Law: RUSA Section 402(16).

1. A solicitation of interest document must accompany a registration by qualification as specified in Section 304(b)(13).

2. Oral offers may be made after a registration statement has been filed.

(16) [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.

**OFFICIAL COMMENT**

1. Sections 202(1)-(7) 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)-(7). A nonissuer, however, can rely on an applicable issuer transaction exemption such as Section

202(11). The term "nonissuer transaction" or "nonissuer distribution" is defined in Section 102(17); the term "issuer" is defined in Section 102(16).

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 (Kansas 1969) (regulation defined isolated transactions to not exceed four persons solicited in a 12 month period); Nelson v. State, 355 P.2d 413, 420 (Okl. Ct. Crim. App. 1960) ("[a]n isolated sale means one standing alone, disconnected from any other"); see generally 1 L. Loss & J. Seligman, Securities Regulation 125-129 (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 be sufficient to constitute a "distribution" as that term is used for purposes of the federal securities laws, see 2 L. Loss & J. 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 offerings are separately addressed in Section 202(12).

3. Section 202(2): Specified Nonissuer Transactions: 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 has adopted an amendment to the 1956 Act Section 402(b) after discussions with the Securities Industry Association and others in the securities industry. This Section generally follows the NASAA amendment.

4. Section 202(3): Foreign Nonissuer Transactions: No Prior Provision. The NASAA amendment 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 or 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 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(6), 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) has been removed.

6. Section 202(5): Nonissuer Transactions in Specified Securities with Fixed Maturity, Interest, or Dividend: Prior Provisions: 1956 Act Section 402(b)(2)(B); RUSA Section 402(4). The substance of this exemption 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.

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 further 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 generally preempted by Section 18(a) of the Securities Act of 1933 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): Pledges: 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): 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.

10. Section 202(9): 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. Otherwise this exemption is substantively identical to the 1956 Act and RUSA.

11. Section 202(10): 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.

12. Section 202(13): 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 similarly 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(6). 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.

13. Section 202(14): Offerings When Registered under this Act and Exempt from 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 had the requirement that a registration statement be filed under this Act, but not yet be effective. By eliminating this 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.

14. Section 202(16): 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 formally abandoned its earlier "no sale" doctrine. See 3 L. Loss & J. 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. Accordingly Section 202(16) does not follow the requirement in RUSA Section 402(17) and require for securities not required to be registered under the Securities Act of 1933 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 the administrator does not disallow the exemption within the next 10 days.

**SECTION 203. ADDITIONAL EXEMPTIONS AND WAIVERS.** The administrator, by rule or order, may exempt a security, transaction, or offer, or class of securities, transactions, or offers from Sections 301 through 306 and 504, and waive a requirement for a security, transaction, or offer or class of securities, transactions, or offers under Sections 201 and 202.

**OFFICIAL COMMENT**

Prior Provision: RUSA Section 403.

Under this type of authority, at least 49 (of 53) jurisdictions through 1999 had adopted the Uniform Limited Offering Exemption (ULOE) or a Regulation D exemption, and 30 jurisdictions had adopted a Rule 144A exemption. The Drafting Committee did not attempt to incorporate ULOE or a Rule 144A exemption as part of this Act because of their complexity and the likelihood of periodic updating of its provisions. The Drafting Committee believes that Rule 144A, and similar exemptions in ULOE, can be most effectively implemented by rule rather than statute.

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).

It is the intent of this provision that ULOE, Rule 144A, and additional exemptions or waivers be adopted uniformly by states, to the extent this is practicable. Cf. Sections 607 and 701.

**SECTION 204. DENIAL, CONDITION, LIMITATION, OR REVOCATION OF EXEMPTIONS.** Except to the extent that a security or transaction involves a federal covered security, the administrator, by order, may deny, condition, limit, or revoke an exemption created under Sections 201(7), 202 or 203 with respect to a specific security, transaction, or offer. The order must be issued in accordance with Section 603. An order issued under this section is not retroactive. A person does not violate Sections 301 through 306 or 504 by reason of an offer to sell or sale 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.

**OFFICIAL COMMENT**

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

Section 204 is potentially far reaching. The ability to deny, condition, limit, or revoke the exemptions specified in Sections 201(7), 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.

No order under Section 204 may be entered except in accordance with the requirements of Section 603 which include prior notice, opportunity for a hearing, written findings of fact and conclusions of law. 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 under Sections 201 through 203; or (3) the security is registered under this [Act].

### OFFICIAL COMMENT

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

1. This Section is substantively identical to the 1956 Act and RUSA except for Section 301(1), which is necessitated by the National Securities Markets Improvement Act of 1996. See Comment to Section 102(6).

2. Unless a federal covered security or exempt, no sale of a security may be made in this State before the security is registered. "Sale" is defined in Section 102(24); "in this State" is addressed in Section 510; 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(14)-(16) operate to permit similar offers for securities that 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(6), are addressed in Section 302.

**SECTION 302. NOTICE FILINGS AND FEES APPLICABLE TO FEDERAL COVERED SECURITIES.**

(a) The administrator, by rule or order, may require the filing of any or all of the following records with respect to a federal covered security, as defined in Section 18(b)(2) of the Securities Act of 1933:

(1) before the initial offer of the 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 [together with 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 located in this State, if the sales data are not included in records filed with the Securities and Exchange Commission, [together with a fee of $____].

(b) A notice filing is effective for a period of one year commencing upon the later of the notice filing or the effectiveness of the offering with the Securities and Exchange Commission. Upon expiration, a notice filing may be renewed by the issuer filing a copy of those records filed by the issuer with the Securities and Exchange Commission that the administrator, by rule or order, specifies [together with the renewal fee of $ ___]. A previously filed consent to service of process may be incorporated by reference in a renewal. A renewed notice filing is effective upon the expiration of the filing being renewed.

(c) With respect to any security that is a federal covered security under Section 18(b)(4)(D) of the Securities Act of 1933, the administrator, by rule, may require the 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 no later than 15 days after the first sale of the federal covered security in this State, [together with a fee of $____].

(d) The administrator may issue a stop order suspending the offer and sale of a federal covered security within this State, except a federal covered security under Section 18(b)(1) of the Securities Act of 1933, if the administrator finds that there is a failure to comply with a notice filing or fee requirement of this section. If the deficiency is corrected, the stop order is void as of the time of its entry.

(e) The administrator, by rule or order, may waive any or all of the requirements of this section.

**OFFICIAL COMMENT**

Prior Provision: None.

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.

2. For Rule 506 offerings which are denoted in 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(7) will permit states to receive electronic filing of records under this Section. The term will also permit states to receive records through a designee such as a central depository or to electronically receive notice filings simultaneously with the Securities and Exchange Commission.

**REPORTER'S COMMENT**

QUERY: Should Section 306(c) provide that a stop order be voided at the time of its entry or upon correction? The Texas Securities Commission urges that the void at the time of entry would mean there is no effective penalty for a deficient filing.

**SECTION 303. SECURITIES REGISTRATION BY COORDINATION.**

(a) 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) 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 510:

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

(2) if the administrator, by rule or order, requires, 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;

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

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

(c) A registration statement under this section becomes effective simultaneously with the federal registration statement when all the following conditions are satisfied:

(1) no stop order under Section 303(d) or 306 or issued by the Securities and Exchange Commission is in effect and no proceeding is pending against the issuer under Section 408; and

(2) the registration statement has been on file for at least 20 days or such shorter period as the administrator, by rule or order, specifies.

(d) The registrant shall promptly notify the administrator in a record of the date and time when the federal registration statement became effective and the content of a price amendment, if any, and shall promptly file a notice containing the information and records in the price amendment. Upon failure to receive the required notice, the administrator may enter a stop order, without notice or hearing, retroactively denying effectiveness to the registration statement or suspending its effectiveness until compliance with this subsection if the administrator promptly notifies the registrant by telephone or electronic means or telegram, and promptly confirms the notice by a record, of the issuance of the order. If the registrant complies with the notice requirements of this subsection, the stop order is void as of the time of its entry. The administrator, by rule or order, may waive any condition specified in this subsection. If the federal registration statement becomes effective before all the conditions in this subsection are satisfied and they are not waived by the administrator, the registration statement automatically becomes effective when all the conditions are satisfied. 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 electronic means, telephone, or telegram whether all the conditions are satisfied and whether the administrator contemplates the commencement of a proceeding under Section 306; but the notice by the administrator does not preclude the commencement of such a proceeding.

(e) The administrator, by rule or order, may waive or modify the application of a requirement of this section if a provision or an amendment, repeal, or other alteration of the

securities registration provisions of the Securities Act of 1933, or the regulations adopted under that Act, render the waiver or modification appropriate to further coordination of state and federal registration.

## OFFICIAL COMMENT

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. The same stop order standards specified in Section 306 govern both registration by coordination and registration by qualification in Section 304.

2. The phrase "in connection with the same offering" 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. Sections 303(a)-(d) are similar to the 1956 Act except that these provisions have been modernized to include electronic filing and electronic notification, cf. Section 102(7). 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. See Section 701.

Potential simultaneous filing could be administered through a designee similar to the current Central Registration Depository or in conjunction with the Securities and Exchange Commission's Electronic Data Gathering and Retrieval System or otherwise.

4. Section 303(b) limits the administrator to requiring only the information and records filed with the Securities and Exchange Commission.

5. Sections 303(c)-(d) describe the conditions to be satisfied to achieve effectiveness of a coordination filing. "Price amendment" is defined in Section 102(22). 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.

6. Section 303(e) follows RUSA Section 303(h) and affords the administrator a basis for modifying any of the requirements of this Section when it is appropriate to do so. An example would be the expedited procedures several states have adopted to coordinate with shelf

registrations under Rule 415 adopted under the Securities Act of 1933. In waiving or modifying requirements, the administrator must make a finding satisfying the requirements of Section 604(b).

**SECTION 304. SECURITIES REGISTRATION BY QUALIFICATION.**

(a) A security may be registered by qualification under this section.

(b) A registration statement under this section shall contain the following information and 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 510:

(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 a director and officer of the issuer, or other person occupying a similar status or performing similar functions, the person's name, address, and principal occupation for the past five years; the amount of securities of the issuer held by the person as of a specified date 30 days 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 a material interest in a material transaction with the issuer or a significant subsidiary effected within the past three years or proposed to be effected;

(3) with respect to persons covered by paragraph (2), the remuneration paid during the past 12 months and estimated to be paid during the next 12 months, directly or indirectly by

the issuer, together with all predecessors, parents, subsidiaries, and affiliates, to all those persons in the aggregate;

(4) with respect to a person owning of record, or 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 past 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 in any material transaction with the issuer or any significant subsidiary effected within the past 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, for which the issuer or any subsidiary has issued its securities within the past 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 cash 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 who 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, together with the amount of any such options held or to be held by each person required to be named in paragraphs (2), (4), (5), (6), or (8), and by any person that holds or will hold 10 percent or more in the aggregate of any such options;

(11) the dates of, parties to, and general effect concisely stated of each management 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 was made within the past two years, together with a copy of the contract;

(12) a description of any pending litigation or proceeding to which the issuer is a party and which materially affects its business or assets, including litigation or a 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(15)(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, currently 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) the consent in a record of any accountant, engineer, appraiser, or other person

whose profession gives authority to a statement made by the person, if the person is named as having prepared or certified a report or valuation, other than a public and official record, which is used in connection with the registration statement;

(17) an audited 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 last fiscal year and the date of the balance sheet, or for the period of the issuer's and any predecessors' 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) the additional information the administrator, by rule or order, specifies.

(c) The administrator may waive any of the requirements of Section 304(b).

(d) A registration statement under this section becomes effective 30 days, or any shorter period as the administrator, by rule or order, specifies, after the date the registration statement or the last amendment other than a price amendment is filed, if:

(1) no stop order is in effect and no proceeding is pending under Section 306;

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

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

(e) The administrator may delay effectiveness for a single period of not more than 90 days if the administrator determines the registration statement is not complete in all material respects and promptly notifies the 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.

(f) The administrator, by rule or order, 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 whom an offer is made, before or concurrently with whichever first occurs:

(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 who 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.

**OFFICIAL COMMENT**

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 any other 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 604(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 Section 304(b)(18) and 304(c) 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, authorizes 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.

**REPORTER'S COMMENT**

The Pennsylvania Securities Commission urges that Section 304(d) should be predicated also on "all information required by the Commission has been furnished" before a person can request effectiveness.

**SECTION 305. GENERAL SECURITIES REGISTRATION.**

(a) [Registration Requirements.] A registration statement may be filed by the issuer, any other person on whose behalf the offering is to be made, or a registered broker-dealer.

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

(c) [Status of Registration Statement.] 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 entered in connection with the offering by the regulatory authority in a State, by a court, or by the Securities and Exchange Commission.

(d) [Incorporation by Reference.] A record filed under this [Act] or a 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) [Waiver of Requirements.] The administrator, by rule or order, may waive the requirement for inclusion of any information or record in a registration statement.

(f) [Nonissuer Distribution.] In the case of a nonissuer distribution, information may not be required under subsection (j) 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 can be furnished by these persons without unreasonable effort or expense.

(g) [Escrow and Impoundment.] The administrator, by rule or order, may require as a condition of registration that 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, 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 administrator, by rule or order, may specify the conditions of any escrow or impoundment required under this subsection, but the administrator may not reject a depository solely because of its location in another State.

(h) [Form of Subscription.] The administrator, by rule or order, may require as a condition of registration that a registered security be sold only on a specified form of subscription or sale contract and that a signed or conformed copy of each contract be filed with the administrator or preserved for a period of not more than three years, specified in the rule or order.

(i) [Effective Period.] Except during the time 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 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 who is still offering part of an unsold allotment or subscription taken as a participant in the distribution. For the purpose of a nonissuer transaction, all outstanding securities of the same class identified in the registration statement as a registered security are considered to be registered while the registration statement is effective. A registration statement may not be withdrawn until one year after its effective date if any securities of the same class are outstanding. A registration statement may be withdrawn only with the approval of the administrator.

(j) [Periodic Reports.] So long as a registration statement is effective, the administrator, by rule or order, may require the person who filed the registration statement to file reports, not more often than quarterly, to keep reasonably current the information contained in the registration statement and to disclose the progress of the offering.

(k) [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 [$__]. Such a posteffective amendment relates back to the date of the offering of the additional securities being registered, if within six months after the date of the sale, the amendment is filed and the additional registration fee is paid.

**OFFICIAL COMMENT**

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(6), 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 "any other person on whose behalf the offering is to be made." This would permit a nonissuer, see definition in Section 102(17), or a broker-dealer to file a registration statement independent of the issuer.

4. This Act is intended to be revenue neutral, see Comment 4 to Section 701. 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(j) periodic reports 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.

9. Section 305(f) 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(f) only applies to registration by qualification under Section 304 and periodic reports for either registration by coordination or registration by qualification under Section 305(j).

10. Section 305(g), 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(g) will be a relatively new promotional or speculative offering.

Under Section 305(g) the administrator would also be authorized to order the release of impounded funds back to prospective purchasers. See, e.g., State ex rel. Ariz. Corp. Comm'n v. Bionomics Int'l, Ltd., 543 P.28 802 (Ariz. Ct. App. 1975). However, before release of funds held in impoundment back to prospective purchasers, the administrator must afford the registrant an opportunity to be heard.

Unlike the statute in Schwaemmle Const. Co. v. Michigan Dep't of Commerce, 360 N.W.2d 141 (Mich. 1984), Section 305(g) 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.

Section 305(g) follows the 1956 Act and RUSA and provides that the administrator may not reject a depository solely because of its location in another state.

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

12. Section 305(i) generally follows the 1956 Act and RUSA.

The term "nonissuer transaction" or "nonissuer distribution" is defined in Section 102(17). 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 sale is not exempt under Section 202(1), it may still be exempted under other transaction exemptions, including Sections 202(2) through (8), (11), or (12).

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(i) 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(i) 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(k) follows RUSA and a procedure limited to investment companies in the 1956 Act in allowing posteffective date amendments. Under Section 305(k) when a posteffective amendment increases the number of securities to be offered or sold an additional registration fee is required. See Comment 4 to Section 305.

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

(a) 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(k) as of its effective date, or a report under Section 305(j), 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, order issued, or condition lawfully 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 occupying 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 entered under any other federal or state law applicable to the offering, but the administrator may not commence a proceeding against an effective registration statement under this paragraph more than one year after the date of the order or injunction relied on, and the administrator may not enter an order under this paragraph on the basis of an order or injunction entered under the securities act of another State unless the order or injunction was based on facts that currently would constitute 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 failed to pay the proper filing fee, but the administrator may enter only a stop order under this paragraph and shall void the order if the deficiency is corrected; or

[(7) the applicant or registration statement violates a rule adopted or order issued by the administrator under this [Act] that:

(A) the offering has worked or tended to work a fraud upon purchasers or would so operate;

(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 participation, or unreasonable amounts or kinds of options; or

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

(b) The administrator may not commence a stop order proceeding against an effective registration statement on the basis of a fact or transaction known to the administrator when the registration statement became effective unless the proceeding is begun within 30 days after the registration statement became effective.

(c) The administrator may summarily revoke, deny, postpone, or suspend the effectiveness of a registration statement pending final determination of an administrative proceeding. Upon the entry of the order, the administrator shall promptly notify each person specified in subsection (d) that the order has been entered, 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, the order remains in effect until it is modified or vacated by the administrator. If a hearing is requested or ordered, the administrator, after notice of and opportunity for hearing to each person specified in subsection (d), may modify or vacate the order or extend it until final determination.

(d) A stop order may not be entered under subsections (a) or (b) 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) opportunity for hearing; and

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

(e) The administrator may modify or vacate a stop order entered under this section if the administrator finds that the conditions that caused its entry have changed or that it is otherwise in the public interest.

**REPORTER'S COMMENT**

1. In Section 306(a)(3), should we include foreign states?

**OFFICIAL COMMENT**

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). Posteffective amendments are not required except to correct inaccuracies as of the effective date.

An administrator may require periodic reports under Section 305(j). With respect to periodic reports under Section 305(j), 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. The term "willfully" has the same meaning in Section 306(a)(2) 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. This definition has been followed by most subsequent courts. See, e.g., State v. Kansas, 460 P.2d 596 (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, (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, ___ P.2d ___ (Idaho 2001) (Docket No. 24670) (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, (Wis. Ct. App. 1996) (willfulness does not require proof that the defendant acted with intent to defraud or knowledge that the law was violated).

"Willfully" would not include negligent or inadvertent conduct.

4. A violation by an issuer has the same consequences whether the issuer has filed a registration statement or has had a local broker-dealer file it. 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. Section 306(a)(7) addresses merit regulation.

Sections 306(E)-(F) of the 1956 Act addressed merit regulation by authorizing 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(h)(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(6) and Comments.

Section 306(a)(7) takes a different approach. Subject to the National Securities Markets Improvement Act of 1996, each of the merit standards in RUSA is retained but on the condition that they are adopted by the administrator, by rule or order. This will provide notice to issuers of a state's merit standards. This notice will address one criticism of merit regulation. See generally 1 L. Loss & J. 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(a)(7). Similarly other state rules or orders could be adopted in the future to address new types of securities as they occur.

Under Section 306(a)(7) 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. Such "blank check offerings" are subject to Rule 419 adopted under the Securities Act of 1933.

9. Section 306(b) 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. The intent is to avoid the necessity of an administrator issuing a stop order prematurely.

10. Sections 306(c)-(d) 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 in accordance with the State Administrative Act and subject to the requirements of Section 603.

11. An administrator must consider the public interest when issuing a stop order and may under Section 306(e) 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 L. Loss & J. Seligman, Securities Regulation 576-589 (3d ed. rev. 1998).

## ARTICLE 4:
## BROKER-DEALERS, AGENTS, INVESTMENT ADVISERS, INVESTMENT ADVISER REPRESENTATIVES, FEDERAL COVERED INVESTMENT ADVISERS, AND INVESTMENT ADVISER REPRESENTATIVES OF FEDERAL COVERED INVESTMENT ADVISERS

### SECTION 401. BROKER-DEALER REGISTRATION REQUIREMENT AND EXEMPTIONS.

(a) 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 provided in subsection (b).

(b) The following broker-dealers are exempt from the registration requirement of subsection (a):

(1) except as provided in subsection (c), 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 broker-dealer registered or not required to be registered under this [Act];

(C) an institutional investor;

(D) a preexisting customer whose principal place of residence is not in this State if the broker-dealer is both registered or not required to be registered under the Securities Act of 1934 and registered under the securities act of the State in which the customer maintains a principal place of residence;

[(E) a preexisting customer whose principal place of residence was not in

this State when the customer relationship was established, but who moved into this State, if:

(i) the broker-dealer is both registered or not required to be registered under the Securities Exchange Act of 1934 and registered under the securities laws of the State from which the customer moved into this State 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 broker-dealer files an application for registration in this State and no further transaction is effected more than 60 days after the date on which the application is filed, or, if earlier, the date on which this State notifies the broker-dealer that it has denied the application for registration or has stayed the pendency of the application for cause;]

(F) not more than three persons in this State during the previous 12 month period, in addition to those specified in paragraphs (A) through (E), provided that the broker-dealer is both registered or not required to be registered under the Securities Exchange Act of 1934 and registered under the securities act in the State in which the broker-dealer has its principal place of business; and

(G) any other person the administrator, by rule or order, specifies.

[(2) a bank if its broker-dealer activities are limited to those specified in Sections 3(a)(4)(i)-(vi) and (viii)-(ix) and Section 3(a)(5)(C) of the Securities Exchange Act of 1934;] and

(3) any other broker-dealer the administrator, by rule or order, exempts.

(c) The exemptions provided in subsection (b) are not available to a broker-dealer that deals solely in government securities and is not registered under the Securities Exchange Act of 1934 unless the broker-dealer is subject to supervision as a dealer in government securities by the

Federal Reserve Board.

(d) It is unlawful for a broker-dealer or issuer engaged in offering securities in this State, directly or indirectly, to employ or associate with an individual to engage in any activity in this State if the individual is suspended or barred from association with a broker-dealer or issuer [or investment adviser] by an order of the administrator. A broker-dealer or issuer does not violate this subsection if the broker-dealer or issuer did not know or in the exercise of reasonable care could not have known, of the suspension or bar. Upon request from a broker-dealer and for good cause shown, the administrator, by order, may waive the prohibition of this subsection with respect to an individual suspended or barred.

**OFFICIAL COMMENT**

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

1. "Broker-dealer" is defined in Section 102(3). The scope of the Section 401(a) reference "to transact business in this State" is specified in Section 510.

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 (Supr. Ct. App. Div. 1977) (requirement that the transactions involve securities).

3. Comments on Section 401(b) will be written.

4. Section 401(d) prohibits a broker-dealer or issuer from employing an individual in a capacity from which that person 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.

**SECTION 402. AGENT REGISTRATION REQUIREMENT AND EXEMPTIONS.**

(a) 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 exempt from registration as provided in subsection (b).

(b) The following agents are exempt from the registration requirement of subsection (a):

(1) an agent acting for a broker-dealer exempt under Section 401(b);

(2) an agent acting for an issuer whose compensation is based in whole or in part upon the amount of purchases or sales of the issuer's own securities, who

(A) effects transactions in a security of the issuer exempted by Section 201;

(B) effects transactions in the issuer's securities exempted by Section 202;

[(3) an agent acting for an issuer who effects transactions solely in federal covered securities of the issuer, except that an agent who effects transactions in a federal covered security to qualified purchasers under Section 18(b)(3) or under Section 18(b)(4)(D) of the Securities Act of 1933 is not exempt if any commission or other remuneration is paid or given directly or indirectly for effecting transactions to a person in this State;]

[(4) an agent acting for a broker-dealer registered in this State under Section 401(a) or exempt under Sections 401(b) or (c) in the offer and sale of securities for any account directed by an investment adviser registered in this State or a federal covered investment adviser;] or

(5) any other agent the administrator, by rule or order, exempts.

(c) An individual may not act as an agent for more than one broker-dealer or one issuer at a time, unless the broker-dealer or issuer for whom the agent acts is affiliated by direct or indirect common control or the administrator, by rule or order, authorizes the multiple associations.

(d) Except as otherwise provided in subsection (b), it is unlawful for a broker-dealer or an

issuer to employ or associate with an agent who transacts business in this State on behalf of the broker-dealer or issuer unless the agent is registered or exempt from registration under this [Act] as an agent.

(e) The registration of an agent is not effective while the agent is not employed by or associated with a broker-dealer registered or exempt under this [Act] or an issuer that offers its securities in this State.

**OFFICIAL COMMENT**

Prior Provisions: 1956 Act Section 201; 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 510.

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 broker-dealer or agent activities. See Section 402(d).

3. Comments on Sections 402(b), (c), and (e) will be written.

**SECTION 403. INVESTMENT ADVISER REGISTRATION REQUIREMENT AND EXEMPTIONS.**

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

(b) The following investment advisers are exempt from the registration requirement of subsection (a):

(1) an investment adviser without a place of business in this State that is registered under the securities act of the State in which the investment adviser has its principal place of

business if its only clients in this State are:

(A) federal covered investment advisers, registered investment advisers, or registered broker-dealers;

(B) institutional investors;

(C) preexisting clients whose principal place of residence is not in this State if the investment adviser both is registered or not required to be registered under the Investment Advisers Act of 1940 and registered under the securities act of the State in which the customer maintains a principal place of residence; or

(D) any other client the administrator, by rule or order, specifies;

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

(3) any other investment adviser the administrator, by rule or order, exempts.

(c) It is unlawful for an investment adviser, directly or indirectly, to employ or associate with an individual to engage in any activity in this State if the individual is suspended or barred from association with the investment adviser by an order of the administrator unless the investment adviser did not know or in the exercise of reasonable care could not have known of the suspension or bar. Upon request from the investment adviser and for good cause shown, the administrator, by order, may waive the prohibition of this subsection with respect to the individual suspended or barred.

**OFFICIAL COMMENT**

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

1. "Investment adviser" is defined in Section 102(14). The scope of the Section 403(a) reference to "transact business in this State" is specified in Section 510.

2. Excluded from the definition of investment adviser in Section 102(14)(C) is a broker-dealer who receives no special compensation for investment advisory services. Such a broker-dealer would not have to register in two different capacities in this State. A broker-dealer who does receive special compensation, on the other hand, would also be a statutory investment adviser and would be required to register in both capacities.

3. Comments on Section 403(b) will be written.

The National Securities Markets Improvement Act of 1996 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) 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 under subsection (b).

(b) The following investment adviser representatives are exempt from the registration requirement of subsection (a):

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

(2) any other investment adviser representative who the administrator, by rule or order, exempts.

(c) It is unlawful for any investment adviser to employ or associate with an investment adviser representative who transacts business in this State on behalf of the investment adviser unless the investment adviser representative is registered or exempt from registration as provided in subsection (b) under this [Act] as an investment adviser representative.

(d) 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 or exempt from registration under this [Act] or a federal covered investment adviser that has made or is required to make a notice filing under Section 405.

(e) An individual may not act as an investment adviser representative for more than one investment adviser at a time unless the administrator, by rule or order, authorizes the association.

(f) It is unlawful for an investment adviser representative, directly or indirectly, to conduct business on behalf of a federal covered investment adviser, if the investment adviser representative is barred or suspended from association with an investment adviser by an order of the administrator under this [Act]. Upon request from the federal covered investment adviser and for good cause shown, the administrator, by order, may waive the prohibition of this subsection with respect to the person suspended or barred.

**OFFICIAL COMMENT**

No Prior Provision.

1. "Investment adviser representative" is defined in Section 102(15). The scope of the Section 404(a) reference to "transacts business in this State" is specified in Section 510.

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. Comments on Sections 404(b)-(e) will be written.

5. Section 404(f) 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(d) and 403(c), 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(d) and 403(c), the administrator may waive this prohibition.

6. The FPA strongly supports permitting at least two IA affiliations under Section 404(e).

**SECTION 405. FEDERAL COVERED INVESTMENT ADVISER NOTICE FILING REQUIREMENT.**

(a) Except with respect to a federal covered investment adviser whose only clients are those described in Section 403(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 (b).

(b) A federal covered investment adviser shall file a notice before acting as a nonexempt federal covered investment adviser in this State, by filing such records as have been filed with the Securities and Exchange Commission under the Investment Advisers Act of 1940, including a consent to service of process, as the administrator, by rule or order, may require, and an annual notice fee of [$___].

(c) The administrator may request a copy of any additional record that has been filed with

the Securities and Exchange Commission under the Investment Advisers Act of 1940.

(d) The notice filing is effective upon its receipt by the administrator or its designee.

**OFFICIAL COMMENT**

No Prior Provision.

1. "Federal covered investment adviser" is defined in Section 102(5). The scope of the Section 405(a) reference to "transacts business in this State" is specified in Section 510.

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.

**SECTION 406. REGISTRATION PROCEDURES FOR BROKER-DEALERS, AGENTS, INVESTMENT ADVISERS, AND INVESTMENT ADVISER REPRESENTATIVES.**

(a) A broker-dealer, agent, investment adviser, or investment adviser representative shall register by filing an application including a consent to service of process complying with Section 510, and paying the fee specified in subsections (h), (i), (j), or (k), and paying any [reasonable] costs charged by the designee for processing the filings. Each application shall contain:

(1) the information required for a uniform application to be filed with the administrator or a designee and any other financial and other information that is material to an understanding of information that is provided to the administrator; or

(2) whatever information the administrator, by rule or order, requires, including any of the following:

(A) the applicant's form and place of organization;

(B) the applicant's proposed method of doing business;

(C) the qualifications and business history of the applicant and in the case of the broker-dealer or investment adviser, the qualifications and business history of each partner, officer, or director, or any person occupying a similar status or performing similar functions, and any person directly or indirectly controlling the broker-dealer or investment adviser;

(D) any injunction or administrative order or conviction of any misdemeanor involving securities or commodities or any aspect of the securities or commodities business or a felony of the applicant or any person specified in subparagraph (C);

(E) the applicant's financial condition and history;

(F) if the applicant is an investment adviser, any information concerning the investment adviser to be furnished or disseminated to any client or prospective client; and

(G) any other information that the administrator determines is material to the application.

(b) If an order is not in effect and no proceeding is pending under Section 408, registration is effective at noon on the 45th day after a completed application is filed. The administrator, by rule or order, may specify an earlier effective date and may by order defer the effective date until noon on the 45th day after the filing of any amendment completing the application.

(c) Each registration is effective until midnight on December 31 of the year for which the application for registration is filed. A registration may be automatically renewed each year unless an order is in effect under Section 408, by filing such records as the administrator, by rule or order, specifies and paying the fee specified in subsection (h), (i), (j), or (k), and paying costs charged by the designee for processing such filings.

(d) When an agent terminates employment by or association with a broker-dealer, or

terminates those activities that require registration as an agent, the agent or the broker-dealer or issuer shall promptly file a notice.

(e) When an investment adviser representative terminates employment by or association with an investment adviser or federal covered investment adviser or terminates activities that require registration as an investment adviser representative, the investment adviser, the federal covered investment adviser, or the investment adviser representative shall promptly file a notice.

(f) When an agent registered under Section 402 terminates employment by or association with an issuer, or a broker-dealer registered under Section 401, and within 30 days begins employment by or association with another issuer or broker-dealer registered under Section 401, the registration of the agent is immediately effective upon payment of the filing fee in subsection (i).

(g) When an investment adviser representative registered under Section 404 terminates employment by or association with an investment adviser registered under Section 403, and within 30 days begins employment with another investment adviser registered under Section 403 or a federal covered investment adviser, the registration of the investment adviser representative is effective immediately upon payment of the filing fee in subsection (k).

(h) A broker-dealer when initially registering shall pay a fee of [$__] and when renewing shall pay a fee of [$__]. When an application is denied or withdrawn, the administrator shall retain [$__] of the fee.

(i) An agent when initially registering shall pay a fee of [$__], when renewing shall pay a fee of [$__], and when transferring shall pay a fee of [$__]. When an application is denied or withdrawn, the administrator shall retain [$__] of the fee.

(j) An investment adviser when initially registering shall pay a fee of [$__] and when renewing shall pay a fee of [$__]. When an application is denied or withdrawn, the administrator shall retain [$__] of the fee.

(k) An investment adviser representative when initially registering shall pay or have paid a fee of [$__], when renewing shall pay or have paid a fee of [$__], and when transferring shall pay or have paid a fee of [$__]. When an application is denied or withdrawn, the administrator shall retain [$__] of the fee.

(l) A broker-dealer, investment adviser, or federal covered investment adviser may succeed to the registration or notice filing of a registrant or of a federal covered investment adviser who has a current notice filing, by filing an application for registration as required by Section 401 or 403, or a notice filing required by Section 405 of a successor, for the unexpired portion of the year. There is no filing fee.

(m) The administrator, by rule or order, may require minimum financial requirements for registered broker-dealers, limited by Section 15(h) of the Securities Exchange Act of 1934, and establish minimum financial requirements for investment advisers, limited by Section 222 of the Investment Advisers Act of 1940.

(n) The administrator, by rule or order, may require each broker-dealer and investment adviser who has custody of or discretionary authority over funds or securities of a client to post a bond or other satisfactory form of security in amounts up to [$__] as the administrator, by rule or order, specifies, subject to Section 15(h) of the Securities Exchange Act of 1934 and Section 222 of the Investment Advisers Act of 1940, and may determine the conditions of the bond or other satisfactory form of security. A bond or other satisfactory form of security may not be required of

a registrant whose net capital or, in the case of an investment adviser whose minimum financial requirements, which the administrator, by rule or order, may define, exceeds the amounts required by the administrator. Each bond or other satisfactory form of security must provide for an action by a person who has a claim under Section 509. Each bond or other satisfactory form of security must provide that an action may not be maintained to enforce any liability on the bond unless commenced within the time limitations of Section 509(7).

(o) An agent may not have custody over client funds or securities except under the supervision of a broker-dealer. The administrator, by rule or order, may prohibit, limit, or impose conditions on an agent from having custody of funds or securities of a client.

(p) An investment adviser representative may not have custody over client funds or securities except under the supervision of an investment adviser or federal covered investment adviser.

(q) The administrator, by rule or order, may prohibit, limit, or impose conditions on an investment adviser from having custody of securities or funds of a client.

(r) A person required to pay a fee under Sections 401 through 406 may transmit the fee through any designee that the administrator, by rule or order, approves.

**REPORTER'S COMMENT**

Prior Provisions: NASAA 1986, 1997, and 2000 Amendments to 1956 Act Section 202; RUSA Section 205(b).

1. Under Section 406(a)(1), 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 Central Registration Depository or the Investment Adviser Registration Depository.

2. NASAA will suggest alternative language for Section 406(g).

3. Hugh Makens proposes adding to Section 406(l):

(A) A broker-dealer or investment adviser may change its form of organization, date or state of incorporation or formation or composition of membership in a partnership or limited liability company by amendment to its registration if the change does not involve any material change in its financial condition or management. The amendment will become effective when filed or upon a date certain designated by the registrant in its filing. The new entity shall be deemed to be a successor to the original registrant. A material change shall require a new application for registration as a broker-dealer. Any registered predecessor shall discontinue conducting securities business other than winding down transactions and shall file for withdrawal of broker-dealer or investment adviser registration within 45 days of filing its amendment to effect succession.

(B) A broker-dealer or investment adviser may change its name by amendment to its registration, and the amendment shall become effective when filed or upon a date certain designated by the registrant.

(C) A change of control of a broker-dealer or investment adviser is effective upon the filing of an amendment to its registration identifying any new controlling person and a letter explaining the background of the transaction and certifying that the new control person has complied with applicable NASD filing requirements to effect a change of control. The amendment will become effective when the amendment and letter have been filed with the administrator or upon a subsequent date certain designated by the registrant in its amendment.

4. In Section 406(m) minimum financial requirements refers, as delineated in Section 15(h) of the Securities Exchange Act, to "capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements."

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. Supr. Ct. App. Div. 1971) (continuing minimum capital requirement).

5. 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. POSTREGISTRATION.**

(a) Except as limited by Section 15(h) of the Securities Exchange Act of 1934 and Section 222 of the Investment Advisers Act of 1940, a registered broker-dealer and a registered

investment adviser shall make and keep the accounts, correspondence, memoranda, papers, books, and other records the administrator, by rule or order, specifies.

(b) With respect to a registered investment adviser, the administrator, by rule or order, may require that information be furnished or disseminated to clients or prospective clients in this State as necessary or appropriate in the public interest or for the protection of investors and advisory clients.

(c) A registered broker-dealer and a registered investment adviser shall file such financial reports as the administrator, by rule or order, prescribes except as limited by Section 15(h) of the Securities Exchange Act of 1934 or Section 222(b) of the Investment Advisers Act.

(d) If the information contained in a record that is filed under subsection (c) is or becomes inaccurate or incomplete in any material respect, the registrant shall promptly file a correcting amendment.

(e) The records of a registered broker-dealer and a registered investment adviser are subject to such reasonable periodic, special, or other examinations by representatives of the administrator within or without this State as the administrator considers necessary or appropriate in the public interest or for the protection of investors. An examination may be made at any time and without prior notice. The administrator may copy, and remove for examination purposes, copies of all records the administrator reasonably considers necessary or appropriate to conduct the examination. The administrator may impose a reasonable fee for the expense of conducting an examination under this subsection.

(f) Except as limited by Section 15(h) of the Securities Exchange Act or Section 222(b) of the Investment Advisers Act, required records may be maintained in any form of data storage

acceptable under Section 17(a) of the Securities Exchange Act of 1934 if they are readily accessible to the administrator.

**REPORTER'S COMMENT**

Prior Provisions: NASAA 1986, 1997; and 2000 Amendments to 1956 Act Section 203; RUSA Section 205(b).

1. Section 701 encourages uniformity of application and construction of this Act among states and with related federal laws and regulations.

2. Section 407(a) authorizes the administrator to require all records to be preserved for the period the administrator prescribes by rule or order.

3. The duty in Section 407(d) to correct or update information is limited to 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. The administrator's power to copy and examine records in Section 407(e) is subject to all applicable privileges. See, e.g., 10 L. Loss & J. Seligman, Securities Regulation 4921-4925 n.69 (3d ed. rev. 1996).

5. Rule 17a-4 is the current Rule under Section 17(a) of the Securities Exchange Act referred to in Section 407(f) that addresses acceptable forms of data storage.

**SECTION 408. DENIAL, REVOCATION, SUSPENSION, CANCELLATION, WITHDRAWAL, RESTRICTION, CONDITION, OR LIMITATION OF REGISTRATION.**

(a) The administrator, by order, may deny, revoke, suspend, restrict, condition or limit any application or registration of a broker-dealer, agent, investment adviser, or investment adviser representative if the administrator finds:

(1) that the order is in the public interest; and

(2) that the applicant or registrant:

(A) within the past 10 years has filed an application for registration in this State which, as of its effective date 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;

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

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

(D) is enjoined or restrained by a court of competent jurisdiction in an action brought by the administrator, a State, or a federal government agency from engaging in or continuing a conduct or practice involving an aspect of the securities or commodities business, or other business investments, franchises, insurance, banking or finance;

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

(i) by the securities administrator of a State or by the Securities and Exchange Commission denying, revoking, or suspending registration as a broker-dealer, agent, investment adviser, or investment adviser representative;

(ii) by the securities administrator of a State or by the Securities

and Exchange Commission against a broker-dealer or an investment adviser;

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

(iv) by a court as a United States Postal Service fraud;

(F) is the subject of an adjudication or determination, after notice and opportunity for hearing, by the Securities and Exchange Commission, the Commodities Futures Trading Commission, the Federal Trade Commission or securities administrator of another State that the person has 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 Commodities Exchange Act, the securities or commodities law of another State, or a federal or state law under which a business involving investments, franchises, insurance, banking or finance is regulated;

(G) 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 subparagraph without a finding of insolvency as to the applicant or registrant;

(H) is not qualified on the basis of factors such as training, experience, and knowledge of the securities business, except as otherwise provided in subsection (c);

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

(J) after notice, failed to pay the proper filing fee within 30 days after being notified by the administrator of a deficiency, but the administrator shall vacate an order under this subparagraph when the deficiency is corrected;

(K) within the past 10 years has been found, after notice and opportunity for a hearing to have:

(i) willfully violated the law of a foreign jurisdiction governing or regulating the business of securities, commodities, insurance, or banking;

(ii) 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, or investment adviser representative; or

(iii) been suspended or expelled from membership by a securities exchange or securities association operating under the authority of the securities regulator of a foreign jurisdiction;

(L) is the subject of a cease and desist order issued by the Securities and Exchange Commission or issued under the securities or commodities laws of a State; or

(M) within the past 10 years has engaged in dishonest and unethical practices in the securities or commodities business.

(b) Under Sections 408(E)(i)-(iv) the administrator may not commence a revocation or suspension proceeding more than one year after the date of the order relied on. The administrator may not enter an order on the basis of an order under another state securities act unless that order was based on facts that would constitute a ground for an order under this Section.

(c) The administrator, by rule or order, may require that an examination, including an

examination developed or approved by an organization of securities administrators, be taken by any class of or all applicants. The administrator, by rule or order, may waive the examination as to a person or class of persons if the administrator determines that the examination is not necessary or appropriate in the public interest or for the protection of investors.

(d) The administrator, by order, may summarily condition, postpone, suspend, or limit registration pending final determination of a proceeding under this Section.

(e) If the administrator determines that a registrant or applicant for registration is no longer in existence or has ceased to do business 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, the administrator, by order, may cancel or suspend the registration or cancel or deny the application. [The administrator may reinstate a canceled or revoked registration, with or without hearing, and may make such registration retroactive.]

(f) Withdrawal from registration as a broker-dealer, agent, investment adviser, or investment adviser representative becomes effective 30 days after receipt of an application to withdraw or within such shorter period as the administrator determines, unless a revocation or suspension proceeding is pending when the application is filed. If a proceeding is pending, withdrawal becomes effective and upon such conditions as the administrator, by order, determines. If no proceeding is pending or commenced and withdrawal automatically becomes effective, the administrator may nevertheless commence a revocation or suspension proceeding under subsection (a)(2)(B) within one year after withdrawal became effective and enter a revocation or suspension order as of the last date on which registration was effective.

(g) An order may not be issued under this section except under subsection (d) without:

(1) appropriate notice to the applicant or registrant, and if the applicant or registrant is an agent or investment adviser representative. the employer or prospective employer;

(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) A person who, directly or indirectly, controls a person not in compliance with any part of this section may also be sanctioned to the same extent as the noncomplying person, unless the controlling person acted in good faith and did not directly or indirectly induce the conduct constituting the violation or cause of action.

**REPORTER'S COMMENT**

Prior Provisions: 1956 Act Section 204, NASAA 1981, 1986, 1987, 1992, and 1994 proposed Amendments; RUSA Sections 212-214.

1. Under Section 603 the administrator may seek other remedies against registrants including civil fines, bars or censures.

2. Section 408 authorizes the administrator to seek a sanction based on the seriousness of the misconduct.

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

4. Section 408(a)(2)(B) can be violated by a refusal to cooperate with an administrator's reasonable audit, examination, 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, examination, 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 408(a)(2)(B).

5. There is no time limit or statute of limitations on felony violations in Section

408(a)(2)(C).

6. Under Section 408(a) the administrator must prove that the denial, revocation, suspension, restriction, condition, or limitation both is (1) in the public interest and (2) in one of the enumerated categories in Section 408(a)(2). See, e.g., Mayflower Sec. Co. v. Bureau of Sec., 312 A.2d 497 (N.J. 1973).

7. 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).

8. The term "dishonest and unethical practices" in Section 408(a)(2)(m) has been held not to be unconstitutionally vague. See, e.g., Brewster v. Maryland Sec. Comm'n, 548 A.2d 157, (M.D. Ct. 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).

9. Hugh Makens proposes adding a new Section 408(a)(2)(n):

> Refuses to allow or otherwise impedes the administrator from conducting an audit, examination or inspection, or refuses access to any registered office to conduct an audit, examination or inspection.

## 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 any device, scheme, or artifice to defraud;

(2) to make any 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 any act, practice, or course of business which operates or would operate as a fraud or deceit upon a person.

### REPORTER'S COMMENT

Source of Law: 1956 Act Section 101; RUSA Section 501.

1. Section 501, which was Section 101 in the 1956 Act, was originally substantially the Rule 10b-5 adopted under the Securities Exchange Act of 1934, which in turn was modeled 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 federal and state case development. 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.

4. Because Rule 10b-5 reaches market manipulation, see 8 L. Loss & J. 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.

5. 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.

6. There is no private cause of action, express or implied, under Section 501. Cf. Section 509(11).

7. NASAA urges Official Comments to clarify what requirements are necessary to state a cause of action under Section 501.

8. The Investment Company Institute recommends a new Official Comment that would state:

> The National Securities Markets Improvement Act of 1996 limits state regulatory authority over federal covered securities to "investigating and bringing enforcement actions with respect to fraud and deceit." (*See* Section 18(c) of the Securities Act of 1933.) In accordance with this limit, the provisions of Section 501 shall apply to federal securities only to the extent that the conduct alleged to be fraudulent would be fraudulent in the absence of any state law provisions defining such conduct as fraudulent.

**SECTION 502. FRAUD IN PROVIDING INVESTMENT ADVICE.**

(a) It is unlawful for a person who receives, directly or indirectly, any consideration from another person primarily for advising the other person as to the value of securities or their purchase or sale, whether through the issuance of analyses or reports or otherwise:

(1) to employ any device, scheme, or artifice to defraud the other person; or

(2) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the other person.

(b) It is unlawful for an investment adviser or investment adviser representative acting as a principal for such person's own account or on behalf of a third party to:

(1) sell a security to a client without disclosing in writing the capacity in which the investment adviser or investment adviser representative is acting before the completion of the transaction; or

(2) fail to obtain the written consent of the client to such transaction after disclosure has been made and before completion of the transaction.

## REPORTER'S COMMENT

Source of Law: 1956 Act Section 102(a); RUSA Section 503; Inv. Adv. Act Section 206.

1. This Act omits 1956 Section 102(b) and amendments as unnecessary in light of the administrator's rulemaking authority in Section 604.

2. Under Section 203A(b)(2) of the Investment Advisers Act states retain their authority to investigate and bring enforcement actions against a federal covered investment adviser or a person associated with a federal covered investment adviser. Under Section 502, 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(14).

3. There is no private cause of action, express or implied, under Section 502. Cf. Section 509(11).

4. The Investment Company Institute recommends revising Section 502 to read:

SECTION 502. PROHIBITED CONDUCT IN PROVIDING INVESTMENT ADVICE

(a) It is unlawful for a person who received, directly or indirectly, any consideration from another person primarily for advising the other person as to the value of securities or their purchase or sale, whether through the issuance of analyses or reports or otherwise:

(1) to employ any device, scheme, or artifice to defraud the other person; or

(2) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the other person.

(b) It shall be unlawful for a registered investment adviser to engage in any act, practice or course of business that is fraudulent, deceptive, or manipulative. The Administrator shall, for purposes of this paragraph (b), by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

(c) It shall be unlawful for a registered investment adviser directly or indirectly to enter into, extend, or renew any investment advisory contract if such contract:

(1) provides for compensation to the investment adviser on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client;

(2) fails to provide, in substance, that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract; or

(3) fails to provide, in substance, that the investment adviser, if a partnership, will notify the other party to the contract of any change in the membership of

such partnership within a reasonable time after such change.

(d) It shall be unlawful for any registered investment adviser, acting as principal for his own account, knowingly to sell any security or to purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. This prohibition shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction.

(e) Subsection (c) or (d) of this section shall be construed to permit an investment adviser to engage in any conduct in which a federal covered adviser may lawfully engage under the Investment Advisers Act of 1940 or the rules thereunder.

5. The ICI also recommends a new Official Comment to read:

The National Securities Markets Improvement Act of 1996 limits state regulatory authority over federal covered advisers to "investigating and bringing enforcement actions with respect to fraud and deceit." (*See* Section 203A(b)(2) of the Investment Advisers Act of 1940.) In accordance with this limit, the provisions of Section 502 shall apply to federal covered advisers only to the extent that the conduct alleged to be fraudulent would be fraudulent either in the absence of any state law provisions defining such conduct as fraudulent or if it has been defined as fraudulent by the Securities and Exchange Commission. While states have the authority under NSMIA to define what constitutes fraudulent, unethical, or dishonest conduct for state-registered advisers, they do not have this authority with respect to federal covered advisers. Accordingly, any such state law provisions regulating the conduct of state registered advisers shall be limited in their application to such advisers and shall not be applied to federal covered advisers unless the conduct proscribed would be fraudulent in the absence of such state law provision.

**SECTION 503. BURDEN OF PERSUASION.**

(a) In a civil action or administrative proceeding under this [Act], a person claiming an exemption, exception, preemption, or exclusion has the burden of proving the applicability of the exemption, exception, preemption, or exclusion.

(b) 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.

## OFFICIAL COMMENT

Source of Law: 1956 Act Section 402(d); RUSA Section 608.

1. The Official Comment 2 to RUSA Section 608 explained:

> Section (b) has been added to clarify the parties' respective obligations in a criminal proceeding. While the standard of proof that the prosecuting attorney is required to meet to obtain a conviction is establishing the requisite elements of the criminal offense "beyond a reasonable doubt," a defendant claiming an exemption or exception as a defense has the burden of offering evidence to establish that defense.

2. The burden of proving an exemption or exception is upon the party claiming it. See, e.g., United States et. rel. Schott v. Tehan, 365 F.2d 191 (6th Cir. 1966) (Ohio blue sky law constitutionally shifts burden of proof 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).

**SECTION 504. FILING OF SALES AND ADVERTISING LITERATURE.** Except as otherwise provided in this Section, the administrator, by rule or order, may require the filing of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature or advertising communication addressed or intended for distribution to prospective investors, including clients or prospective clients of an investment adviser registered or required to be registered in this State, in connection with a security or investment advice. The provisions of this Section shall not apply to any such communication relating to a federal covered security, a federal covered adviser, or any security or transaction exempted by Sections 201-202.

## OFFICIAL COMMENT

Source of Law: 1956 Act Section 403; RUSA Section 405.

1. The prospectuses, pamphlets, circulars, form letters, advertisements, sales literature or advertising communications, or other records includes material disseminated electronically or

available on a web site.

2. The administrator may enjoin the publications circulation or use of any materials that violate Section 505. See Section 603.

**SECTION 505. MISLEADING FILINGS.** It is unlawful for a person to make or cause to be made, in a record that is filed or used in a proceeding 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 such statement, to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

**OFFICIAL COMMENT**

Source of Law: 1956 Act Section 404; RUSA Section 504.

The definition of "materiality" in TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 439 (U.S. 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 L. Loss & J. Seligman, Securities Regulation 2071-2105 (3d ed. rev. 2000).

**SECTION 506. MISREPRESENTATIONS CONCERNING REGISTRATION OR EXEMPTION.**

(a) The fact that an application for registration, a registration statement, or a notice filing has been filed under this [Act], the fact that a person is registered or has made a notice filing, or the fact that a security is registered under this [Act] does not constitute a finding by the administrator that a record filed under this [Act] is true, complete, and not misleading. Those facts or the fact that an exemption, exception, preemption, or exclusion is available 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.

(b) It is unlawful to make, or cause to be made, to a purchaser, customer, client, or prospective client, a representation inconsistent with subsection (a).

**OFFICIAL COMMENT**

Source of Law: RUSA Section 505; 1956 Act Section 405.

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) A broker-dealer, agent, investment adviser, or investment adviser representative shall make truthful and accurate statements in any record required by the administrator, the Securities and Exchange Commission, or any self-regulatory organization.

(b) A broker-dealer, agent, investment adviser, or investment adviser representative is not liable to another broker-dealer, agent, investment adviser, or investment adviser representative, for a defamation claim relating to an alleged untrue statement that is contained in a record required by the administrator, the Securities and Exchange Commission, or a self-regulatory organization unless it is shown by clear and convincing evidence that the person knew, or should have known at the time that the statement was made, that it was false in any material respect or the person acted in reckless disregard of the statement's truth or falsity.]

**REPORTER'S COMMENT**

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). It has not been approved by the Securities and Exchange Commission.

2. The National Association of Securities Dealers proposal is limited to arbitration proceedings.

3. An alternative approach would be a standard providing for absolute immunity. See generally Wright, Form U-5 Defamation, 52 Wash. & Lee L. Rev. 1299 (1995).

4. 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 L. Loss & J. Seligman, Securities Regulation 4818-4821 (3d ed. rev. 1996).

**SECTION 508. CRIMINAL PENALTIES.**

(a) A person who willfully violates of this [Act], or a rule adopted or order issued under this [Act], except the notice filing requirements of Section 302 or 405, or who willfully violates Section 505 knowing the statement made to be false or misleading in any material respect, upon conviction, shall be fined [not more than [$X] or imprisoned not more than [Y] years, or both]; but a person may not be imprisoned for the violation of a rule adopted or order issued if the person proves that the person did not have knowledge of the rule or order. An indictment or information may not be returned under this [Act] more than [Z years] after the commission of the offense.

(b) The [Attorney General or the proper prosecuting attorney] with or without a reference from the administrator, may commence appropriate criminal proceedings under this [Act].

(c) This [Act] does not limit the power of this State to punish a person for conduct that constitutes a crime by statute or at common law.

## REPORTER'S COMMENT

The SIA urges that violations of Section 504 be excepted from this section.

## OFFICIAL COMMENT

Source of Law: 1956 Act Section 409.

1. This section follow the 1956 Act and the federal securities laws in awarding 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. On the meaning of "willfully", see Comment 3 under Section 306.

3. The appropriate state prosecutor under Section 508(c) may decide whether to bring a criminal action under this statute, another statute, or common law.

4. This section does not specify maximum dollar amounts for criminal fines, maximum terms for imprisonment, nor a statute of limitations, but does require that each state include appropriate standards for these matters.

5. In certain states the administrator has full or limited criminal enforcement powers.

**SECTION 509. CIVIL LIABILITIES.** Except as limited by the Securities Litigation Uniform Standards Act of 1998:

(1) A person who:

(A) sells a security in [knowing] violation of Section 301;

(B) sells a security in [knowing] violation of 401(a), 402(a), [or 506(b) or of a rule adopted or order issued under Section 504]; or

(C) purchases or sells a security by means of any untrue statement of a material fact or an omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, the buyer not knowing of the untruth or omission, and who does not sustain the burden of proof that the person did not

know, and in the exercise of reasonable care could not have known of the untruth or omission is liable to a person buying or selling the security from her or him, who may sue either at law or in equity to recover the consideration paid for the security, [together with interest at x percent per year] from the date of payment, costs, and reasonable attorneys' fees determined by the court, less the amount of any income received on the security, upon the tender of the security, or for damages if the person no longer owns the security.

(2) A person who:

(A) [knowingly] violates Section 403(a), 404(a), [or 506(b),] or of a rule adopted or order issued under those sections is liable to a person buying or selling the security from her or him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at [x] percent per year from the date of payment of the consideration plus costs and reasonable attorneys' fees determined by the court, less the amount of any income received from the advice; or

(B) receives directly or indirectly any consideration from another person for advice as to the value of securities or their purchase or sale, whether through the issuance of analyses, reports, or otherwise and employs any device, scheme, or artifice to defraud such other person or engages in any act, practice, or course of business that operates or would operate as a fraud or deceit on the other person, is liable to the person who may sue either at law or in equity to recover the consideration paid for the advice and any loss due to the advice, together with interest at [x] percent from the date of payment of the consideration plus costs and reasonable attorney's fees determined by the court, less the amount of any income received from the advice.

(3) The following persons are liable jointly and severally and to the same extent as:

(A) a person who directly or indirectly controls a person liable under subsections (1) and (2);

(B) a person who is a partner, officer, or director of a person liable under subsection (1)(A) including each person occupying a similar status or performing similar functions;

(C) a person who is an employee of a person liable under subsections (1) and (2) who materially aids and abets conduct giving rise to the liability; and

(D) a person who is a broker-dealer or agent or an investment adviser or investment adviser representative who materially aids and abets the conduct in subsections (1) and (2).

(4) A person specified in subsections (3)(A) and (B) will not be liable if the person sustains the burden of proof that the person did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

(5) The tender specified in this section may be made at any time before entry of judgment. Tender requires only notice in a record of willingness to exchange the security for the amount specified. A purchaser who no longer owns the security may recover damages. Damages are the amount that would be recoverable upon a tender less the value of the security when the purchaser disposed of it, plus interest [at X percent per year] from the date of disposition of the security, costs, and reasonable attorneys' fees determined by the court.

(6) A cause of action under this section survives the death of a person who might have been a plaintiff or defendant.

(7) A person may not obtain relief under this section unless suit is brought within the earliest of one year after the discovery of the violation, one year after discovery should have been made by the exercise of reasonable care, or three years after the act, omission, or transaction constituting the violation.

(8) A purchaser may not sue under this section if:

(A) the purchaser received, before suit is commenced, an offer in a record:

(i) stating the respect in which liability under this section may have arisen and fairly advising the purchaser of the purchaser's rights of rescission;

(ii) if the basis for relief under this subsection may have been a violation of section 501(2), including financial and other information necessary to correct all material misstatements or omissions in the information which was required by this [Act] to be furnished to the purchaser as of the time of the sale of the security to the purchaser;

(iii) offering to repurchase the security for cash, payable on delivery of the security, equal to the consideration paid, plus interest [at X percent per year] from the date of payment, less income received thereon, or, if the purchaser no longer owns the security, offering to pay the purchaser upon acceptance of the offer an amount in cash equal to the damages computed under this section and the offeror has the present ability to pay the repurchase price; and

(iv) stating that the offer may be accepted by the purchaser within 30 days after the date of its receipt by the purchaser or any shorter period, not less than 3 days, the administrator by order prescribes; or

(B) the purchaser received an offer before suit and at a time when the purchaser

did not own the security and the purchaser rejected the offer in a record within 30 days after its receipt.

(9) A person who 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 who has acquired a purported right under the contract with knowledge of the facts by reason of which its making or performance was in violation, may not base a suit on the contract.

(10) 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.

(11) The rights and remedies provided by this [Act] are in addition to any other rights or remedies that may exist at law or in equity, but this [Act] does not create a cause of action not specified in this section or Section 406(n).

**REPORTER'S COMMENT**

Source of Law: 1956 Act Section 410; RUSA Sections 605-607, 609, 802.

1. The prefatory clause referencing the Securities Litigation Uniform Standards Act of 1998 modifies the entire Section 509.

2. In Section 509(3)(B) partner is intended to be limited to partners with management responsibilities rather than a partner with a passive investment.

3. The good faith defense in Section 604(f) is applicable to civil liability actions.

4. The vast majority of states have a statute of limitations in their securities laws. The statutes, however, vary in length, typically from one to five years, and in whether there is a unitary statute or a bifurcated statute as in the federal securities laws and in Section 509(7).

5. There were several proposals to revise Section 509, including:

a. Eliminating Sections 509(1)(A)-(B) and 509(2)(A) or limiting Section

509(1)(A) to Section 301;

b. Adding an inadvertent violation defense such as that in Rule 508 under the Securities Act of 1933; limiting the scope of awards; or adding State power to compel restitution.

c. NASAA proposes lengthening the statute of limitations period in Section 509(7).

d. Should there be an exemption in Section 202 for revocation offers in compliance with Section 509(8)?

e. NASAA particularly stresses its concern that there is no private right of action for secondary market fraud in Section 509.

f. In contrast the SIA proposes limiting derivative liability under Section 509(3) to control persons and proposes eliminating from Section 509(11) liability for violations under Sections 406(n) through (q).

6. In Section 509(1)(C), the phrase "the buyer not knowing of the untruth or omission" has been read as requiring proof that the plaintiff exercised reasonable care under the circumstances. S & F Supply Co. v. Hunter, 527 P.2d 217, 221 (Utah 1974); Darling & Co. v. Clouman, 87 F.R.D. 756 (N.D. Ill. 1980). Neither causation nor reliance has been held to be an element of a private cause of action under the precursor to Section 509(1)(C). See Gerhard W. Gohler, IRA v. Wood, 919 P.2d 561 (Utah 1996); Ritch v. Robinson-Humprhey Co., 748 So. 2d 861 (Ala. 1999).

In Kaufman v. i-Stat Corp., 754 A.2d 1188 (N.J. 2000), the New Jersey Supreme Court interpreted the New Jersey Uniform Securities law to require privity and misrepresentations but not reliance.

7. Section 509(1)(A)-(C) are subject to a privity requirement articulated by the phrase "liable to a person buying or selling the security from her or him". See, e.g., Hoover v. E. F. Hutton & Co., Inc., 1980 Fed. Sec. L. Rep. (CCH) ¶97,654 (E.D. Pa. 1980).

In Zack Co. v. Sims, 438 N.E. 2d 663 (Ill. App. Ct. 1982), the court held 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 benefited 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).

8. The "reasonable attorneys' fees" specified in Section 509(1) are permissive, not mandatory. See, e.g., Andrews v. Blue, 489 F.2d 367, 377 (10th Cir. 1973), (Colorado Statute).

A request for attorney's fees may be made by motion a reasonable time after the final judgment under the Florida statute. Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 767 F.2d 1498, 1503-1504 (11th Cir. 1985).

9. In providing for damages as an alternative to rescission, Section 509(1) 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. See Windswept Corp. v. Fisher, 683 F. Supp. 233, 239 (W.D. Wash. 1988) (Washington).

10. The measure of damages in Section 509(5) is that contemplated by Section 12 of the Securities of 1933. See 9 L. Loss and J. Seligman, Securities Regulations 4242-4246 (3d ed. 1992).

11. Section 509(2) is based on a 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."

12. The control liability provision in Section 509(3)(A) is modeled on Section 15 of the Securities Act of 1933 and Section 20(a) of the Securities Exchange Act of 1934. See 9 L. Loss & J. Seligman, Securities Regulations 4457-4475 (3d ed. 1992). 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). On the meaning of "control," see 4 L. Loss & J. Seligman, Securities Regulations 1703-1727 (3d ed. rev. 2000).

13. Under Section 509(3)(B), 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(3)B) 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).

Under Section 509(3)(B) partners, officers, and directors are liable, subject to the special defense afforded by Section 509(4), without proof that they aided in the sale.

14. On the interpretation of the "material aids" in Section 509(3)(C). 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. See generally Heilbron v. ARC Energy Corp. 757 S.W.2d 294 (Mo. App. 1988) (president of a corporation that was the general partner of a limited partnership in which interest were sold without registration was jointly and severally liable under Missouri Uniform Securities Act to same extent as the limited partnership).

This provision of the Uniform Act may be broader than Section 12(a)(1) of the Securities Act of 1933. See Pinter v. Dahl, 485 U.S. 622, 641-655 (1988). Cf. Foster v. Jesup & Lamont Sec. Co., Inc. 482 So. 2d 1201 (Ala. 1986) (holding that the "materially aids" standard of the Uniform Act is broader than the counterpart language in §12(a)(2)).

The statutory language covers an employer. Todaro v. E.F. Hutton & Co. Inc., 1982-1984 Blue Sky L. Rep. (CCH) ¶71,957 at 70,413 (E.D. Va. 1982). But an auditor is not an agent *per se*. Jenson v. Touche, Ross & Co., 355 N.W.2d 720, 729 (Minn. 1983). With respect to the activities that might bring a lawyer within this kind of language, see Annot., Attorney's Preparation of Legal Document Incident to Sale of Securities as Rendering Him Liable under State Securities Regulation Statutes, 62 ALR3d 252. A lawyer may be liable without proof of knowledge of illegality, since a nonseller who "materially aids in the sale" is liable under Section 509(3) unless he or see proves "that he 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." See Heilbron v. ARC Energy Corp., 757 S.W.2d at 296; Prince v. Brydon, 307 Or. 146, 764 P.2d 1370 (1988).

15. The defense of lack of knowledge in Section 509(4) is modeled on Section 15 of the Securities Act of 1933 or Section 20(a) of the Securities Exchange Act of 1934. See generally 9 L. Loss & J. Seligman, Securities Regulation 4467-4475 (3d.1992). Washington's Supreme Court contrasts this defense 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(7) 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).

16. The contribution provision in Section 509(4) is a safeguard to avoid the common law rule that prohibited contribution among joint tortfeasors. In Black & Co., Inc. v. Nova-Tech, Inc., 333 F. Supp. 468, 471 (D. Or. 1971), the court held under the Oregon provision 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.

17. The statute of limitations in Section 509(7) follows RUSA on the type of statutes of limitations available under the federal securities laws rather than the 1956 Act.

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 declined to extend a statute of limitations period on grounds of 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).

Section 509(7) is similar to the statute of limitations that the United States Supreme Court construed in Lampf, Pleva, Lipkiw, Prepis & Petigrew v. Gilbertson, 501 U.S. 350 (1991) in which it has held that there was no equitable tolling under the federal one year after discovery and three years after the act formula. See generally 10 L. Loss & J. Seligman, Securities Regulation 4505-4525 (3d. ed. rev. 1996).

18. A recission offer must meed the specific requirements of Section 509(8). Cf. Binder v. Gordian Sec., Inc., 742 F. Supp. 663, 666 (N.D. Ga. 1990). A buyer who accepts a statutory offer of rescission may not later sue for attorneys' fees incurred in seeking the rescission, although the court noted that fees would have been awarded if the plaintiff had prevailed in an action for rescission. Brockmann Indus., Inc., v. Carolina Sec. Corp. 861 F.2d 798, 800-801 (4th Cir. 1988) (South Carolina statute). But see Dixon v. Oppenheimer & Co., Inc., 739 F.2d 165 (4th Cir. 1984) (Virginia version precursor to Section 509(8) is limited to the securities sold in violation that the purchaser seeks to have rescinded). See generally Rowe, Rescission Offers under Federal and State Securities Law, 12 J. Corp. L. 383 (1987). In Mashburn v. First Investors Corp., 432 S.E.2d 869 (N.C. App. 1993), *cert. denied,* 439 S.E.2d 18, the court relied on *Brockmann* and the Rowe article to dismiss a claim after a rescission offer had been accepted.

19. Section 509(9) is similar to Section 29(b) of the Securities Exchange Act and is intended only to apply to actions to *enforce* illegal contracts. See L. Loss, Commentary on the

Uniform Securities Act 150 (1976). Nevertheless at least one court has read the provision as barring an action for *rescission* by a buyer 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).

20. Section 509(11) follows the 1956 Act. 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).

Nonetheless Section 509 and Section 406(n) are intended to be the exclusive private causes of action under this Act.

21. The ICI recommends adding the following Official Comment:

> Under the National Securities Markets Improvement Act of 1996 there is no private right of action for the failure of an issuer of federal covered securities to make a notice filing or pay a notice filing fee under this Act.

**SECTION 510. JURISDICTION AND SERVICE OF PROCESS.**

(a) Sections 301, 302, 401(a), 402(a), 403(a), 404(a), 501, 506, and 509 apply to a person who sells or offers to sell a security when an offer to sell is made in this State, or an offer to buy is made and accepted in this State.

(b) Sections 401(a), 402(a), 403(a), 404(a), 501, and 506 apply to a person who buys or offers to buy a security when an offer to buy is made in this State, or an offer to sell is made and accepted in this State.

(c) For the purpose of this section, an offer to sell or to buy a security is made in this State, whether or not either party is then present in this State, when the offer:

(1) originates from this State; or

(2) is directed by the offeror to this State and received at the place to which it is directed [or at any post office in this State, in the case of a mailed offer].

(d) For the purpose of this section, an offer to buy or to sell is accepted in this State when acceptance:

(1) is communicated to the offeror in this State; and

(2) has not previously been communicated to the offeror, orally or in a record, outside this State; and is communicated to the offeror in this State, whether or not either party is then present in this State, when the offeree directs it to the offeror in this State reasonably believing the offeror to be in this State and it is received at a place in this State to which it is directed [or at any post office in this State, in the case of a mailed acceptance].

(e) An offer to sell or to buy is not made in this State when a publisher circulates or there is circulated on the publisher's behalf in this State any 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 a radio or television program or other electronic communication originating outside this State is received in this State. A radio or 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 signal 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 signal that originates in this State, but which is not intended for redistribution to the general public in this State.

(f) Sections 403(a), 404(a), 502, and 506 apply to an investment adviser and investment adviser representative when conduct instrumental in effecting prohibited conduct is employed in this State, whether or not either party is then present in this State.

(g) A consent to service of process required by this [Act] shall be filed in the form the administrator, by rule, specifies. An irrevocable consent appointing the administrator the person's agent for service of process in a noncriminal proceeding against the person, a successor, or personal representative, which arises 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 served personally on the person filing the consent.

(h) A person who has filed a consent complying with subsection (g) in connection with a previous application for registration or notice filing need not file an additional consent.

(i) If a person, including a nonresident of this State, engages in conduct 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 (g), and subsequently engaged in conduct prohibited or made actionable by this [Act], the conduct

constitutes the appointment of the administrator as the person's agent for service of process in a noncriminal proceeding against a person, successor, or personal representative.

(j) Service under subsection (i) may be made by leaving a copy of the process in the office of the administrator, but it is not effective unless:

(1) the plaintiff, who may be the administrator, promptly sends notice of the service and a copy of the process by registered or certified mail, 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 steps reasonably calculated to give notice; and

(2) the plaintiff files an affidavit of compliance with this subsection in the 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.

(k) Service as provided in subsection (j) may be used in a proceeding before the administrator or by the administrator in a proceeding in which the administrator is the moving party.

(l) If the process is served under subsection (j), 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.

**REPORTER'S COMMENT**

Source of Law: 1956 Act Section 414; NASAA Proposed 1986 and 1997 Amendments to Section 414; and RUSA Sections 708, 801.

1. The phrase "other electronic means" is coextensive with computer or other information technology permitted by Sections 102(7), 102(23).

2. 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. For example, Section 414(a) of the 1956 Uniform Securities Act provided that its jurisdiction reached all persons offering or selling securities when "(1) an offer to sell is made in this State, or (2) an offer to buy is made and accepted in this State." The 1956 Act further provided that an offer to sell or buy is made "in this State, whether or not either party is then present in this State, when the offer (1) originates from this State or (2) is directed by the offeror to this State and received at the place to which it is directed." 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.

The ABA Global Cyberspace Jurisdiction Project, 55 Bus. Law. 1801, 1931-1937 (2000), generally emphasized that “there is and should be less focus on the residence of either the seller or purchaser and more focus on the marketplace where the transaction occurs,” but specifically recognized that an investor’s residence takes on greater significance in public or private offerings of new securities than in secondary trading. Id. at 1931-1932. The Project recognized that “the prevailing trend in jurisdiction over securities transactions has been to focus on the place to which information on securities is directed by the offeror.” Id. at 1934.

3. Courts have interpreted the precursor to Section 510(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.

4. Application of the Section 510(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 510(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 county in which defendant accepted and negotiated checks).

5. With respect to Section 510(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.

6. With respect to Section 510(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.

7. The required consent to service of process in Section 510(g) extends to process in any proceeding "which arises under this act," and substituted service under Section 510(i) applies to any proceeding "which grows out of" conduct "prohibited or made actionable by this act."

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 510(i) or on a state's long m 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).

8. NASAA questions whether there should be clearer reference to the Internet in Section 510 or in related Comments.

9. The SIA proposes a new Section 510(f):

> (f) For the purposes of this Section, an offer or sale is not made in this State if the offer or sale of a security by or through an offeror licensed in this State is directed to a resident of another state, territory or country who is neither domiciled in this State to the knowledge of the offeror, nor actually present in this State, and the offer or sale is not in violation of any securities law of the state, territory or country to which the offer or sale is directed.

## ARTICLE 6:
## ADMINISTRATION AND JUDICIAL REVIEW

### SECTION 601. ADMINISTRATION OF [ACT].

(a) This [Act] shall be administered by the [insert name of local administrative agency and any related provisions on method of selection, salary, term of office, budget, selection and remuneration of personnel, annual reports to the legislature or governor, etc., which are appropriate to the particular State].

(b) It is unlawful for the administrator or any of the administrator's officers and employees to use for personal benefit information that is filed with or obtained by the administrator and which is not made public. This [Act] does not authorize the administrator or any of the administrator's officers and employees to disclose the information, except among themselves, or when necessary or appropriate in a proceeding or investigation under this [Act], or in cooperation with other agencies in accordance with Section 607(a). This [Act] does not create or derogate from any privilege that exists at common law or otherwise when records or other evidence is sought under a subpoena directed to the administrator or an officer or employee of the administrator.

### OFFICIAL COMMENT

Prior Provisions: 1956 Act Section 406; RUSA Sections 701-702.

1. Each State, the District of Columbia, Guam, and Puerto Rico today has enacted an administrative procedure act. Article 6 has been drafted on the assumption that each sate adopting this Act has a comprehensive administrative procedure act. It is the assumption of this Act that a person against whom an order may be issued or a sanction imposed generally 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 on orders issued under this Act are subject to judicial review.

2. Section 601(b) should be read with Section 606. The intent of Section 601(b) is to prohibit the administrator or the administrator's officers and employees from using for personal benefit records or information that Section 606(b) specifies as not constituting public information. Section 601(b) is not intended to limit in any way the operation of Section 606(a).

3. The last sentence of Section 601(b) 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) The administrator:

(1) may make 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) may require or permit a person to testify or to file a statement or a record, under oath or otherwise as the administrator determines, as to all the facts and circumstances concerning the matter to be investigated; and

(3) may publish information concerning a proceeding, an investigation, 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 or for the protection of investors.

(b) 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, and require the production of any books, papers, correspondence,

memoranda, agreements, documents, or other records, however created, produced, or stored, that the administrator considers relevant or material to the investigation.

(c) In case of contumacy by or refusal to obey a subpoena issued to, a person, the [insert name of appropriate court] or a court of another State able to assert jurisdiction over the person refusing to testify or produce, if the person is not subject to service of process in this State, upon application by the administrator or the designated officer, may order the person to appear before the administrator or the designated officer, to produce evidence in a record or to give evidence touching the matter under investigation or in question.

(d) If a person fails or refuses to testify, to file a statement or report, or to produce books, papers, correspondence, memoranda, agreements, or other records, or to obey a subpoena issued 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 appropriate court] to enforce compliance. The court may order any or all of the following:

(1) injunctive relief, restricting or prohibiting the offer or sale of securities or providing investment advice;

(2) production of books, papers, correspondence, memoranda, agreements, or other records; or

(3) any other necessary or appropriate relief.

(e) An order under subsection (d) is effective until further order of the court.

(f) A person is not excused from attending and testifying or from producing a record before the administrator, or in obedience to the subpoena of the administrator or a designated officer, or in any proceeding instituted by the administrator, on the ground that the required

testimony or evidence may tend to incriminate the person or subject the person to a penalty or forfeiture; but evidence, or other record compelled or information derived, directly or indirectly, from the evidence or other record, may not be used against a person so compelled in a criminal case, except that the person testifying is not exempt from prosecution and punishment for perjury or contempt committed in testifying. In the event a person makes a claim against self-incrimination, the administrator may apply [in the appropriate court] to compel testimony or the production of records

(g) The administrator may issue and apply to enforce subpoenas in this State at the request of a securities administrator of another State.

**OFFICIAL COMMENT**

Source of Law: 1956 Act Section 407

1. Section 602(a)-(c) and (f) 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. Sections 602(d)-(e) amplifies the last sentence of Section 407(c) of the 1956 Act which had provided in toto: "Failure to obey the order of the court may be punished by the court as a contempt of court." See Feigis v. Colorado Nat'l Bank, N.A., 879 P.2d 814, 818-819 (Color. 1995).

3. Section 602(d)(1) 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(d). This subsection does not limit the powers of an administrator under other provisions of this Act.

4. Where appropriate under Section 602(f), an administrator could move to authorize admission of a requesting state's attorney under existing *pro hac vice* rules.

5. Section 602(g) 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.

6. 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, se Section 601(b), 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(3). If the individual invokes the privilege against self-incrimination, Section 602(f) 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 being used in a criminal case. See People v. District Co. of Arapahoe County, 894 P.2d 739 (Colo. 1995).

**SECTION 603. ENFORCEMENT.**

(a) Whenever it appears to the administrator that a person has engaged, is engaging, or is about to engage in an act or practice constituting a violation of this [Act] or a rule adopted or order issued under this [Act], the administrator may do one or more of the following:

(1) issue a cease and desist order against the person engaged in the prohibited act or practice, directing them to cease and desist from further illegal acts or practices;

(2) bring an action in the [insert the name of appropriate court] to enjoin the acts or practices and to enforce compliance with this [Act] or a rule adopted or order issued under this [Act];

(3) censure the person, if the person is a registered broker-dealer, agent, investment adviser, or investment adviser representative;

(4) bar or suspend the person from association with a registered broker-dealer or

investment adviser in this State or a person from representing an issuer offering or selling securities in this State or acting as a promoter, officer, director, or partner of an issuer offering or selling securities in this State, or of a person who controls or is controlled by the issuer; or

(5) may consent to a settlement.

(b) In an action brought under subsection (a)(2) and upon a proper showing:

(1) the court may grant a permanent or temporary injunction, restraining order, asset freeze, accounting, writ of attachment, writ of general or specific execution, or writ of mandamus and appoint a receiver or conservator for the defendant or the defendant's assets;

(2) the court may order the administrator to take charge and control of a party's property, including rents and profits, to collect debts, and to acquire and dispose of property;

(3) the court may enter an order of rescission, civil penalty up to a maximum of [$X] for a single violation or of [$Y] for multiple violations in a single proceeding or a series of related proceedings, a declaratory judgment, restitution, or disgorgement directed to a person who has engaged in an act or practice constituting a violation of this [Act] or a rule adopted or order issued under this [Act];

(4) the court may order the payment of prejudgment and postjudgment interest or other relief the court considers just; and

(5) the court may not require the administrator to post a bond.

(c) The administrator may use emergency administrative proceedings if an immediate danger to public investors requires immediate action. The administrator may take this action only when necessary to prevent or avoid an immediate danger to public investors that justifies use of emergency administrative proceedings. If the administrator initiates a proceeding under this

subsection, the administrator must issue an order, including a brief statement of findings of fact, conclusions of law, and, if it is an exercise of the agency's discretion, policy reasons for the decision to justify the determination of an immediate danger to public investors and the administrator's decision to take the specific action. The administrator must give the notice as is practicable to persons who are required to comply with the order. The order is effective when issued.

(d) After issuing an order under subsection (c), the administrator shall proceed as expeditiously as feasible to complete proceedings that would be required [under the state administrative procedure act] if the matter did not involve an immediate danger.

(e) The record of the administrator under subsection (c) consists of the records regarding the matter which were considered, prepared, or obtained by the administrator. The administrator shall maintain these records as the official record.

(f) Unless otherwise required by law, the administrator's record under subsection (c) need not constitute the exclusive basis for the administrator's action in an emergency administrative proceeding or for judicial review of the emergency action.

**REPORTER'S COMMENT**

Source of Law: 1956 Act Section 408; NASAA 1987 Proposed Amendments to Section 408; RUSA Sections 602-603; Iowa Unif. Sec. Act Section 502.603 for Section 603(a)(2).

1. Constitutional due process considerations should be addressed by rulemaking or incorporation of the applicable administrative procedure act provisions of each jurisdiction. Except to the extent otherwise provided in Section 603(c), it is anticipated that no action under Sections 603(a)-(b) would be sought without (1) appropriate notice to any person who is subject to a proceeding and (2) opportunity for hearing.

2. Section 603(a)(5) authorizes an administrator to consent to a settlement, which could include a monetary settlement.

3. The RUSA Official Comments to Section 602 provided in part:

> One of the major revisions from the 1956 Act has been to increase the administrative remedies available to the administrator when he or she has reasonable grounds to believe that a violation has occurred. . . .
>
> The purpose behind the broader range of sanctions is to give the administrator greater flexibility in imposing sanctions. Under the 1956 Act, an administrator often faced the difficult choice of whether or not to suspend the license of a broker-dealer who had violated the Act, irrespective of the severity of the violation – a very drastic remedy and consequence. This Section now permits the administrator to impose a less drastic sanction, e.g., a civil penalty. In egregious cases, on the other hand, an administrator could, if warranted, impose multiple sanctions.

4. Section 603 does not include a statute of limitations. State statutes of limitations applicable to administrative enforcement actions, however, would be applicable here.

5. NASAA proposes adding to this section:

> A person violating a summary order issued under this subsection shall be deemed in contempt of that order. The administrator may petition the district court to enforce the order as certified by the administrator. The district court shall adjudge the person in contempt of the order if the court finds after hearing that the person is not in compliance with the order. The court shall assess a civil penalty against the person in an amount not less than [$X] but not greater than [$Y] per violation, and may issue further orders as it deems appropriate.

**SECTION 604. RULES, FORMS, ORDERS, AND HEARINGS.**

(a) The administrator may make, amend and rescind the rules, and issue the forms and orders that are necessary or appropriate to carry out this [Act], including rules and forms governing registration statements, applications, notice filings, reports, and other records, and define terms, whether or not used in this [Act], when these definitions are not inconsistent with this [Act].

(b) A rule or form may not be adopted, amended, or rescinded, or an order issued, amended, or rescinded, 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 consistent with the purposes fairly intended by the policy and provisions of this [Act]. In adopting rules and forms, the administrator may cooperate under Section 607 to effectuate the purposes of this [Act] and to achieve maximum uniformity in the form and content of registration statements, applications, reports, and other records. A uniform form may be adopted by the administrator by rule or order.

(c) Except to the extent limited by Section 15(h) of the Securities Exchange Act or Section 222 of the Investment Advisers Act of 1940, the administrator, by rule or order, may prescribe:

(1) the form and content of financial statements required under this [Act];

(2) the circumstances under which consolidated financial statements must be filed; and

(3) whether required financial statements must be audited by independent certified public accountants.

(d) All financial statements filed under this [Act] must be prepared in accordance with generally accepted accounting principles in the United States, unless this requirement is waived by the administrator.

(e) All rules, forms, and orders of the administrator shall be publicly available.

(f) The imposition of liability under this [Act] does not apply to conduct that is done or omitted in good faith conformity with a rule, form, or order of the administrator under this [Act].

(g) A hearing in an administrative proceeding under this [Act] shall be conducted publicly unless the administrator grants a request joined in by all the respondents that the hearing not be conducted publicly.

## REPORTER'S COMMENT

Source of Law: 1956 Act Section 412; 1987 NASAA Proposed Amendment to Section 412(a); RUSA Sections 705, 707.

1. It is anticipated that the administrator will make amendments under Section 604(a) to remain coordinated with relevant federal law, including the National Association of Securities Dealers, and to achieve uniformity among the States.

2. Uniform forms such as Form B-D, U-4, and U-5 are today common in the securities industry and would be authorized by section 604(b).

3. Section 604(d) 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. Section 604(f) 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 605. ADMINISTRATIVE FILES AND OPINIONS.

(a) The administrator or through its designee shall maintain a register of all applications for registration of securities, registration statements, notice filings, all applications for broker-dealer, agent, investment adviser, and investment adviser representative registration and all notice filings by a federal covered investment adviser which are or have been effective under this [Act] and predecessor acts; all notices of claim of exemption from registration or notice filing requirements contained in a record; all orders entered under this [Act] and predecessor acts; and all interpretative opinions or no-action determinations issued under this [Act].

(b) Upon request, the administrator shall furnish to a person a copy of a record that is a matter of public record. The administrator, by rule or order, may prescribe a reasonable charge for furnishing such a record. In a proceeding or prosecution under this [Act], a copy so certified is prima facie evidence of the record certified.

(c) The administrator may honor requests from interested persons for interpretative opinions or may issue determinations that the administrator will not institute enforcement proceedings against specified persons for engaging in specified conduct if the determination is consistent with the purposes fairly intended by this [Act].

**OFFICIAL COMMENT**

Prior Provisions: 1956 Act Section 413; RUSA Section 709.

1. "Record" is defined in Section 102(23).

2. Compliance with a state comprehensive records law will typically satisfy the requirements of Section 605(a).

**SECTION 606. PUBLIC INFORMATION; CONFIDENTIALITY.**

(a) Except as otherwise provided in subsection (b), records filed with or obtained by the administrator, including information contained in or filed with any registration statement, application, notice filing, or report, are public information and are available for public examination under the [freedom of information or open records laws of this State].

(b) The following records do not constitute public information under subsection (a) and are not a matter of public record under section 605(b):

(1) information or records obtained by the administrator in connection with an examination under Section 407(e) or an investigation under Section 602;

(2) information or records filed in connection with a registration statement under Sections 301 and 303 through 305 or a report under Section 407 and constituting trade secrets or commercial or financial information when the person filing the registration statement or report has asserted a claim of confidentiality or privilege that is authorized by law;

(3) information or records that are not required to be filed with or provided to the administrator under this [Act] and are provided to the administrator only on the condition that the information will not be subject to public examination or disclosure under the [freedom of information or open records laws of this State]; and

(4) information to or from a securities agency, law enforcement agency or agency or administrator specified in section 607;

(5) any "personal identifying information" contained in a record that is filed unless required by court order; the term "personal identifying information" means any social security number, home address, and home telephone number; and

[(6) information or records obtained by the administrator through a designee which have been deleted from the designee or designated as nonpublic or nondisclosable by the designee].

(c) This section does not create a privilege or diminish a privilege existing at common law, by statute, rule, or otherwise.

**REPORTER'S COMMENT**

Source of Law: RUSA Section 703; SEC Rule Section 200.80(b)(4); Securities Exchange Act of 1934 Sections 24(d)-(e).

**SECTION 607. COOPERATION WITH OTHER AGENCIES.**

(a) To encourage uniform interpretation and administration of this [Act] and effective securities regulation and enforcement, the administrator may cooperate with the securities agencies or administrators of one or more States, Canadian provinces or territories, or another country, the Securities and Exchange Commission, the Commodity Futures Trading Commission,

the Securities Investor Protection Corporation, a self regulatory organization, a national or international organization of securities officials or agencies, banking and insurance agencies, and any governmental law enforcement or regulatory agency.

(b) The cooperation authorized by subsection (a) includes the following actions:

(1) establishing or employing a designee 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 common forms;

(3) making a joint examination or investigation;

(4) holding a joint administrative hearing;

(5) filing and prosecuting a joint civil or administrative proceeding;

(6) sharing and exchanging personnel;

(7) coordinating registration under Sections 301 and 401 through 404 with other jurisdictions;

(8) sharing and exchanging information and records subject to the restrictions of [insert applicable state law];

(9) formulating, in accordance with the [administrative procedure act] of this State, rules or proposed rules on matters such as statements of policy, guidelines, forms, and interpretative opinions and releases;

(10) formulating common systems and procedures; and

(11) public notification of proposed rules, forms, statements of policy, and guidelines.

## OFFICIAL COMMENT

Prior Provision: RUSA Section 704.

1. Uniformity of regulation among the states and coordination with the Securities and Exchange Commission is a principal objective of this Act. See also Section 701. Section 607 is intended to encourage such cooperation to the maximum extent appropriate.

2. Section 607(b) lists some joint or coordinated efforts which might be undertaken. Other appropriate cooperative activities are also encouraged.

3. In cooperating with other agencies, an administrator must also comply with its own State's laws and rules, including those with respect to administrative procedure.

**SECTION 608. JUDICIAL REVIEW.** Rules adopted and orders issued under this [Act] are subject to judicial review [in accordance with the state administrative procedure act].

QUERY: Should this provision be deleted? Cf. Comment 1 to Section 601.

## REPORTER'S COMMENT

Source of Law: RUSA Section 711(b).

1. The 1956 Act Section 411 instead 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 or Uniform State Laws 334 (1944) and partly on Section 25 of the Securities Exchange Act.

2. The Official Comment 2 to RUSA Section 711 states: "The Section does not preclude persons from waiving their rights to an administrative proceeding if, with full knowledge of their rights, they choose to do so."

## ARTICLE 7:
## MISCELLANEOUS

**SECTION 701. UNIFORMITY OF APPLICATION AND CONSTRUCTION.** In applying and construing this Uniform Act, consideration must be given to the need to promote uniformity of the law among states that enact it and to the coordination of the application, construction, and administration of this [Act] with the Securities Act of 1933, Securities Exchange Act of 1934, Public Utility Holding Company Act of 1935, Investment Company Act of 1940, Investment Advisers Act of 1940, and the regulations adopted under those acts, all as in effect on the effective date of this [Act] [, or as later amended]. This Act shall be applied and construed to protect investors and, to the extent consistent with this purpose, to encourage capital formation.

### REPORTER'S COMMENT

Source of Law: 1956 Act Section 415, RUSA Section 803.

1. 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 Central Registration Depository, the Investment Adviser Registration Depository, or the Securities and Exchange Commission Electronic Data Gathering and Retrieval System. 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.

2. This Act is intended to be revenue neutral in its impact on existing state laws.

3. This Section is intended to be for the guidance of the administrator and any reviewing court.

**[SECTION 702. ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT.** The provisions of this [Act] governing the legal effect, validity, or

enforceability of electronic records or signatures, and of contracts formed or performed with the use of such records or signatures conform to the requirements of Section 102 of the Electronic Signatures in Global and National Commerce Act, and supersede, modify, and limit the Electronic Signatures in Global and National Commerce Act.]

**SECTION 703. 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] which can be given effect without the invalid provision or application, and to this end the provisions of the [Act] are severable.

**OFFICIAL COMMENT**

Prior Provisions: 1956 Act Section 417; RUSA Section 805.

1. Cf. Florida Realty, Inc. v. Kirkpatrick, 509 S.W.2d 114, 121 (Mo. 1974) (reading exemption in blue sky law in the light of the common law rule that "a negation in or exception to a statute will be construed so as to avoid nullifying or restricting its apparent principal purpose . . . 'and no conflict will be found unless the same is clear and inescapable'").

**SECTION 704. REPEALS.** The following Act is repealed:

[Insert name of former State securities act].

**SECTION 705. APPLICATION TO EXISTING RELATIONSHIPS.**

(a) Law repealed under Section 705 exclusively governs all suits, actions, prosecutions, or proceedings that are pending or may be initiated on the basis of facts or circumstances occurring before the effective date of this [Act], except that a civil suit or action may be maintained to enforce any liability under law repealed under Section 705 unless brought within any period of

limitation that applied when the cause of action accrued or within two years after the effective date of this [Act], whichever is earlier.

(b) All effective registrations under law repealed under Section 705, all administrative orders relating to the registrations, statements of policy, interpretive opinions, declaratory rulings, no action determinations, and all conditions imposed upon the registrations remain in effect while they would have remained in effect if this [Act] had not been enacted. They are considered to have been filed, entered, or imposed under this [Act], but are governed by law repealed under Section 705.

(c) Law repealed under Section 705 applies in respect of any offer or sale made within one year after the effective date of this [Act] under an offering begun in good faith before the effective date of this [Act] because of an exemption available under law repealed under Section 705.

**OFFICIAL COMMENT**

Source of Law: 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.

**SECTION 706. EFFECTIVE DATE.** This [Act] takes effect on [insert date, which should be at least 60 days after enactment].

**OFFICIAL COMMENT**

Prior Provisions: 1956 Act Section 419; RUSA Section 806.