

**UNIFORM SECURITIES ACT (1985)  
WITH 1988 AMENDMENTS**

*Drafted by the*

NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM STATE LAWS

*and by it*

APPROVED AND RECOMMENDED FOR ENACTMENT  
IN ALL THE STATES

*at its*

ANNUAL CONFERENCE  
MEETING IN ITS NINETY-SEVENTH YEAR  
IN WASHINGTON, D.C.  
JULY 29 - AUGUST 5, 1988

*WITH PREFATORY NOTE AND COMMENTS*

**UNIFORM SECURITIES ACT (1985)  
WITH 1988 AMENDMENTS**

The Committee that acted for the National Conference of Commissioners on Uniform State Laws in preparing the Uniform Securities Act (1985) with 1988 Amendments was as follows:

JOHN FOX ARNOLD, 714 Locust Street, St. Louis, MO 63101, *Co-Chairman*  
HAROLD E. READ, JR., P.O. Box 5283, Carefree, AZ 85377, *Co-Chairman*  
DAVID N. BARKHAUSEN, Suite 2700, 69 West Washington Street, Chicago, IL 60602  
PETER J. DYKMAN, Room 217 North, State Capitol Building, Madison, WI 53702,  
STANLEY M. FISHER, 1100 Huntington Building, Cleveland, OH 44115  
MENDES HERSHMAN, 575 Madison Avenue, New York, NY 10022  
CARL H. LISMAN, P.O. Box 728, Burlington, VT 05402  
FRED H. MILLER, University of Oklahoma, College of Law, 300 West Timberdell Road,  
Norman, OK 73019  
MICHAEL P. SULLIVAN, P.O. Box 35286, Minneapolis, MN 55435  
HOWARD J. SWIBEL, 75th Floor, 233 South Wacker Drive, Chicago, IL 60606  
ROBERT B. TITUS, Western New England College, School of Law, 1215 Wilbraham Road,  
Springfield, MA 01119, *Reporter*  
CARLYLE C. RING, JR., Room 322-D, 5390 Cherokee Avenue, Alexandria, VA 22312,  
*President (Member Ex Officio)*  
WILLIAM J. PIERCE, University of Michigan Law School, Ann Arbor, MI 48109, *Executive  
Director*  
MAURICE A. HARTNETT, III, Chambers, Court of Chancery, 45 The Green, Dover, DE  
19901, *Chairman, Division G (Member Ex Officio)*

**Review Committee**

WILLIAM H. WOOD, 210 Walnut Street, Harrisburg, PA 17108, *Chairman*  
ARTHUR E. BONFIELD, University of Iowa, College of Law, Iowa City, IA 52242  
DAVID HUDSON, 202 Central Park One, 525 Central Park Drive, Oklahoma City, OK 73105  
ROGER P. MORGAN, One Financial Plaza, Hartford, CT 06103

**Advisors to Special Committee on  
Uniform Securities Act (1985)**

MARY BELLAMY, Investment Company Institute  
ROBERT L. BEVAN, American Bankers Association  
CHARLES H.B. BRAISTED, American Bar Association  
MILTON H. GRAY, American Bar Association, Section of Corporation, Banking and Business  
Law  
ROYCE O. GRIFFIN, North American Securities Administrators Association  
ROBERT D. GUIOD, American Bar Association, Section of Corporation, Banking and  
Business Law  
JACK S. LEVIN, American Bar Association, Section of Taxation  
BARRY W. MOSES, National Association of Attorneys General  
LANNY PROFFER, National Conference of State Legislatures  
FRED M. STONE, American Stock Exchange  
FRANK J. WILSON, National Association of Securities Dealers

**Advisors to Special Committee on 1988 Amendments  
to Uniform Securities Act (1985)**

GRAIG GOETTSCHE, North American Securities Administrators Association  
CONRAD G. GOODKIND, American Bar Association, Committee on State Regulation of  
Securities  
F. LEE LIEBOLT, JR., American Bar Association, Committee on State Regulation of Securities  
HUGH H. MAKENS, American Bar Association, Committee on State Regulation of Securities  
JAMES C. MEYER, North American Securities Administrators Association  
ROBERT D. STRAHOTA, American Bar Association, Committee on State Regulation of  
Securities  
BOB F. THOMPSON, American Bar Association, Committee on State Regulation of Securities

Final, approved copies of this Act and copies of all Uniform and Model Acts and other printed  
matter issued by the Conference may be obtained from:

NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM STATE LAWS  
676 North St. Clair Street, Suite 1700  
Chicago, Illinois 60611  
(312) 915-0195

**UNIFORM SECURITIES ACT (1985)  
WITH 1988 AMENDMENTS**

**TABLE OF CONTENTS**

PREFATORY NOTE

**PART I  
DEFINITIONS**

SECTION 101. DEFINITIONS

**PART II  
LICENSING OF BROKER-DEALER, SALES  
REPRESENTATIVE, AND INVESTMENT ADVISER**

SECTION 201. LICENSING OF BROKER-DEALER AND SALES REPRESENTATIVE  
SECTION 202. EXEMPT BROKER-DEALERS AND SALES REPRESENTATIVES  
SECTION 203. LICENSING OF INVESTMENT ADVISER  
SECTION 204. EXEMPT INVESTMENT ADVISERS  
SECTION 205. APPLICATION  
SECTION 206. LICENSING FEES  
SECTION 207. EXAMINATIONS  
SECTION 208. LICENSING, GENERAL PROVISIONS  
SECTION 209. POST-LICENSING REQUIREMENTS  
SECTION 210. LICENSING OF SUCCESSOR FIRMS  
SECTION 211. POWER OF INSPECTION  
SECTION 212. GROUNDS FOR DENIAL, SUSPENSION, OR REVOCATION  
SECTION 213. DENIAL, SUSPENSION, OR REVOCATION ON GROUNDS OF LACK OF  
QUALIFICATION  
SECTION 214. WITHDRAWAL  
SECTION 215. CUSTODY OF CLIENT'S SECURITIES AND FUNDS

**PART III  
REGISTRATION OF SECURITIES**

SECTION 301. REGISTRATION REQUIREMENT  
SECTION 302. REGISTRATION BY FILING  
SECTION 303. REGISTRATION BY COORDINATION  
SECTION 304. REGISTRATION BY QUALIFICATION  
SECTION 305. PROVISIONS APPLICABLE TO REGISTRATION GENERALLY  
SECTION 306. DENIAL, SUSPENSION, AND REVOCATION OF REGISTRATION

**PART IV  
EXEMPTIONS FROM REGISTRATION**

- SECTION 401. EXEMPT SECURITIES
- SECTION 402. EXEMPT TRANSACTIONS
- SECTION 403. ADDITIONAL EXEMPTIONS
- SECTION 404. REVOCATION OF EXEMPTIONS
- SECTION 405. FILING OF SALES AND ADVERTISING LITERATURE

PART V  
FRAUDULENT AND OTHER PROHIBITED PRACTICES

- SECTION 501. OFFER, SALE, AND PURCHASE
- SECTION 502. MANIPULATION OF MARKET
- SECTION 503. PROHIBITED TRANSACTIONS BY INVESTMENT ADVISERS
- SECTION 504. MISLEADING FILINGS
- SECTION 505. UNLAWFUL REPRESENTATION CONCERNING LICENSING,  
REGISTRATION, OR EXEMPTION

PART VI  
ENFORCEMENT AND CIVIL LIABILITY

- SECTION 601. INVESTIGATION; SUBPOENA POWER
- SECTION 602. ENFORCEMENT
- SECTION 603. POWER OF COURT TO GRANT RELIEF
- SECTION 604. CRIMINAL PENALTIES
- SECTION 605. CIVIL LIABILITY
- SECTION 606. STATUTE OF LIMITATIONS
- SECTION 607. OFFER OF RESCISSION OR SETTLEMENT
- SECTION 608. BURDEN OF PROOF
- SECTION 609. LIABILITY; GENERAL PROVISIONS

PART VII  
ADMINISTRATION

- SECTION 701. ADMINISTRATION OF [ACT]
- SECTION 702. PROHIBITIONS ON USE OF INFORMATION
- SECTION 703. PUBLIC INFORMATION; CONFIDENTIALITY
- SECTION 704. COOPERATION WITH OTHER AGENCIES
- SECTION 705. RULES, FORMS, AND ORDERS
- SECTION 706. DECLARATORY ORDERS AND RULINGS
- SECTION 707. GOOD FAITH RELIANCE
- SECTION 708. CONSENT TO SERVICE OF PROCESS
- SECTION 709. ADMINISTRATIVE FILES AND RECORDS
- SECTION 710. ADMINISTRATIVE PROCEEDINGS
- SECTION 711. PROVISIONS APPLICABLE TO ADMINISTRATIVE PROCEEDINGS
- SECTION 712. EMERGENCY ADMINISTRATIVE PROCEEDINGS

PART VIII  
MISCELLANEOUS PROVISIONS

- SECTION 801. SCOPE OF [ACT]
- SECTION 802. CONTRACT PROVISIONS
- SECTION 803. UNIFORMITY OF APPLICATION AND CONSTRUCTION
- SECTION 804. SHORT TITLE
- SECTION 805. SEVERABILITY CLAUSE
- SECTION 806. EFFECTIVE DATE
- SECTION 807. REPEAL AND SAVING PROVISIONS

**UNIFORM SECURITIES ACT (1985)  
WITH 1988 AMENDMENTS**

**PREFATORY NOTE**

The original Uniform Securities Act was promulgated by the National Conference of Commissioners on Uniform State Laws in 1956. The 1956 Act has been adopted, in whole or in part, in 37 jurisdictions.

In undertaking to draft a revised Uniform Securities Act, the Drafting Committee was guided by the following principles:

(1) The 1956 Act generally has worked well and the substantive content of that Act should be modified only if there is shown to be a need to do so;

(2) The licensing and registration procedures specified in the 1956 Act should be updated to reflect the various federal and state securities law developments during the past 30 years;

(3) The authority of the state securities administrators in the enforcement area should be strengthened; and

(4) Some expedited registration process should be available for certain "seasoned" issuers where there appears less need for detailed securities review in order to protect investors.

The Drafting Committee reviewed numerous drafts. The Committee had the assistance of advisers from several interested groups, including, alphabetically, the American Bankers Association, the American Bar Association, the American Stock Exchange, the Investment Company Institute, the National Association of Securities Dealers, Inc., the North American Securities Administrators Association, and the Securities Industry Association. In addition, the Reporter and individual members of the Drafting Committee met on various occasions with committees or representatives of these groups.

Notwithstanding comprehensive reorganization and relocation, a very substantial amount of the statutory law of the 1956 Act has been retained in the Uniform Securities Act (1985). The cross-reference sheet included with these materials indicates where the provisions of the 1956 Act may be found in the draft Uniform Securities Act (1985).

The structural reorganization undertaken follows the Conference's general drafting style. The Uniform Securities Act (1985) is divided into eight sections as follows (the comparable sections of the 1956 Act are noted parenthetically):

Part I - Definitions (401)

- II - Broker-Dealer, Sales  
Representatives, and  
Investment Adviser Licensing  
(201-204)
- III - Registration of Securities  
(301-306)
- IV - Exemptions from Registration  
(402-403)
- V - Fraudulent and other  
Prohibited Practices  
(101-102, 404-405)
- VI - Enforcement and Civil  
Liability (407-410)
- VII - Administration (406, 412-413)
- VIII - Miscellaneous (414-419)

While a state which previously has adopted the 1956 Act obviously could choose to update only certain of its law by adopting provisions from one or more Parts above, the Drafting Committee strongly encourages that a state not do so. The revisions encompassed in this Act reflect a conscious effort to carefully balance the various interests involved in state securities regulation.

It should be noted that considerable effort was expended by the Drafting Committee to reach an accommodation of competing interests on the issues generating the most discussion. Thus, Section 302, the expedited registration of securities provision, was modified significantly from the draft presented to the Conference at the 1984 Annual Conference. In its final form, the section includes several criteria for eligibility designed to assure that the expedited registration process is available only to active operating companies with well established market activity for their securities.

Similarly, the new provision regarding administrative sanctions, Section 602, spells out the various enforcement sanctions available to an administrator and cross-references the procedural and substantive provisions applicable to the imposition of those sanctions.

To the extent practicable, the Uniform Securities Act (1985) encourages both greater coordination between federal and state securities law regulation and greater cooperation among states. Sections 205 and 209 reflect the former theme in the licensing and post-licensing provisions applicable to broker-dealers and investment advisers. Section 704 specifies numerous areas in which it is hoped that the states will continue to work jointly and achieve a maximum



degree of uniformity.

Section 705 sets forth in a single provision the general standards guiding the state securities administrator, which standards essentially are the same as those under the 1956 Act, namely that the action to be taken is "in the public interest and appropriate for the protection of investors" and is "consistent with the purposes fairly intended by the policy and provisions of this [Act]."

The comments following the sections have been prepared by the Reporter and the Chairmen of the Drafting Committee, based, among other sources, upon discussions and comments from various parties during the Drafting Committee meetings and comments to comparable provisions of the 1956 Act, where applicable.

**UNIFORM SECURITIES ACT (1985)**  
**WITH 1988 AMENDMENTS**

**PART I**

**DEFINITIONS**

**SECTION 101. DEFINITIONS.**

As used in this [Act], unless the context otherwise requires:

(1) "[Administrator]" [substitute any other appropriate term, such as "Commission," "Commissioner," "Secretary"] means the [insert name of administrative agency or individual].

(2) "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:

(i) a sales representative;

(ii) an issuer, except when effecting transactions other than with respect to its own securities;

(iii) a depository institution; or

(iv) any other person the [Administrator], by rule or order, designates.

(3) "Depository institution" means:

(i) a person that is organized, chartered, or holding an authorization certificate under the laws of a state or of the United States which authorizes the person to receive deposits, including a savings, share, certificate, or deposit account, and which is supervised and examined for the protection of depositors by an official or agency of a state or the United States; and

(ii) a trust company or other institution that is authorized by federal or state law to

exercise fiduciary powers of the type a national bank is permitted to exercise under the authority of the Comptroller of the Currency and is supervised and examined by an official or agency of a state or the United States. The term does not include an insurance company or other organization primarily engaged in the insurance business or a Morris Plan bank, industrial loan company, or a similar bank or company unless its deposits are insured by a federal agency.

(4) "Filed" means the actual delivery of a document or application to the [Administrator] or designee of the [Administrator] or to the principal office of the [Administrator].

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

(i) a depository institution;

(ii) an insurance company;

(iii) a separate account of an insurance company;

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

(v) an employee pension, profit-sharing, or benefit plan if the plan has total assets in excess of \$5,000,000 or its investment decisions are made by a named fiduciary, as defined in the Employee Retirement Income Security Act of 1974, that is either 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, a depository institution, or an insurance company; and

(vi) any other institutional buyer.

(6) "Fraud," "deceit," and "defraud" are not limited to common-law fraud or deceit.

(7) "Investment adviser" means a person who, for compensation, engages in the

business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities or who, for compensation and as a part of a business, issues or promulgates analyses or reports concerning securities. The term does not include:

(i) an employee of an investment adviser;

(ii) a depository institution;

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

(iv) a broker-dealer 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;

(v) a publisher, employee, or columnist of a newspaper, news magazine, or business or financial publication, or an owner, operator, producer, 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;

(vi) a person whose advice, analyses, or reports relate only to securities exempt under paragraph (1) of Section 401(b); and

(vii) any other person the [Administrator], by rule or order, designates.

(8) Except as provided in subparagraph (i), (ii), or (iii), "issuer" means a person who issues or proposes to issue a security, but:

(i) 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 pursuant to the trust or other agreement or instrument under which the security is issued.

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

(iii) 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.

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

(10) "Person" means an individual, corporation, business trust, estate, trust, partnership, association, joint venture, government, governmental subdivision or agency, or any other legal or commercial entity.

(11) "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.

(12) "Promoter" includes:

(i) a person who, acting alone or in concert with one or more other persons, takes the entrepreneurial initiative in founding or organizing the business or enterprise of an issuer;

(ii) an officer or director owning securities of an issuer or a person who owns,

beneficially or of record, ten percent or more of a class of securities of the issuer if the officer, director, or person acquires any of those securities in a transaction within three years before the filing by the issuer of a registration statement under this [Act] and the transaction does not possess the indicia of arms-length bargaining; and

(iii) a member of the immediate family of a person within subparagraph (i) or (ii) if the family member receives securities of the issuer from that person in a transaction within three years before the filing by the issuer of a registration statement under this [Act] and the transaction does not possess the indicia of arms-length bargaining.

(13) "Sale" or "sell" includes every contract of sale, contract to sell, or other disposition, of a security or interest in a security for value. In this context:

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

(ii) "Offer to purchase" includes every attempt or 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.

(iii) A security given or delivered with, or as a bonus on account of, a purchase of securities or other item is considered to constitute part of the subject of the purchase and to have been offered and sold for value.

(iv) A gift of assessable stock is deemed to involve an offer and sale.

(v) A sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, or a 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, is deemed to include an offer of the other security.

(vi) The terms defined in this paragraph do not include the creation of a security interest or a loan; 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 and each stockholder may elect to take the dividend in cash, property, or stock; or 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 exchange and partly for cash.

(14) "Sales representative" means an individual, other than a broker-dealer, authorized to act and acting for a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities. A partner, officer, or director of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is a sales representative only if the person otherwise comes within the definition.

(15) "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," "Employee Retirement Income Security Act of 1974," "National Housing Act," and "Commodity Exchange Act" mean the federal statutes of those names, as amended.

(16) "Security" means: a note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in a profit-sharing agreement; a limited partnership interest; 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:

(i) 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 some other specified period; or

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

(17) "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, the Municipal Securities Rulemaking Board established under Section 15B(b)(1) of the Securities Exchange Act of 1934, or Section 21 of the Commodity Exchange Act.

(18) "State" means a state, commonwealth, territory, or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico.

#### **COMMENT**

1. Under Section 705(a)(4) the Administrator has power to define by rule any terms, whether or not used in this Act, so long as the definition so adopted is not inconsistent with the provisions of this Act.

2. Definition (1) [Prior Provision: USA 401(a)].

3. Definition (2) [Prior Provision: USA 401(c)]. This definition generally follows the



definition of "broker-dealer" in the 1956 Act. 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). An individual who is merely a substantial trader in securities is not considered to be "engaged in the business of effecting transactions."

The prior provision also excluded from the definition of broker-dealer persons who conducted the business of a broker-dealer but had only de minimis or incidental contacts with the state. The Committee believes it is appropriate to recognize that entities such as these are broker-dealers exempt from licensing. Section 202(a) now identifies the categories of broker-dealers exempt from licensing.

The exclusion in the 1956 Act for banks and other financial institutions has been retained, notwithstanding that many depository institutions now offer to customers brokerage services. The Committee concluded that comprehensive resolution of this issue can only be accomplished by legislation at the federal level. Under most legislative and administrative agency proposals under consideration, any financial institution wishing to offer brokerage services would have to establish a separate subsidiary. This also appears to be the most likely result under Rule 3b-9 promulgated by the Securities and Exchange Commission. Since the exclusion in Section 101(2)(iii) does not extend to a subsidiary established for such a purpose, that entity would be a broker-dealer subject to the licensing requirements of this Act.

Subparagraph (iv) was added to give the Administrator authority, by rule or order, to exempt additional persons from the definition. In taking such action, the Administrator is to be guided by the general standards provision of Section 705(c).

4. Definition (3) [Prior Provision: None]. This definition was added to enable uniform treatment in this Act of all banks and other similar depository institutions. As a result of recent regulatory developments, the differences among the powers of various banking entities have been substantially eliminated. While both a dual federal and state regulatory scheme and a diffusion of responsible agencies at the federal level still exist, the Committee was unable to justify differential treatment for purposes of this Act.

The definition expressly excludes insurance companies as well as various institutions which conduct small loan business operations.

5. Definition (4) [Prior Provision: USA 413(a)]. This definition prescribes no particular method of filing, although the Administrator is free to specify further by rule under Section 705. The scope of the definition is broad enough to authorize filing with another entity designated by the Administrator, *e.g.*, the CRD system presently administered by the National Association of Securities Dealers, Inc. Since the definition does not describe any actual means of delivery, it also is sufficient to authorize filing through a central electronic dissemination and retrieval system such as Project Edgar if and when that technology is more generally available.

This definition does use a different standard than that of contract law. Under this Act,

the document actually must be received in order to be filed; mere mailing is not sufficient.

A document delivered without a required fee is "filed" under this definition. An Administrator may deny effectiveness of a license or a registration statement for failure to pay the required fee (see Sections 212(a)(ii)(12) and 306(a)(2)(ix)), but that requires affirmative action by the Administrator.

6. Definition (5) [Prior Provision: None; see USA 402(b)(8)]. In light of the recurrent use of the concept of financial and institutional investors, *e.g.*, see Sections 202(a), 204(a), and 402(10), a definition based largely upon the listing in Section 402(b)(8) of the 1956 Act has been added here. The retention of the term "institutional buyer" in subparagraph (vi) is meant to preserve the exemption in Section 402(10) when offers and sales are made to other appropriate persons, *e.g.*, a college purchasing for its endowment fund.

The federal securities laws utilize the concept of "accredited investors" which include a variety of corporate and individual investors satisfying financial and other criteria.

An Administrator obviously may add, by rule, additional categories of persons who qualify as financial or institutional investors.

The term "separate account" in subparagraph (5)(iii) has the same meaning as in Section 2(a)(37) of the federal Investment Company Act of 1940.

In light of developments in the employee retirement plan area since the 1956 Act was promulgated, changes have been made concerning employee pension, profit-sharing or other benefit plans. Those plans now qualify as a financial or institutional investor only if the total plan assets exceed \$5,000,000 or there is an independent plan fiduciary of the type noted.

7. Definition (6) [Prior Provision: USA 401(d)]. This definition continues the 1956 Act rule that "fraud" as used in the federal and state securities laws is not limited to common law deceit.

The term "fraud" is used both in connection with the registration of securities provisions (Section 306) and in the general antifraud provisions (Sections 501 and 503).

8. Definition (7) [Prior Provision: USA 401(f)]. The intent is to follow the scope and interpretations under Section 202(a)(11) of the Investment Advisers Act of 1940 generally and the provisions of paragraphs (1) through (5) of Section 401(f) of the 1956 Act. The exclusions in paragraph (6) of the existing definition in the 1956 Act have been recast in this Act as exemptions from the investment adviser licensing requirements. See Section 204.

The term "engineer" in subparagraph (7)(iii) can include a geologist or geophysicist.

Subparagraph (v) has been revised to make it clear that newsletters, radio, or TV broadcasts and other financial publications do not constitute giving investment advice if the

information is made available to the general public and the content is not based upon the specific investment situations of the publisher's clients. This provision is consistent with the United States Supreme Court's construction in *Lowe v. SEC*, 105 S. Ct. 2557 (1985), of the counterpart provision in the Investment Advisers Act of 1940.

9. Definition (8) [Prior Provision: USA 401(g)]. Subparagraph (i) follows the 1956 Act and Section 2(4) of the Securities Act of 1933.

Subparagraph (ii) has been added to reflect the use of equipment trust and conditional sale financing devices as substitutes for direct issues of securities.

Subparagraph (iii) does modify the rule articulated in the 1956 Act. It seems appropriate to identify a person who creates fractional undivided interests in an oil, gas, or other mineral lease or comparable right as the issuer of the fractional interests, who must thus register or otherwise establish an exemption for the securities represented by the fractional interests.

10. Definition (9) [Prior Provision: USA 401(h)]. This definition is primarily relevant to secondary trading transactions. See Sections 305(m) and 402(1) through (5) and the comments relating to those provisions.

11. Definition (10) [Prior Provision: USA 401(i)]. This language is the standard definition used by the National Conference of Commissioners on Uniform State Laws.

12. Definition (11) [Prior Provision: None]. This concept concerns only the registration by filing (Section 302) and registration by coordination (Section 303) provisions. The definition has been drafted to reflect the increasing practice whereby issuers are not required to file a final amendment to their registration statement under the Securities Act of 1933, but rather set forth the offering price and underwriters' commissions in a final prospectus filed under Rule 424 promulgated by the Securities and Exchange Commission.

13. Definition (12) [Prior Provision: None]. The concept of a "promoter" is relevant primarily to the registration of securities. Section 306(a)(ii)(6) authorizes the Administrator to deny registration of securities if the offering is made with "unreasonable amounts of ... promoter's profits." Under Section 305(g) the Administrator may require the escrow for a period of up to three years of securities issued to a promoter within three years prior to a registered public offering for a consideration substantially less than the offering price at which the security would now be sold to the public.

While this definition is not exhaustive, it is intended to give guidance both to practitioners and to the Administrator as to what persons should be considered to be promoters of a particular issuer. There may well be other factual circumstances in which, due to absence of arms-length bargaining or other factors, other persons similarly should be treated as promoters.

14. Definition (13) [Prior Provision: USA 401(j)]. Much of this definition follows the 1956 Act and Section 2(3) of the Securities Act of 1933.

The exclusion in subparagraph (ii) for transactions subject to Section 14(d) of the Securities Exchange Act of 1934 simply means that tender offers are not the subject of regulation by this Act. It is not intended to limit the exercise of jurisdiction by a state under other law with respect to tender offers if and to the extent a state constitutionally may do so.

Subparagraph (v) provides that there is always an "offer" of the security called for by a conversion privilege or a warrant to purchase a security. Hence, that security must be registered (unless some exemption is available) before the convertible security or the warrants are offered. Under certain conditions, Section 402(14) exempts offers to existing security holders, specifically including "persons who at the time of the transaction are holders of transferable warrants exercisable within not more than 90 days of their issuance, convertible securities, or nontransferable warrants."

Stock dividends have been treated almost universally as not involving a "sale" since there is no volitional element on the part of the recipient of the stock dividend. Under subparagraph (vi) a stock dividend does not involve either an "offer" or a "sale."

The substitution of "security interest" for "pledge" reflects current terminology.

The former exception from the definition for statutory mergers and sales of assets has been deleted in light of the change in the federal securities law regarding such transactions. Corporate combinations involving the exchange of stock now generally require registration pursuant to Rule 145 promulgated under the Securities Act of 1933. This Act conceptually treats such transactions in the same manner; however, many such transactions will qualify under the exemption from registration set out in Section 402(17).

The exclusion in the 1956 Act for judicially approved reorganizations is retained in the last part of subparagraph (vi).

15. Definition (14) [Prior Provision: USA 401(b)]. In keeping with current industry practices, the term "sales representative" has been substituted for the term "agent."

Certain of the exceptions to the prior definition of agent are now treated as classes of sales representatives exempt from licensing. See Section 202(b).

The definition is intended to include any person who acts as sales representative, whether or not the person conducts business as an incorporated organization, a phenomenon which occurs from time to time, usually for federal tax purposes.

An individual who acts concurrently or sequentially on behalf of a number of issuers, *e.g.*, a general partner of various oil and gas partnerships who receives commissions for selling securities of those entities, may be considered a broker-dealer rather than a sales representative.

This section continues the prior practice of not considering a person a sales

representative merely because of status as a partner, officer, or director of a broker-dealer or issuer. If the person is limited to a purely managerial or clerical role without ever attempting to effect purchases or sales or simply has furnished capital without taking an active role in management, there appears no need to include that person within the scope of a sales representative.

16. Definition (15) [Prior Provision: USA 401(k)].

17. Definition (16) [Prior Provision: USA 401(l)]. Except for the added language regarding limited partnership interests and various option securities, this section follows the 1956 Act provision. That provision in turn was substantially identical to Section 2(1) of the Securities Act of 1933.

A number of states, *e.g.*, Oklahoma, Hawaii, and Washington, have adopted revised definitions of "security" incorporating additional criteria. The Committee determined to retain the essential parts of the existing definition because it has been broadly construed in federal and state courts and seems adequate generally to embrace most investment vehicles that the human mind can conceive. With respect to the specific, more traditional instruments included within the definition, for example, the courts have used a "plain meaning" approach, *i.e.*, does the particular instrument possess the usual characteristics associated with that instrument? If so, then the relevant securities act applies. See, *e.g.*, *Landreth Timber Company v. Landreth*, 471 U.S. 681 (1985). For other specific instruments, the "unless the content otherwise requires" language may require a further inquiry. The burden, however, still will be on the person claiming that the instrument is not a security to establish either that such instrument does not possess the essential attributes or that it bears a strong family resemblance to those instruments not commonly understood as being securities (*e.g.*, notes issued in truly mercantile transactions as opposed to notes issued to investors). See *Exchange National Bank of Chicago v. Touche Ross & Co.*, 544 F.2d, 1126 (2 Cir., 1976). The more unusual investment devices continue to be judged by the "economic realities" test of *SEC v. W.M. Howey Co.*, 328 U.S. 293 (1946).

The introductory clause "unless the context requires otherwise," which modifies all the definitions in the Act, has been retained due in part to the relevance of that language to the various federal and state court decisions interpreting the definition of a "security."

Interests in various employee plans governed by ERISA are excluded from the definition. Similarly, insurance products providing for the payment of a fixed sum of money are excluded from the definition. Variable annuities and similar products are treated as securities under this definition, but are exempted from registration under Section 401(4).

18. Definition (17) [Prior Provision: None]. This definition is patterned after a comparable provision in the Federal Securities Code. The term "self-regulatory organization" is used on numerous occasions in Parts II and VI, the most typical such organizations being the national stock exchanges and the National Association of Securities Dealers, Inc.

19. Definition (18) [Prior Provision: USA 401(m)]. This language makes clear that the

term does include territories and possessions as well as the District of Columbia and Puerto Rico, but that it does not include any foreign government.

## PART II

### **LICENSING OF BROKER-DEALER, SALES REPRESENTATIVE, AND INVESTMENT ADVISER**

#### **SECTION 201. LICENSING OF BROKER-DEALER AND SALES REPRESENTATIVE.**

(a) A person may not transact business in this State as a broker-dealer or sales representative unless licensed or exempt from licensing under this [Act].

(b) A broker-dealer licensed under this [Act] and an issuer may not employ a person as a sales representative in this State unless the sales representative is licensed under this [Act] or is exempt from licensing under this [Act].

(c) A broker-dealer or issuer engaged in offering securities in this State may not employ, directly or indirectly, a person to engage in any activity in this State contrary to a suspension or bar from association with a broker-dealer or investment advisor imposed against that person by the [Administrator]. A broker-dealer or issuer does not violate this subsection unless the broker-dealer or issuer knows or in the exercise of reasonable care should know of the suspension or bar. Upon request from a broker-dealer or issuer and for good cause shown, the [Administrator], by order, may waive the prohibition of this subsection with respect to a person suspended or barred.

#### **COMMENT**

Prior Provision: USA 201; New.

1. "Broker-dealer" and "sales representative" are defined in Sections 101(2) and 101(14). The scope of subsection (a) with reference to the phrase "transact business in this State" is specified in Section 801.

2. Subsection (b) prohibits a broker-dealer or issuer from employing a person as sales representative unless the latter is licensed as such or exempt under Section 202(b). The duration and effectiveness of a sales representative's license are set forth in Section 208(b) through (e).

3. Subsection (c) prohibits a broker-dealer or issuer from employing any person in a capacity from which that person has been suspended or barred by the Administrator. Violation of this provision does not result in strict liability. Ordinarily, both the Administrator and the person suspended or barred would have knowledge of the order. However, in order for the employer to be liable, it also either must have known or should have known of the existence of the order.

A broker-dealer or issuer may request a waiver of the prohibitions of this subsection for good cause shown.

## **SECTION 202. EXEMPT BROKER-DEALERS AND SALES REPRESENTATIVES.**

(a) The following broker-dealers are exempt from the licensing requirements of Section 201:

(1) a broker-dealer who either is registered or, except as provided in subsection (b), is not required to be registered under the Securities Exchange Act of 1934 and who has no place of business in this State if:

(i) the transactions effected by the broker-dealer in this State are exclusively with the issuer of the securities involved in the transactions, other broker-dealers licensed or exempt under this [Act], or financial or institutional investors;

(ii) the broker-dealer is licensed under the securities act of a state in which the broker-dealer maintains a place of business and the broker-dealer offers and sells in this State to a person who is an existing customer of the broker-dealer and whose principal place of residence

is not in this State; or

(iii) the broker-dealer is licensed under the securities law of a state in which the broker-dealer maintains a place of business and the broker-dealer during any 12 consecutive months does not effect ~~more than [15]~~ transactions with more than [5] persons in this State in addition to transactions with the issuers of the securities involved in the transactions, financial or institutional investors, or broker-dealers, whether or not the offeror or an offeree is then present in this State; and

(2) other broker-dealers the [Administrator] by rule or order exempts.

(b) The exemption provided in subsection (a)(1)(i) is not available to a broker-dealer who 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.

(c) The following sales representatives are exempt from the licensing requirements of Section 201:

(i) a sales representative acting for a broker-dealer exempt under subsection (a);

(ii) a sales representative acting for an issuer in effecting transactions in a security exempted by paragraphs (1) through (4) and (11) through (13) of Section 401(b);

(iii) a sales representative acting for an issuer effecting offers or sales of securities in transactions exempted by Section 402;

(iv) a sales representative acting for an issuer effecting transactions with employees, partners, officers, or directors of the issuer, a parent or a wholly-owned subsidiary of the issuer, if no commission or other similar compensation is paid or given directly or indirectly to the sales representative for soliciting an employee, partner, officer, or director in this State;



and

(v) other sales representatives the [Administrator] by rule or order exempts.

## COMMENT

Prior Provision: USA 401(b) and (c).

1. The predominant existing pattern of state regulation is to exclude from the definition of broker-dealer any person who has no place of business in the state if he effects transactions with specified classes of investors or only a fixed number of persons within any 12 consecutive months. That pattern has been continued in subsection (a) except that such persons are simply exempted from the licensing requirements rather than being excluded from the definition entirely.

Where the activities being carried on by a person are generic broker-dealer activities, it is appropriate to require that person to be subject to broker-dealer regulation at some level. Accordingly, an additional condition to the exemption is that the person be registered as a broker-dealer under the Securities Exchange Act of 1934 unless exempt under the terms of that act. However, by virtue of subsection (b), a person who is exempt from registration under the 1934 Act by reason of acting as a secondary dealer in government securities is required to register as a broker-dealer if otherwise within the definitional provisions. The intent of the exclusion for dealers subject to supervision by the Federal Reserve Board is to exclude the so-called primary dealers from the licensing requirements.

2. Subsection (a)(i)(2) was added to cover the nonresident broker who has contact with a customer whose residence is in another state and who is in this State on a temporary basis, *e.g.*, vacationing.

3. Subsection (c) continues the existing pattern of exempting sales representatives of issuers effecting exempt transactions. However, one should note that some of the exemption provisions are applicable only if no compensation is paid or if the only compensation paid is paid to a broker-dealer licensed or not required to be licensed under this Act. See, for example, Section 402(11). This approach should minimize the potential for abuse which has occurred in the past with respect to unlicensed sales representatives offering securities in limited or private offerings.

Sales representatives acting on behalf of issuers offering certain exempt securities may be exempt under subsection (c)(iii). A person acting on behalf of an issuer offering securities exempt under paragraphs (5) through (10) and paragraph (14) of Section 401(b) is required to be licensed if he or she otherwise comes within the definition of sales representative in Section 101(14).

4. The Administrator has authority to exempt additional classes of persons from the broker-dealer or sales representative licensing requirements, assuming the standards set forth in

Section 705(c) are met.

### **SECTION 203. LICENSING OF INVESTMENT ADVISER.**

(a) A person may not transact business in this State as an investment adviser unless licensed as an investment adviser or exempt from licensing under this [Act].

(b) An investment adviser may not employ, directly or indirectly, a person to engage in any activity in this State contrary to a suspension or bar from association with a broker-dealer or investment adviser imposed against that person by the [Administrator]. An investment adviser does not violate this subsection unless the investment adviser knows or in the exercise of reasonable care should know of the suspension or bar. Upon request from an investment adviser and for good cause shown, the [Administrator], by order, may waive the prohibition of this subsection with respect to a person suspended or barred.

### **COMMENT**

Prior Provision: USA 201(c); New.

1. "Investment adviser" is defined in Section 101(7). That definition excludes a broker-dealer who receives no special compensation for investment advisory services. In that instance, the broker-dealer does not have to become licensed in two different capacities in this State. The scope of subsection (a) with respect to the phrase "transact business in this State" is specified in Section 801.

2. Subsection (b) prohibits an investment adviser from employing any person in any capacity from which suspended or barred by the Administrator. In order for the investment advisor to be liable, it must know or should know of the existence of the order. An investment adviser may request a waiver of the prohibition for good cause shown.

3. Licensing of employees or representatives of an investment adviser has not been required. The Committee concluded that such separate licensing was not essential to adequate regulation since the Administrator has authority over the investment adviser itself. However, the antifraud provision relating to investment adviser activities, Section 503, does extend to such persons.

## **SECTION 204. EXEMPT INVESTMENT ADVISERS.**

The following investment advisers are exempt from the licensing requirements of Section 203:

(1) an investment adviser who is registered or is not required to be registered as an investment adviser under the Investment Advisers Act of 1940 if:

(i) its only clients in this State are other investment advisers, broker-dealers, or financial or institutional investors;

(ii) the investment adviser has no place of business in this State and the investment adviser directs business communications in this State to a person who is an existing client of the investment adviser and whose principal place of residence is not in this State; or

(iii) the investment adviser has no place of business in this State and the investment adviser during any 12 consecutive months does not direct business communications in this State to more than [five] present or prospective clients other than those specified in subparagraph (i), whether or not the person or client to whom the communication is directed is present in this State; and

(2) other investment advisers the [Administrator], by rule or order, exempts.

### **COMMENT**

Prior Provision: USA 401(f).

1. A person exempt from licensing under any of the paragraphs of this section remains subject to the broad antifraud provisions of Sections 501 and 503.

2. Paragraphs (1)(ii) and (iii) create exemptions from licensing for persons dealing solely with transient clients or a de minimis number of clients comparable to the exemption provisions of Section 202(a) relating to broker-dealers.

3. The Administrator has power to exempt additional classes of persons from the licensing requirements, subject to the applicable standards of Section 705(c).

## **SECTION 205. APPLICATION.**

(a) An applicant for licensing as a broker-dealer, sales representative, or investment adviser shall file with the [Administrator] an application for licensing and a consent to service of process under Section 708. The application for licensing must contain the information that the [Administrator], by rule, requires.

(b) The requirements of subsection (a) are satisfied by an applicant who has filed and maintains a completed and current registration with the Securities and Exchange Commission or a self-regulatory organization by filing with the [Administrator] notice of the registration in the form and content determined by the [Administrator], by rule, and a consent to service of process under Section 708. The registration information filed with the Securities and Exchange Commission or self-regulatory organization must be available to the [Administrator] through a central registration depository system approved by the [Administrator]. The [Administrator], by order, may require the submission of additional information by an applicant.

### **COMMENT**

Prior Provision: USA 202(a).

1. This section has been revised to eliminate the listing of specific information required in applications for licensing. Emphasis is placed on coordinating the requirements of federal and state securities agencies.

Subsection (b) recognizes the substantial steps at coordination already undertaken by those agencies. The subsection provides that licensing may be accomplished through a central registration depository system such as the CRD system of the National Association of Securities Dealers, Inc. Unless the Administrator requires additional information in a particular case, the information filed by the applicant with the Securities and Exchange Commission or a self-regulatory organization is sufficient for licensing purposes. The definition of "filed" in Section 101(3) includes the filing of information with an approved designee of the Administrator.

2. Section 101(14) states that a "partner, officer, or director of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is a sales representative only if the person otherwise comes within the definition." Unlike the present law, the licensing of a firm does not automatically constitute the licensing as a sales representative of each such person. If any such person intends to act as a sales representative in this State, he or she must become licensed as such. Otherwise, there is no requirement that the executive officers of a broker-dealer be separately licensed, as principals or otherwise. However, the qualifications of those principals may be considered by the Administrator in determining whether the broker-dealer satisfies the requisite experience and training disqualification of a partner, executive officer, or director, as distinct from an ordinary sales representative, is a basis for a proceeding against the firm if the Administrator finds it in the public interest to do so. See Section 212.

3. The prior practice of renewal applications has been eliminated. Section 206 merely requires in its place the filing of an annual fee.

#### **SECTION 206. LICENSING FEES.**

(a) An applicant for licensing shall pay a licensing fee as follows:

(1) broker-dealer [\$100] and for each branch office [\$50].

(2) sales representative [\$25].

(3) investment adviser [\$50].

(b) Except in a year in which a licensing fee is paid, a licensed person shall pay an annual fee as follows:

(1) broker-dealer [\$75] and for each branch office [\$30].

(2) sales representative [\$15].

(3) investment adviser [\$35].

(c) For purposes of this section, "branch office" means an office of a broker-dealer in this State, other than the principal office in this State of the broker-dealer, from which three or more sales representatives transact business.

(d) If an application is denied or withdrawn or the license is revoked, suspended, or withdrawn, the [Administrator] shall retain the fee paid.

## COMMENT

Prior Provision: USA 202(b).

1. Each state should determine the appropriate fees to be assessed for each type of license. Recommended amounts are set forth in brackets.
2. The definition of "branch office" includes only offices in this State from which three or more sales representatives transact business. Computer processing facilities and other locations at which sales representatives are not located do not constitute branch offices.
3. The Administrator, by rule, may require licensed persons to submit sufficient information as to the licensed person, its sales representatives, or branch offices to enable the Administrator to verify or ascertain the fees due under this section.

### **SECTION 207. EXAMINATIONS.**

- (a) The [Administrator], by rule or order, may require an examination of:
  - (1) an applicant for licensing under this Part;
  - (2) a class of applicants; and
  - (3) a class of persons who will represent an investment adviser in performing an act that requires licensing as an investment adviser in this State.
- (b) An examination may be administered by the [Administrator] or a designee of the [Administrator]. An examination may be oral or written, or both, and may differ for each class of applicants.
- (c) The [Administrator], by rule or order, may waive an examination as to a person or class of persons if the [Administrator] determines that an examination is not necessary for the protection of investors.

## COMMENT

Prior Provision: USA 204(b)(6).

1. Requirements for examination of applicants for licensing are discretionary with the

Administrator, subject, of course, to the limitations in Section 213 regarding denials, suspensions, or revocations based upon lack of qualification. Examinations are intended to relate to the qualifications required in order for the applicant to conduct the business for which it is being licensed.

2. Subsection (b) is intended to encourage coordination among federal and state agencies in administering examinations.

3. Subsection (c) gives the Administrator authority to waive examination requirements either as to a particular applicant or a class of applicants if the Administrator determines that investor protection will not be jeopardized. For example, the Administrator could elect to waive for a minimum period of time the examination requirements for persons in a successor firm which takes over a troubled broker-dealer or investment adviser, to enable the uninterrupted operation of the rescued firm.

## **SECTION 208. LICENSING, GENERAL PROVISIONS.**

(a) Unless a proceeding under Section 212 is instituted or the applicant is notified that the application is incomplete, the license of a broker-dealer, sales representative, or investment adviser becomes effective 30 days after the later of the date an application for licensing is filed and is complete or the date an amendment to an application is filed and is complete, in either case only if all requirements imposed under Section 207 are satisfied. An application is complete when the applicant has furnished information responsive to each applicable item of the application. The [Administrator] by order may authorize an earlier effective date of licensing.

(b) The license of a broker-dealer, sales representative, or investment adviser is effective until terminated by expiration, revocation, or withdrawal.

(c) The license of a sales representative is effective only with respect to transactions effected on behalf of the broker-dealer or issuer for whom the sales representative is licensed.

(d) A person may not act at any one time as a sales representative for more than one broker-dealer or for more than one issuer, unless the broker-dealers or issuers for whom the sales representative acts are affiliated by direct or indirect common control or the [Administrator], by

rule or order, authorizes multiple licenses.

(e) If a person licensed as a sales representative terminates association with a broker-dealer or issuer or ceases to be a sales representative, the sales representative and the broker-dealer or issuer on whose behalf the sales representative was acting shall promptly notify the [Administrator].

(f) The [Administrator] by rule may authorize one or more special classifications of licenses as a broker-dealer, sales representative, or investment adviser to be issued to applicants subject to limitations and conditions on the nature of the activities that may be conducted by persons so licensed.

## COMMENT

Prior Provision: USA 202(a).

1. Subsection (a) is similar to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(c) of the Investment Advisers Act of 1940. Unless the Administrator determines that an application is incomplete or has initiated a proceeding under Section 212, an application becomes effective automatically 30 days after the later of the date of filing or the date of any amendment to the initial application, provided any examination requirements imposed under Section 207 have been satisfied. The 30-day period may be shortened by the Administrator in an appropriate case.

Subsection (a) attempts to set forth a statutory test as to when an application is complete in the absence of any contrary notification from the Administrator.

2. Nothing in this section precludes an applicant from waiving the 30-day automatic effectiveness period if it chooses to do so, *e.g.*, to avoid the institution otherwise by the Administrator of a denial proceeding under Section 212(a)(ii)(1).

3. The federal pattern of continuing registration has been adopted in lieu of the 1956 Act provisions requiring annual renewals. Under subsection (b), expiration, revocation, or withdrawal are the events now which generally terminate the effectiveness of a license.

4. The license of a sales representative expires when he or she ceases to be employed by the broker-dealer or issuer for whom licensed. Both the sales representative and the former broker-dealer are required to notify the Administrator promptly.



5. Except in the circumstances noted in subsection (d), a sales representative may not act at the same time for more than one broker-dealer or issuer. As used in this subsection, "affiliated" means controlling, controlled by, or under common control with another. Subsection (e) imposes a duty on a sales representative and his or her former employer to notify the Administrator promptly upon termination of their association.

6. The purpose of subsection (f) is to authorize limited licenses in appropriate situations. Thus, a person may be licensed to engage in a narrow range of activities (*e.g.*, sale of real estate partnership interests) without having to satisfy all the conditions applicable to ordinary broker-dealers, sales representatives, or investment advisers. Any limited license is subject to such limitations and conditions as the Administrator reasonably may specify.

## **SECTION 209. POST-LICENSING REQUIREMENTS.**

(a) The [Administrator] by rule may require that:

(1) a licensed broker-dealer who is not registered under the Securities Exchange Act of 1934 maintain minimum net capital and a prescribed ratio between net capital and aggregate indebtedness, which may vary with type or class of broker-dealer; or

(2) a licensed investment adviser who is not registered under the Investment Advisers Act of 1940 maintain a minimum net worth.

(b) If a licensed broker-dealer or investment adviser knows, or has reasonable cause to know, that a requirement imposed on it under this subsection is not being met, the broker-dealer or investment adviser shall promptly notify the [Administrator] of its current financial condition.

(c) The [Administrator] by rule may require a fidelity bond from a broker-dealer who is not registered under the Securities Exchange Act of 1934.

(d) A licensed broker-dealer or investment adviser shall file with the [Administrator] the financial and other information the [Administrator] by rule or order requires, but:

(1) A licensed broker-dealer required to file financial reports under the Securities Exchange Act of 1934 may satisfy periodic financial report requirements of this subsection by

filing with the [Administrator] a copy of the financial reports filed under the Securities Exchange Act of 1934; and

(2) A licensed investment adviser required to file financial reports under the Investment Advisers Act of 1940 may satisfy periodic financial report requirements of this subsection by filing with the [Administrator] a copy of the financial reports filed under the Investment Advisers Act of 1940.

(e) A licensed broker-dealer, sales representative, or investment adviser shall maintain the records the [Administrator] by rule requires, but compliance with the recordkeeping requirements of the Securities Exchange Act of 1934 by a broker-dealer or the Investment Advisers Act of 1940 by an investment adviser satisfies the requirements of this subsection.

(f) Required records may be maintained in any form of data storage if they are readily accessible to the [Administrator]. Required records must be preserved for [five] years unless the [Administrator] by rule specifies a different period for a particular type or class of records.

(g) If the information contained in a document filed with the [Administrator] as part of the application for licensing or under this section, except information the [Administrator] by rule or order excludes, is or becomes inaccurate or incomplete in a material respect, the licensed person shall promptly file correcting information, unless notification of termination has been given under Section 208(e).

## **COMMENT**

Prior Provision: USA 202(d), (e); 203(a) through (e).

1. Financial and reporting requirements appear to be two particular areas in which it is important to encourage substantial uniformity and federal-state coordination. Indeed, this already is an area where a substantial federal-state coordination effort has been undertaken. Subsections (d) and (e) reflect these developments, providing that compliance with the applicable federal financial and reporting requirements ordinarily satisfies the state requirement

as well. On the other hand, a state may have reporting or other requirements, *e.g.*, relating to sales representatives, for which there is no federal counterpart. Those requirements are not affected by these provisions.

2. The 1956 Act's surety bond requirements have been replaced by a provision authorizing the Administrator to require fidelity bonds.

3. Subsection (d) continues to be modeled on Section 17(a) of the Securities Exchange Act of 1934.

4. Subsection (e) is based upon Section 203(c) of the 1956 Act and a comparable provision appears in most state statutes.

### **SECTION 210. LICENSING OF SUCCESSOR FIRMS.**

(a) A licensed broker-dealer or investment adviser may file an application for licensing of a successor, whether or not the successor is in existence, if the fee the [Administrator] prescribes for the application is submitted with the application.

(b) If a broker-dealer or investment adviser succeeds to and continues the business of a licensed broker-dealer or investment adviser and the successor files an application for licensing within 30 days after the succession, the license of the predecessor remains effective as the license of the successor for 60 days after the succession.

(c) Licensing of each licensed sales representative of the broker-dealer filing an application under subsection (a) or (b) continues without a separate filing or fee upon the licensing of the successor.

### **COMMENT**

Prior Provision: USA 202(c).

Subsection (a) is designed to avoid unnecessary interruptions of business by removing any question as to the propriety of a predecessor's filing an application for registration of a successor. Subsection (b) authorizes the emergency takeover of a troubled broker-dealer by deeming the license of that company to remain effective as the license of a successor, provided an application is filed by the successor within 30 days after the succession. The provision is

modeled after a comparable rule under the Securities Exchange Act of 1934. Subsection (c) eliminates the necessity for reapplying for sales representative licenses on behalf of employees continuing with the successor company.

#### **SECTION 211. POWER OF INSPECTION.**

(a) The [Administrator], without notice, may examine in a manner reasonable under the circumstances the records, within or without this State, of a licensed broker-dealer, sales representative, or investment adviser in order to determine compliance with this [Act]. Broker-dealers, sales representatives, and investment advisers shall make their records available to the [Administrator] in legible form.

(b) The [Administrator] may copy records or require a licensed person to copy records and provide the copies to the [Administrator] to the extent and in a manner reasonable under the circumstances.

(c) The [Administrator] may impose a reasonable fee for the expense of conducting an examination under this section.

#### **COMMENT**

Prior Provision: USA 203(d).

This provision is based upon Section 203(d) of the 1956 Act and Section 17(b) of the Securities Exchange Act of 1934. It vests in the Administrator a visitatorial power which is to be distinguished from the power to investigate and issue subpoenas under Section 601. Failure to submit to a reasonable inspection is a violation of the Act. See Section 602.

Section 702 includes provisions intended to prevent misuse by the Administrator or his or her employees of information obtained in the course of an inspection.

#### **SECTION 212. GROUNDS FOR DENIAL, SUSPENSION, OR REVOCATION.**

(a) The [Administrator] by order may (i) deny, suspend, or revoke a license, (ii) limit the securities activities that an applicant or licensed person may perform in this State, (iii) bar an

applicant or licensed person from association with a licensed broker-dealer or investment adviser, or (iv) bar from employment with a licensed broker-dealer or investment adviser a person who is a partner, officer, director, or a person occupying a similar status or performing a similar function for an applicant or licensed person. Subject to Section 213, those actions may be taken only if the [Administrator] finds that the order is in the public interest and that the applicant or licensed person or, in the case of a broker-dealer or investment adviser, a partner, officer, or director, a person occupying a similar status or performing similar functions, or a person directly or indirectly controlling the broker-dealer or investment adviser:

(1) has filed an application for licensing with the [Administrator] which, as of its effective date or any date after filing in the case of an order denying effectiveness, was incomplete in a material respect or contained a statement that was, in light of the circumstances under which it was made, false or misleading with respect to a material fact;

(2) has willfully violated or willfully failed to comply with this [Act], a predecessor act, or a rule or order under this [Act] or a predecessor act;

(3) is the subject of an adjudication or determination, after notice and opportunity for hearing, within the last five years by a securities agency or administrator of another state or a court of competent jurisdiction 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 Commodity Exchange Act, or the securities law of any other state but only if the acts constituting the violation of that state's law would constitute a violation of this [Act] had the acts occurred in this State;

(4) within the last ten years, has been convicted of an offense that the [Administrator] finds:

(i) involves the purchase or sale of a security, taking a false oath, making a false report, bribery, perjury, burglary, robbery, or attempt or conspiracy to commit any of those offenses;

(ii) arises out of the conduct of business as a broker-dealer, investment adviser, depository institution, insurance company, or fiduciary; or

(iii) involves the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities or an attempt or conspiracy to commit any of those offenses;

(5) is permanently or temporarily enjoined by a court of competent jurisdiction from acting as an investment adviser, underwriter, broker-dealer, or as an affiliated person or employee of an investment company, depository institution, or insurance company, or from engaging in or continuing conduct or practice in connection with any of the foregoing activities, or in connection with the purchase or sale of a security;

(6) is the subject of an order of the [Administrator] denying, suspending, or revoking the person's license as a broker-dealer, sales representative, or investment adviser;

(7) is the subject of any of the following orders that are currently effective and were issued within the last five years:

(i) an order by the securities agency or administrator of another state or Canadian province or territory, or by the Securities and Exchange Commission, entered after notice and opportunity for hearing, denying, suspending, or revoking the person's license as a broker-dealer, sales representative, or investment adviser, or the substantial equivalent of those terms;

(ii) a suspension or expulsion from membership in or association with a

member of a self-regulatory organization;

(iii) a United States Postal Service fraud order;

(iv) a cease and desist order entered after notice and opportunity for hearing by the [Administrator], the securities agency or administrator of another state, or a Canadian province or territory, the Securities and Exchange Commission, or the Commodity Futures Trading Commission; or

(v) an order by the Commodity Futures Trading Commission denying, suspending, or revoking registration under the Commodity Exchange Act;

(8) has engaged in unethical or dishonest practices in the securities business;

(9) is insolvent, either in the sense that liabilities exceed assets or in the sense that obligations cannot be met as they mature, but the [Administrator] may not enter an order against a broker-dealer or investment adviser under this subsection without a finding of insolvency as to the broker-dealer or investment adviser;

(10) is determined by the [Administrator] in compliance with Section 213 not to be qualified because of the lack of training, experience, and knowledge of the securities business;

(11) has failed reasonably to supervise a sales representative or employee; or

(12) has 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 subsection when the deficiency is corrected.

(b) The [Administrator] may not begin a proceeding on the basis of a fact or transaction known to the [Administrator] when the license became effective unless the proceeding is begun within the 90 days after issuance of the license.

(c) If the [Administrator] finds that an applicant or licensed person is no longer in

existence, has ceased to do business as a broker-dealer, sales representative, or investment adviser, is adjudicated mentally incompetent or subjected to the control of a committee, conservator, or guardian, or cannot be located after reasonable search, the [Administrator], by order, may deny the application or revoke the license.

### COMMENT

Prior Provision: USA 204(a).

1. If the requisite determination is made under Section 212(a), the Administrator may take one or more of the following actions:

- i. deny, revoke, or suspend the license in question;
- ii. limit the activities in which the licensed person can engage; or
- iii. bar the applicant or licensed person from association with a licensed broker-dealer or investment adviser.

These sanctions are intended to be available to the Administrator primarily as an adjunct to the licensing responsibilities under Part II. The Administrator is not precluded from seeking sanctions under Sections 602 or 603 against licensed persons in appropriate cases.

2. The reference in subparagraph (a) to the "public interest" is intended to emphasize that not every minor or technical infraction is meant to result in one of the above sanctions being imposed.

3. Paragraph (1): The completeness and accuracy of the application for licensing are to be tested as of its effective date in a suspension or revocation proceeding. The fact that an application has become misleading by virtue of developments after its effective date is not a ground for action under this paragraph; action in that instance would have to be predicated under paragraph (2) upon violation of Section 209(e).

On the other hand, in a proceeding to deny effectiveness to a pending license application, the completeness and accuracy of the application cannot be tested as of the effective date; it is judged "as of any date after filing."

4. Paragraphs (2) and (3): As the federal courts and the Securities and Exchange Commission have construed the term "willfully" in Section 15(b) of the Securities Exchange Act of 1934, all that is required is proof that the person acted intentionally in the sense that the person was aware of what he or she was doing.

Paragraph (3) is new and affords the Administrator an additional basis for denial,



revocation, suspension, or other specified actions. In order to constitute such a ground, there must have been an adjudication, after notice and opportunity for hearing, that the person violated the other securities law specified.

5. Paragraphs (4) and (5): These provisions are similar to Section 15 of the Securities Exchange Act of 1934. "Affiliated" person for purpose of paragraph (5) has the meaning attributed to that term by the self-regulatory organizations authorized by the 1934 Act.

6. Paragraphs (5), (6), and (7): The present tense of the word "is" means that an injunction or order which has expired or been vacated is no longer a ground for action under the appropriate paragraph.

7. Paragraph (8): This carries over the language of the former clause (G), itself the subject of considerable controversy. See, *e.g.*, the discussion in Loss and Cowett, *Blue Sky Law* at p. 276. It should be noted that the National Association of Securities Dealers, Inc. and other self-regulatory organizations have evolved some ethical standards based upon their authority under Section 15A of the Securities Exchange Act of 1934. It is the Committee's belief that the customs and practices in the securities industry at any particular time are important factors to be considered in determining whether a particular act or practice is unethical.

8. Paragraph (9): A broker-dealer's or investment adviser's insolvency may be used against that licensed person, but an order may not be entered against a broker-dealer or investment adviser on the basis of the insolvency of a partner, officer, director, or controlling person.

9. Paragraph (11): This paragraph continues the view held by regulatory agencies that licensed persons must be held responsible for violations resulting from inadequate supervision of subordinates.

10. Subsection (b) simply means that when an Administrator knowingly waives an old criminal conviction or other adverse determination and permits an applicant to become licensed, neither the Administrator nor his or her successor may continue to hold that over the licensed person's head as long as the latter is licensed.

However, if the Administrator is still investigating an applicant when the application would automatically become effective under Section 205, the last clause of subsection (b) gives the Administrator an additional period of time to determine whether or not to institute a proceeding against the applicant.

### **SECTION 213. DENIAL, SUSPENSION, OR REVOCATION ON GROUNDS OF LACK OF QUALIFICATION.**

The [Administrator's] determination that an applicant or licensed person lacks qualification

under Section 212 is limited by the following provisions:

(1) The [Administrator] may not enter an order against a broker-dealer because of the lack of qualification of (i) a person other than the broker-dealer if the broker-dealer is an individual or (ii) a sales representative of the broker-dealer.

(2) The [Administrator] may not enter an order against an investment adviser because of the lack of qualification of (i) a person other than the investment adviser if the investment adviser is an individual or (ii) any other person who represents the investment adviser in doing an act that makes the person an investment adviser.

(3) The [Administrator] may not enter an order solely because of lack of experience of the applicant or licensed person if the applicant or licensed person is qualified by training or knowledge, or both.

(4) The [Administrator] shall consider that a sales representative who will work under the supervision of a licensed broker-dealer need not have the same qualifications as a broker-dealer.

(5) The [Administrator] shall consider that an investment adviser is not necessarily qualified solely because of experience as a broker-dealer or sales representative.

### **COMMENT**

Prior Provision: USA 204(b).

1. This section operates as a limitation upon the Administrator's power to deny, revoke, or suspend under Section 212(a)(10).

2. Paragraphs (1) and (2) do not permit the Administrator to find a broker-dealer or investment adviser unqualified simply because some persons, *e.g.*, limited partner investors, other than the principals of the business (who must be qualified), are not.

3. Paragraph (3) makes it clear that adequate training or knowledge may be substituted for experience. Often the qualification for the securities business is satisfied by experience,

either as a broker-dealer in another state or as an agent for a broker-dealer locally or elsewhere.

#### **SECTION 214. WITHDRAWAL.**

(a) An application for a license may be withdrawn by the applicant without prejudice before the license becomes effective.

(b) Withdrawal from licensing as a broker-dealer, sales representative, or investment adviser becomes effective 30 days after receipt by the [Administrator] of an application to withdraw or within any shorter period the [Administrator], by order, determines, unless:

(1) a revocation or suspension proceeding is pending when the application is filed;

(2) a proceeding to revoke or suspend or to impose conditions upon the withdrawal is instituted within 30 days after the application is filed; or

(3) additional information is requested by the [Administrator] regarding the withdrawal application.

(c) If a proceeding is pending or instituted under subsection (b), withdrawal becomes effective at the time and upon the conditions the [Administrator] by order determines. If additional information is requested, withdrawal is effective 30 days after the additional information is filed. Although no proceeding is pending or instituted and withdrawal becomes effective, the [Administrator] may institute a proceeding under Section 212 within one year after withdrawal became effective and enter an order as of the last date on which licensing was effective.

#### **COMMENT**

Prior Provision: USA 204(e).

1. Subsection (a) allows an application for licensing to be withdrawn at any time before effectiveness without prejudice.

2. Subsection (b) is modeled after Section 15(b)(5) of the Securities Exchange Act of 1934, although it goes further in allowing the Administrator to request additional information. The provision is designed to make it possible for an Administrator to prevent the withdrawal of an effective license when there are some significant questions outstanding concerning the licensed person.

Ordinarily a licensed person would file either the BD-W or ADV-W or equivalent forms and would be permitted to withdraw without question. This section gives the Administrator authority to obtain sufficient assurances that customer obligations will be satisfied and any other necessary action taken by the withdrawing licensed party.

### **SECTION 215. CUSTODY OF CLIENT'S SECURITIES AND FUNDS.**

(a) Unless prohibited by rule or order of the [Administrator], an investment adviser registered under the Investment Advisers Act of 1940 may take or retain custody of securities or funds of a client.

(b) To the extent permitted by rule or order of the [Administrator], an investment adviser exempt from registration under the Investment Advisers Act of 1940, but licensed as an investment adviser under this [Act], may take or retain custody of securities or funds of a client.

### **COMMENT**

Prior Provision: USA 102(c).

This modifies the 1956 Act provisions. Under subsection (a), an investment adviser registered under the Investment Advisers Act of 1940 may have custody of customer securities or funds unless the Administrator adopts a rule or order prohibiting the custody. On the other hand, under subsection (b) an investment adviser not federally registered may have custody only if and to the extent permitted by rule or order of the Administrator.

Investment advisers registered under the 1940 Act who have custody of customer funds or securities are subject to certain additional requirements. Subsection (b) affords the Administrator the authority to prescribe comparable or other safeguards for nonfederally registered investment advisers.

PART III  
**REGISTRATION OF SECURITIES**

**COMMENT**

This Part contains three procedures by which securities can be registered: by "filing" (Section 302), by "coordination" (Section 303), and by "qualification" (Section 304). The "notification" procedure which was included in the 1956 Act has been used little in recent years and therefore has been eliminated. Section 305 contains various provisions which are applicable to all or most registration procedures.

**SECTION 301. REGISTRATION REQUIREMENT.**

A person may not offer to sell or sell a security in this State unless it is registered under this [Act] or the security or transaction is exempt under this [Act].

**COMMENT**

Prior Provision: USA 301.

Section 301 forbids sales prior to the effectiveness of a registration statement. The term "sale" is defined in Section 101(13).

The Securities Act of 1933 permits certain types of offers during the "waiting period" between the filing and the effectiveness of a registration statement. The exemptive provisions of Sections 402(15) and (16) operate to permit similar offers for securities which are in the process of registration under federal or state statutes or both.

The scope of the phrase "in this State" in Section 301 is determined by Section 801.

**SECTION 302. REGISTRATION BY FILING.**

(a) Securities for which a registration statement has been filed under the Securities Act of 1933 in connection with the offering of the securities may be registered by filing, whether or

not they are also eligible for registration under Section 303 or 304, if:

(1) the issuer is organized under the laws of the United States or a state or, if the issuer is not organized under the laws of the United States or a state, it has appointed a duly authorized agent in the United States for service of process;

(2) the issuer has actively engaged in business operations in the United States for a period of at least 36 consecutive calendar months immediately before the filing of the federal registration statement;

(3) the issuer has registered a class of equity securities under Section 12(b) or 12(g) of the Securities Exchange Act of 1934, which class of securities is held of record by 500 or more persons;

(4) the issuer has:

(i) either a total net worth of \$4,000,000 or a total net worth of \$2,000,000 and net pretax income from operations before allowances for extraordinary items, for at least two of the three preceding fiscal years;

(ii) not less than 400,000 units of the class of security registered under Section 12 of the Securities Exchange Act of 1934 held by the public, excluding securities held by officers and directors of the issuer, underwriters and persons beneficially owning ten percent or more of that class of security; and

(iii) no outstanding warrants and options held by the underwriters and executive officers and directors of the issuer in an amount exceeding ten percent of the total number of shares to be outstanding after completion of the offering of the securities being registered;

(5) the issuer has been subject to the requirements of Section 12 of the Securities

Exchange Act of 1934 and has filed all the material required to be filed under Sections 13 and 14 of that act for at least 36 consecutive calendar months immediately before the filing of the federal registration statement and the issuer has filed in a timely manner all reports required to be filed during the 12 calendar months next preceding the filing of the federal registration statement;

(6) for at least 30 days during the three months next preceding the offering of the securities registered there have been at least four market makers for the class of equity securities registered under Section 12 of the Securities Exchange Act of 1934;

(7) each of the underwriters participating in the offering of the security and each broker-dealer who will offer the security in this State is a member of or is subject to the rules of fair practice of a national association of securities dealers with respect to the offering and the underwriters have contracted to purchase the securities offered in a principal capacity;

(8) the aggregate commissions or discounts to be received by the underwriters will not exceed ten percent of the aggregate price at which the securities being registered are offered to the public;

(9) neither the issuer nor any of its subsidiaries, since the end of the fiscal year next preceding the filing of the registration statement, have (i) failed to pay a dividend or sinking fund installment on preferred stock, (ii) defaulted on indebtedness for borrowed money, or (iii) defaulted on the rental on one or more long-term leases, which defaults in the aggregate are material to the financial position of the issuer and its subsidiaries, taken as a whole; and

(10) in the case of an equity security, the price at which the security will be offered to the public is not less than five dollars a share.

(b) A registration statement under this section must contain the following information

and be accompanied by the following documents in addition to the information specified in Section 305(c) and the consent to service of process required by Section 708:

- (1) a statement demonstrating eligibility for registration by filing;
- (2) the name, address, and form of organization of the issuer;
- (3) with respect to a person on whose behalf a part of the offering is to be made in a nonissuer distribution: 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; and a statement of the reasons for making the offering;
- (4) a description of the security being registered; and
- (5) a copy of the latest prospectus filed with the registration statement under and satisfying the requirements of Section 10 of the Securities Act of 1933.

(c) If the information and documents required to be filed by subsection (b) have been on file with the [Administrator] for at least [five] business days or any shorter period the [Administrator] by rule or order allows and the applicable registration fee has been paid before the effectiveness of the federal registration statement, a registration statement under this section automatically becomes effective concurrently with the effectiveness of the federal registration statement. If the federal registration statement becomes effective before the conditions in this subsection are satisfied and they are not waived, the registration statement becomes effective when the conditions are satisfied. The registrant shall promptly notify the [Administrator] by telephone or telegram of the date and time when the federal registration statement became effective and the content of the price amendment, if any, and shall file promptly a post effective amendment containing the information and documents in the price amendment. The [Administrator] shall promptly acknowledge receipt of notification and effectiveness of the



registration statement as of the date and time the registration statement became effective with the Securities and Exchange Commission.

## COMMENT

Prior Provision: None.

1. This section provides a new procedure for registration by filing in place of the former notification procedure. The intent is to provide a "super coordination" procedure for certain issuers who satisfy specified criteria that demonstrate that those issuers are seasoned companies as to which there already is substantial marketplace information and activity.

2. This procedure for registration allows an eligible issuer to file with various states and become effective concurrent with SEC effectiveness. Unlike a registration by coordination, however, such registration would not be subject to a stop order based upon either Section 306(a)(2)(v) or (vi) - the so-called merit standards. The offering nevertheless is subject to the issuance of a stop order based on inadequate disclosure or any of the other grounds set forth in Section 306(a)(2).

3. The criteria have been drawn from a variety of sources, including the S-2/S-3 registration statement eligibility requirements and several additional requirements urged by representatives of the securities industry and state securities regulators.

In addition to the issuer having securities registered under Section 12 of the 1934 Act and having been engaged in active business operations for at least three years (which should eliminate any attempted use of the procedure by shell companies), subsection (a) also mandates certain minimum net worth, "public float," and breadth of market requirements. See paragraphs (2) through (6) of the subsection.

4. Among the offering conditions to be satisfied is a requirement that all participating underwriters either be a member of, or agree to be bound by the Rules of Fair Practice of, a self-regulatory organization such as the NASD. The obligation of the underwriters must be what historically has been referred to as a "firm commitment" underwriting, rather than simply an agency or best-efforts arrangement. See subsection (a)(7).

5. A further offering condition to be satisfied is a requirement that the aggregate commissions or discounts to the underwriters not exceed 10% of the public offering price (subsection (a)(8)). The Committee's intent here is to limit the direct compensation received for the underwriting and selling effort and avoid the uncertainties raised by trying to include other and more indirect benefits or rights received by such parties (such as a right of first refusal or warrants with an exercise price greater than the public offering price). An alternative formulation would be to specify that the person(s) on whose behalf the securities are offered must receive proceeds equal to 90% or more of the aggregate public offering price.

### **SECTION 303. REGISTRATION BY COORDINATION.**

(a) Securities for which a registration statement has been filed under the Securities Act of 1933 in connection with the offering of the securities may be registered by coordination.

(b) A registration statement under this section must contain the following information and be accompanied by the following documents in addition to the information specified in Section 305(c) and the consent to service of process required by Section 708:

(1) two copies 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 an 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, subject to paragraph (2) of Section 703(b), any other information, or copies of any other document, filed under the Securities Act of 1933; and

(4) an undertaking to forward promptly, and not later than the first business day after the day they are forwarded to or filed with the Securities and Exchange Commission, all future amendments to the federal prospectus, other than an amendment that delays the effective date of the registration statement.

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

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

(2) the registration statement has been on file with the [Administrator] for at least

ten days, but if the registration statement is not filed with the [Administrator] within ten days after the initial filing under the Securities Act of 1933, the registration statement has been on file with the [Administrator] for 30 days or any shorter period the [Administrator], by rule or order, specifies; and

(3) a statement of the maximum and minimum proposed offering prices and the maximum underwriting discounts and commissions has been on file for two full business days or any shorter period the [Administrator], by rule or order, specifies and the offering is made within those limitations.

(d) The registrant shall promptly notify the [Administrator] by telephone or telegram of the date and time when the federal registration statement became effective and the content of the price amendment, if any, and shall promptly file a post-effective amendment containing the information and documents in the price amendment.

(e) Upon failure to receive the required notification or post-effective amendment with respect to the price amendment, the [Administrator], without notice or hearing, may enter a stop order retroactively denying effectiveness to the registration statement or suspending its effectiveness until the registrant complies with subsection (d). The [Administrator] shall promptly notify the registrant by telephone or telegram, and promptly confirm by letter or telegram if the [Administrator] notifies by telephone, of the issuance of the order. If the registrant proves compliance with the requirements of subsection (d) as to notice and post-effective amendment, the stop order is void as of its entry.

(f) The [Administrator] by rule or order may waive either or both of the conditions specified in subsection (c)(2) and (3).

(g) If the federal registration statement becomes effective before all of the conditions in

subsection (c) are satisfied and they are not waived, the registration statement becomes effective when all the conditions are satisfied. If the registrant advises the [Administrator] of the date when the federal registration statement is expected to become effective, the [Administrator] shall promptly advise the registrant by telephone or telegram, at the registrant's expense, whether all the conditions are satisfied and whether the [Administrator] then contemplates commencing a proceeding under Section 306; but the advice by the [Administrator] does not preclude the institution of a proceeding for a stop order suspending the effectiveness of the registration statement. A stop order issued under this subsection is not retroactive.

(h) 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 for further coordination of state and federal registration.

### **COMMENT**

Prior Provision: USA 303.

1. The pattern of dual federal-state regulation of securities is accepted as one of the major premises of this Act as it was under the 1956 Act. However, the legitimate interests of persons offering securities on an interstate basis require that there be some coordination between the federal and state registration statutes without making either subservient to the other. Section 303 is a procedure for coordinating the state registrations with the registration being effected under the Securities Act of 1933.

The vast majority of registrations for which a registration statement has been filed under the Securities Act of 1933 are likely to be effected under this section rather than Section 302. While this section is intended to facilitate state registration by coordination with the federal processing, all the stop order standards set forth in Section 306(a)(2) are applicable.

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. In most instances, they would be. However, counsel should note that if the state filing is not made within

ten days of the initial filing under the Securities Act of 1933, subsection (c)(2) lengthens the time period before which the state registration will become effective.

2. Subsection (b) limits the Administrator to requiring only such information as is filed with the SEC.

3. Subsections (c) through (g) describe the conditions to be satisfied to achieve effectiveness of a coordination filing. For a detailed discussion of this process, see Loss & Cowett's discussion in their book *Blue Sky Law* at pp. 294-299. The reference to notification by telephone or telegram is intended to include the various contemporary means of written electronic notification.

As noted above, the Administrator retains the right to test the registration statement by the substantive standards of Section 306(a)(2) and may issue a stop or denial order if the Administrator believes any of those provisions are applicable.

4. Subsection (h) has been added to afford the Administrator a basis for modifying any of the requirements of this section if it is appropriate to do so. An example would be the expedited review and processing procedures a number of states have adopted with respect to "shelf registrations" under Rule 415 under the Securities Act of 1933. Alternatively, filing of registration statements through a central electronic dissemination and retrieval system such as Project Edgar could be authorized under this subsection.

In waiving or modifying requirements, the Administrator must make a finding satisfying the general standard set forth in Section 705(c).

#### **SECTION 304. REGISTRATION BY QUALIFICATION.**

(a) A security may be registered by qualification.

(b) A registration statement under this section must contain the following information and be accompanied by the following documents in addition to the information specified in Section 305(c) and the consent to service of process required by Section 708:

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

(3) with respect to persons covered by paragraph (2): the compensation paid or given, directly or indirectly, during the last 12 months and estimated to be paid during the next 12 months, 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, ten percent or more of the outstanding shares of a class of equity security of the issuer: the information specified in paragraph (2) other than occupation;

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

(6) with respect to a person on whose behalf a part of the offering is to be made in a nonissuer distribution: 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 a significant subsidiary, effected within the last 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 a 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 a subsidiary has issued its securities within the last 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 therefrom 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 other 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 every underwriter and every recipient of a finder's fee; a copy of any underwriting or selling-group agreement pursuant to which the distribution is to be made, or the proposed form of the agreement whose terms have not yet been determined; and a description of the plan of distribution of securities that are to be offered other 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 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 funds to be raised from other sources to achieve the purposes stated; the sources of the funds; and, if part of the proceeds is to be used to acquire property, including goodwill, other than in the ordinary course of business, the names and addresses of the vendors, the purchase price, the names of the persons who have received commissions in connection with the acquisition, and the amounts of commissions and any other expense in connection with the acquisition, including the cost of borrowing money to finance the acquisition;

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

(11) the dates of, parties to, and general effect concisely stated of, every management or other material contract made or to be made other than in the ordinary course of business, if it is to be performed in whole or in part at or after the filing of the registration statement or was made within the last two years; and a copy of the contract;

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

(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;

(14) a specimen, copy, or description of the security being registered; a copy of the issuer's articles of incorporation and by-laws, or their substantial equivalents, as 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 as to the legality of the security being registered, with an English translation if it is in a foreign language, which states whether the security when sold will be legally issued, fully paid, and nonassessable, and, if a debt security, a binding obligation of the issuer;

(16) the written consent of an 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 document or statement, which is used in connection with the registration statement;

(17) a statement of financial condition of the issuer as of a date within four months preceding the filing of the registration statement; a statement of results of operations and analysis of surplus for each of the three fiscal years preceding the date of the statement of financial condition and for any period between the close of the last fiscal year and the date of the statement of financial condition, or for the period of the issuer's and any predecessors' existence if less than three years; and, if part of the proceeds of the offering is to be applied to the purchase of a business, the same financial statements that would be required if the business were the registrant; and

(18) any additional information the [Administrator] by rule or order specifies.

(c) A registration statement under this section becomes effective 30 calendar days, or any shorter period 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 ordered under subsection (d) that effectiveness be delayed; and

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

(d) 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 delay effectiveness for a single period of not more than 30 days if the [Administrator] determines that the delay is necessary, whether or not the [Administrator] previously delayed effectiveness under this subsection.

### COMMENT

Prior Provision: USA 304.

1. Any security may be registered by qualification, whether or not one or both of the other two procedures were available. Ordinarily, however, an issuer is likely to use the qualification procedure only if it is not eligible to use the filing or coordination procedures, *e.g.*, the local or small offering that is not required to be registered under the Securities Act of 1933 but which is not exempt under this Act.

2. Subsection (b) originally was modeled on the basic S-1 registration form under the Securities Act of 1933. This section retains the substantial specificity of the 1956 Act provision without significant change.

Section 705(e) grants the Administrator authority to specify the form and content of financial statements, including whether or not they must be certified.

3. Under the 1956 Act, there was no time limit within which an Administrator had to act on an application for registration by qualification. Subsection (c) now requires automatic effectiveness 30 days after the last filing, but with adequate provisions for delay of effectiveness at either the Administrator's or the applicant's request.

4. Section 305 contains a number of provisions which are applicable to each of the registration procedures, including registration under this section.

### SECTION 305. PROVISIONS APPLICABLE TO REGISTRATION GENERALLY.

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

(b) Except as provided in subsection (c), a person filing a registration statement shall pay a fee of [1/20 of one] percent of the maximum aggregate offering price at which the registered securities are to be offered in this State, but not less than [\$50] or more than [\$500]. If a registration statement is withdrawn before the effective date or a pre-effective stop order is entered under Section 306, the [Administrator] shall retain [\$50] of the fee.

(c) An open-end management company, a face-amount certificate company, or a unit investment trust, as defined in the Investment Company Act of 1940, may register an indefinite amount of securities under a registration statement. The registrant, at the time of filing, shall pay a fee of [\$100] and within 60 days after the registrant's fiscal year during which its registration statement is effective, pay a fee of [\$500] or file a report on a form the [Administrator] by rule adopts, specifying its sale of securities to persons in this State during the fiscal year and pay a fee of [1/20 of one] percent of the aggregate sales price of the securities sold to persons in this State, but the latter fee must not be less than [\$50] or more than [\$500].

(d) Except as permitted by subsection (c), a registration statement must specify the amount of securities to be offered in this State and the states in which a registration statement or similar document in connection with the offering has been or is to be filed and any adverse order, judgment, or decree entered by a court, the securities agency or administrator in any state, or the Securities and Exchange Commission in connection with the offering.

(e) A document 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 if the document is currently accurate.

(f) The [Administrator] by rule or order may permit the omission of an item of information or document from a registration statement.

(g) In the case of a nonissuer offering, the [Administrator] may not require information under subsection (n) or Section 304 unless it is known to the person filing the registration statement or to the person on whose behalf the offering is to be made, or can be furnished by the person without unreasonable effort or expense.

(h) In the case of a registration under Section 303 or 304 by an issuer that has no public market for its shares or no significant earnings from continuing operations during the last five years or any shorter period of its existence, the [Administrator] by rule or order may require as a condition of registration that the following securities be deposited in escrow for not more than [three] years:

(i) a security issued to a promoter within the three years next preceding the offering or to be issued to a promoter for a consideration substantially less than the offering price; and

(ii) a security issued to a promoter for a consideration other than cash, unless the registrant demonstrates that the value of the noncash consideration received in exchange for the security is substantially equal to the offering price for the security.

(i) The [Administrator] by rule or order may determine the conditions of an escrow required under subsection (h), but the [Administrator] may not reject a depositary solely because of its location in another state.

(j) The [Administrator] by rule or order may require as a condition of registration under Section 303 or 304 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. The [Administrator] by rule or order may determine the conditions of an impoundment required under this subsection, but the [Administrator] may not reject a depositary solely because of its location in another state.

(k) If a security is registered under Section 302 or 303, the prospectus filed under the Securities Act of 1933 must be delivered to each purchaser in accordance with the prospectus delivery requirements of the Securities Act of 1933.

(l) If a security is registered under Section 304, an offering document containing information the [Administrator] by rule or order designates must be delivered to each purchaser with or before the earliest of:

(1) the first written offer made to the purchaser 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 it as a participant in the distribution;

(2) confirmation of a sale made by or for the account of a person named in paragraph (1);

(3) payment pursuant to a sale; or

(4) delivery pursuant to a sale.

(m) A registration statement remains effective for one year after its effective date unless the [Administrator] by rule or order extends the period of effectiveness. All outstanding securities of the same class as a registered security are considered to be registered for the purpose of a nonissuer transaction while the registration statement is effective, unless the [Administrator] by rule or order provides otherwise. A registration statement may not be withdrawn after its effective date if any of the securities registered have been sold in this State, unless the [Administrator], by rule or order, provides otherwise. A registration statement is not effective while a stop order is in effect under Section 306(a).

(n) During the period in which an offering is being made pursuant to an effective

registration statement, 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.

(o) A registration statement filed under Section 302 or 303 may be amended after its effective date to increase the securities specified being offered and sold. The amendment becomes effective upon filing of the amendment and payment of an additional filing fee, calculated in the manner specified in subsection (b) or (c), with respect to the additional securities to be offered and sold. The effectiveness of the amendment relates back to the date of sale of the additional securities being registered.

(p) A registration statement filed under Section 304 may be amended after its effective date to increase the securities specified to be offered and sold, if the public offering price and underwriters' discounts and commissions are not changed from the respective amounts of which the [Administrator] was informed. The amendment becomes effective when the [Administrator] so orders and relates back to the date of sale of the additional securities being registered. A person filing an amendment shall pay an additional filing fee [two] times the initial registration fee, calculated in the manner specified in subsection (b) or (c), with respect to the additional securities to be offered and sold.

#### **COMMENT**

Prior Provision: USA 305; New.

1. The majority of the provisions in this section apply to all three types of registration: filing, coordination, and qualification; a few apply only to the filing and coordination registrations where there is also a federal registration statement and a few apply only to registration by qualification.

2. Subsection (a) [Prior Provision: USA 305(a)] recognizes that in all cases the filing may be made by either the issuer or a broker-dealer licensed under this Act. The reference to "any other person on whose behalf the offering is made" is designed for nonissuer distributions. See the COMMENT under subsection (m) relating to nonissuer distributions.

3. Subsection (b) [Prior Provision: USA 305(b)]. The registration fee is based on the dollar amount of securities being offered in the state, subject to designated minimum and maximum amounts.

In the case of warrants or rights the registration fee should be based on the total offering price of the security called for by the warrants or rights, together with the offering price of the warrants or rights, if any. In the case of convertible securities, the fee ordinarily should be based solely on the offering price of the convertible security, since the only consideration usually given for the second security is the surrender for conversion of the convertible security.

4. Subsection (c) is new. It adopts the practice followed at the federal level of registering initially an indefinite amount of securities by an open-end management company, face amount certificate company, or unit investment trust. At that time, the registrant pays a designated flat fee. Subsequently the registrant pays an additional fee which is either the maximum or, if less, the fee determined on the basis of the amount of securities sold within the state during the year. The additional fee must be paid within 60 days after the end of the fiscal year of the issuer during which the registration statement becomes effective.

5. Subsection (d) [Prior Provision: USA 305(c)]. Each registration statement filed must specify the amount of securities to be offered in this State. The sole exception is a filing subject to subsection (c) above which allows the registration of an indefinite amount of securities in certain circumstances. In addition, each registration statement filed under this Act must disclose the other states in which a registration statement or similar document has or will be filed in connection with the offering. Disclosure of any adverse order, judgment, or decree must be made; however, no notice is required with respect to any order permitting the withdrawal of a registration statement.

6. Subsection (e) [Prior Provision: USA 305(d)]. Incorporation by reference is permitted as a matter of administrative practice. If a document is currently accurate, no time limitation is necessary. The bracketed language relates to those states which do not keep files and records indefinitely. If a state keeps files and records for other than five years, an appropriate substitution should be made.

7. Subsection (f) is substantially the equivalent of Section 305(e) of the 1956 Act.

8. Subsection (g) [Prior Provision: USA 305(f)] is designed to take care of the situation where the seller is a person other than the issuer and cannot obtain certified financial statements and other data normally required. 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 merely incidental to supplying 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.

This subsection specifically applies only to Section 304 (registration by qualification) and Section 305(n).

9. Subsection (h) [Prior Provision: USA 305(g)] specifically relates to an issuer who has no public market for its shares or which has no significant earnings from continuing operations during the last five years (or its period of existence, if shorter). The provision is not applicable to registration by filing (Section 302). Its greatest utility obviously will be with respect to promotional or speculative offerings.

The subsection allows the Administrator to require the securities to be deposited in escrow for up to three years if a promoter has received a security from the issuer for either a cash amount substantially less than the offering price or noncash consideration the value of which does not equal the proposed offering price of the security to the public. See Section 101(12) for the definition of "promoter." A three year escrow period is suggested; a shorter or longer time may be chosen by a state enacting this Act.

10. Subsection (i) [Prior Provision: USA 305(g)]. An escrow deposit may not be rejected solely because the escrow depository is in another state.

11. Subsection (j) [Prior Provision: USA 305(g)]. The Administrator may require proceeds to be impounded in certain promotional or speculative offerings until the issuer receives a specified amount (established by the Administrator) from sales of the security.

12. Subsection (k) [Prior Provision: None]. In a registration by filing (Section 302) or by coordination (Section 303), the then current prospectus delivery requirements under the Securities Act of 1933 must be met for each purchaser in this State. This is a change from prior law.

13. Subsection (l) [Prior Provision: None]. With respect to registration by qualification (Section 304), the Administrator shall specify the contents of the offering documents which shall be delivered to each purchaser on or before the earliest of the four dates enumerated in this subsection. In most instances the document - a prospectus or offering circular - presumably will include information comparable to that which would be included were a prospectus delivered under the Securities Act of 1933. In special circumstances the Administrator might determine that no written offering document need be delivered.

14. Subsection (m) [Prior Provision: USA 305(i)]. Section 301 applies broadly to any offer to sell or sale of a security by any person. The term "nonissuer transaction" is defined in Section 101(9) to mean any transaction "not directly or indirectly for the benefit of the issuer." Under federal securities law, that would exclude transactions by persons in a control relationship with the issuer. Section 402(1) exempts from registration "an isolated transaction, whether or not effected through a broker-dealer." When the nonissuer distribution is more than an "isolated transaction," an exemption nevertheless may be available under one of several other sections,



*e.g.*, 401(b)(7), 401(b)(8), 401(b)(9), 402(2), 402(3), 402(4), 402(5), 402(8), 402(9), or 402(10), among others.

If no exemption is available for the nonissuer distribution, the security must be registered under Part III. Under the first sentence of subsection (m), every registration statement is effective for at least one year and for any longer period as the Administrator may determine. However, no registration statement is effective while a stop order with respect to it is in effect under Section 306.

All outstanding securities "of the same class" as a registered security are considered to be registered for the purpose of any nonissuer transaction so long as the registration statement remains effective. Subsection (n) gives the Administrator power by rule or order to require the registrant to file reports or other information so long as the registration statement remains effective. The result is that during the effective period of a registration statement under this Act all securities of the same class legally can be traded by anyone as if they were registered.

Subsection (m) also provides that, unless the Administrator determines otherwise, a registration statement cannot be withdrawn at any time after its effective date if any of the securities registered have been sold in this State. This is designed to protect sellers who would be unaware of such a withdrawal from otherwise being subjected to civil liability.

15. Subsection (n) [Prior Provision: USA 305(j)] gives the Administrator the power to require periodic reports during the time a registration statement remains effective. Pursuant to Section 305(g), a person may use the reports called for in this subsection to satisfy certain information requirements under Section 304.

16. Subsection (o) [Prior Provision: USA 305(k)] allows the issuer in the case of a registration by filing or coordination to adjust for the situation where more shares are sold than were initially registered in the state, a not uncommon event with nationally syndicated offerings. The issuer may file an amendment increasing the number of shares registered in this State and paying the appropriate additional fee.

The 1956 Act provision covers only securities of certain investment companies. As drafted, this subsection now covers all securities filed under these two procedures.

17. Subsection (p) [Prior Provision: None]. In the case of a registration by qualification, the issuer may amend the registration statement to reflect the fact that more shares were sold in this State than initially registered, but only if the public offering price and underwriters' discounts and commissions remain unchanged and if a fee of twice the fee payable under Section 305(b) is paid.

## **SECTION 306. DENIAL, SUSPENSION, AND REVOCATION OF 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 as of the proposed effective date in the case of an order denying effectiveness, an amendment under Section 305(o) or (p) as of its effective date, or a report under Section 305(n) 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, order, 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, a person occupying a similar status or performing a similar function, 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 institute 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) the offering has worked or tended to work a fraud upon purchasers or would so operate;

[alternative subparagraph (5): the offering is being made on terms that are unfair, unjust, or inequitable;]

(6) 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;

(7) a security sought to be registered under Section 302 is not eligible for registration under Section 302;

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

(9) the applicant or registrant has failed to pay the proper filing fee; but the [Administrator] may enter only a denial order under this paragraph and shall vacate the order if the deficiency is corrected.

(b) The [Administrator] may not institute a stop-order proceeding:

(1) 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; or

(2) with respect to a registration statement filed under Section 302, on the basis of paragraph (5) or (6) of subsection (a).

(c) The [Administrator] by order under Section 712 may summarily 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 and of the reasons for the postponement or suspension and that within 15 days after the receipt of a written request from the person the matter will be set down for hearing. If no hearing is 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 subsection (a) or (b) without (i) appropriate notice to the applicant or registrant, the issuer, and the person on whose behalf the securities are to be or have been offered, (ii) opportunity for hearing, and (iii) written findings of fact and conclusions of law [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 prompted entry have changed or that it is otherwise in the public interest.

## **COMMENT**

Prior Provision: USA 306.

1. With two important exceptions, Section 306 applies to all three types of registration under this Part. It parallels Section 212 in that the Administrator, in order to issue a stop order, must find that it is in the public interest and that one or more of the enumerated paragraphs is applicable.

The two exceptions are the merit standards found in subparagraphs (5) and (6) of Section 306(a) which are not applicable to registrations by filing under Section 302. Although an Administrator may not claim these grounds for issuance of a stop order in such a registration, a stop order still can be issued under subparagraph (i) if the registration statement is misleading or contains incomplete disclosures or any other paragraph of Section 306(a) is applicable.

Subparagraph (1): In a suspension or revocation proceeding, the completeness and accuracy of a registration statement are tested as of its effective date. Post-effective amendments

are necessary only to correct inaccuracies as of the effective date. If under Section 305(n) an Administrator requires periodic reports to keep an effective registration statement accurate, filing a misleading report would be a basis for a stop order under paragraph (1) and the failure to file the report would be a basis for a stop order under paragraph (2). In a proceeding to deny effectiveness, on the other hand, the completeness and accuracy can only be judged against what has been filed.

Subparagraph (2): "Willful" has been construed to mean intentionally committing the act which constitutes the violation. A violation by the issuer has the same consequences whether the issuer has filed the 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.

Subparagraph (3): The Administrator may act on the basis of an injunction or stop order entered in another state if the grounds for the injunction or stop order would also serve as a basis for a stop order in this State. However, a stop order or injunction which by its terms has expired is not a ground for action under this subparagraph.

Subparagraph (4): This provision applies to activity, such as gambling, which is conducted in a state where that activity is illegal. It does not apply if the activity is not illegal under state law. In addition, this subparagraph is not meant to apply to an activity which is lawful where conducted, although it would be illegal if conducted in the state where the registration statement is filed.

Subparagraph (5): The unbracketed version of this subparagraph is the language as the subparagraph appears in the 1956 Act and in a majority of the states which have adopted the 1956 Act.

The language of subparagraph (5) in the unbracketed version is meant to emphasize conduct which appears to be fraudulent in the general sense of Section 501. This subparagraph, of course, must be considered as one of several grounds by which an Administrator may challenge an offering. A stop order also may be issued under subparagraph (1) when there is less than full disclosure, under subparagraph (2) when there has been a willful violation of the Act, and under subparagraph (6) if the Administrator determines that unreasonable amounts of expenses, commissions, or promoters' participations are involved. The Committee believes that the experience of those states which have had these provisions in their securities laws has demonstrated the efficiency of the provisions in addressing fraudulent or troublesome offerings.

Since a substantial minority of states have adopted in lieu of the standard language an alternative test using the so-called "fair, just and equitable" merit standard, the Committee has provided alternative language in brackets. A state wishing to adopt or retain such a merit standard should adopt the bracketed alternative. The practical effect of the alternative language is that an Administrator may judge the terms and conditions of the offering or the underlying business against various standards set forth in the Administrator's rules or statements of policy.

As noted above, the concept of fraud as used in this subparagraph (5) is essentially the

same as that embodied in Section 501.

Subparagraph (6): This provision is a more specific example of a merit standard which has been carried over from the 1956 Act. It permits the Administrator to review the amounts paid to or received by certain persons having an interest in the offering. While the terms leave considerable discretion to the Administrator, it is intended that industry practices and guidelines, *e.g.*, the NASD's corporate financing guidelines, ordinarily would be accorded significant weight in determining whether a particular amount or percentage was "unreasonable."

Subparagraphs (7) through (9): These subparagraphs concern procedural or technical compliance matters rather than matters of substance.

2. Subsection (b)(1) allows an Administrator who is aware of a fact or transaction and is in the process of an investigation at the time a registration statement becomes effective to avoid the necessity of issuing a stop order prematurely. The Administrator has 30 days after the effective date to issue a stop order on the basis of such fact or transaction. If there is no basis to do so, the effectiveness of the registration statement simply will continue.

Just as the Administrator must consider the public interest when issuing a stop order (reference should be made to Section 705 as to the appropriate standards), the public interest also must be considered when vacating or modifying a stop order.

3. Subsection (d) assures the applicant a prompt hearing if the registrant wishes to challenge any stop order issued by the Administrator. The administrative proceedings provisions of the state's administrative procedure act will apply to such. See Sections 710 through 712.

4. Subsection (e) recognizes that in some instances a summary suspension may be necessary. In order to use that power, the Administrator must satisfy the conditions required under Section 712.

## PART IV

### EXEMPTIONS FROM REGISTRATION

#### SECTION 401. EXEMPT SECURITIES.

(a) As used in this section:

(1) "Guaranteed" means guaranteed as to payment of all or substantially all of principal and interest or dividends.

(2) "Insured" means insured as to payment of all or substantially all of principal and interest or dividends.

(b) The following securities are exempt from Sections 301 and 405:

(1) a security, including a revenue obligation, issued, insured, or guaranteed by the United States, an agency or corporate or other instrumentality of the United States, an international agency or corporate or other instrumentality of which the United States and one or more foreign governments are members, a state, a political subdivision of a state, or an agency or corporate or other instrumentality of one or more states or their political subdivisions; or a certificate of deposit for any of the foregoing [, but this exemption does not include a security payable solely from revenues to be received from a nongovernmental industrial or commercial enterprise unless the payments are insured or guaranteed by a person whose securities are exempt from registration under paragraph (2), (3), (4), (5), (7), (9), or (13) or the revenues from which the payments are to be made are a direct obligation of such a person];

(2) 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, or any other foreign government or governmental combination or entity with which the United States maintains diplomatic relations, if the security is recognized as a valid obligation by the issuer, insurer, or guarantor;

(3) a security issued by and representing an interest in or a direct obligation of, or guaranteed by, a depository institution if the deposit or share accounts of the depository

institution are insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the National Credit Union Share Insurance Fund, or a successor to an applicable agency authorized by federal law;

(4) a security issued by and representing an interest in or a direct obligation of, or insured or guaranteed by, an insurance company organized under the laws of any state and authorized to do business in this State;

(5) a security issued or guaranteed by a railroad, other common carrier, public utility, or holding company that is:

(i) subject to the jurisdiction of the Interstate Commerce Commission;

(ii) 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;

(iii) regulated in respect to its rates and charges by a governmental authority of the United States or a state; or

(iv) regulated in respect to the issuance or guarantee of the security by a governmental authority of the United States, a state, Canada, or a Canadian province or territory;

(6) equipment trust certificates in respect to equipment leased or conditionally sold to a person, if securities issued by the person would be exempt under this section;

(7) a security listed or approved for listing upon notice of issuance on the New York Stock Exchange, the American Stock Exchange, or the Midwest Stock Exchange [, or listed on the (insert names of appropriate regional stock exchange)], if, in either case, quotations have been available and public trading has taken place for the class of security listed before the offer or sale of a security in reliance upon this exemption; any other security of the same issuer which is of senior or substantially equal rank; a security called for by subscription right or



warrant so listed or approved; or a warrant or right to purchase or subscribe to any of the foregoing;

(8) a security designated or approved for designation upon issuance for inclusion in the national market system by the National Association of Securities Dealers, Inc., if, in either case, quotations have been available and public trading has taken place for the class of security designated before the offer or sale of a security in reliance upon this exemption; any other security of the same issuer which is of senior or substantially equal rank; a security called for by subscription right or warrant so designated; or a warrant or a right to purchase or subscribe to any of the foregoing;

(9) an option issued by a clearing agency registered under the Securities Exchange Act of 1934, other than an off-exchange futures contract or substantially similar arrangement, if the security, currency, commodity, or other interest underlying the option:

(i) is registered under Section 302, 303, or 304;

(ii) is exempt under this section; or

(iii) is not otherwise required to be registered under this [Act];

(10) a security issued by a person organized and operated not for private profit but exclusively for a religious, educational, benevolent, charitable, fraternal, social, athletic, or reformatory purpose, or as a chamber of commerce or trade or professional association [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];

(11) a promissory note, draft, bill of exchange, or banker's acceptance that

evidences an obligation to pay cash within nine months after the date of issuance, exclusive of days of grace, is issued in denominations of at least \$50,000, and receives a rating in one of the three highest rating categories from a nationally recognized statistical rating organization; or a renewal of such an obligation that is likewise limited, or a guarantee of such an obligation or of a renewal;

(12) a security issued in connection with an employees' stock purchase, savings, option, profit-sharing, pension, or similar employees' benefit plan;

(13) a membership or equity 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 any state if not traded to the public;

(14) a security issued by an issuer registered as an open-end management investment company or unit investment trust under Section 8 of the Investment Company Act of 1940 if:

(i) the issuer is advised by an investment adviser that is a depository institution exempt from registration under the Investment Adviser Act of 1940 or that is currently registered as an investment adviser, and has been registered, or is affiliated with an adviser that has been registered, as an investment adviser under the Investment Advisers Act of 1940 for at least three years next preceding an offer or sale of a security claimed to be exempt under this paragraph; and the issuer has acted, or is affiliated with an investment adviser that has acted, as investment adviser to one or more registered investment companies or unit investment trusts for at least three years next preceding an offer or sale of a security claimed to be exempt under this paragraph; or

(ii) the issuer has a sponsor that has at all times throughout the three years before an offer or sale of a security claimed to be exempt under this paragraph sponsored one or more registered investment companies or unit investment trusts the aggregate total assets of which have exceeded [\$100,000,000].

For the purpose of this paragraph, an investment adviser is affiliated with another investment adviser if it controls, is controlled by, or is under common control with the other investment adviser.

### COMMENT

1. The exemptions in Sections 401 and 402 operate as exemptions only from the securities registration requirements (Section 301) and the filing of sales literature requirements (Section 405).

It should be clear, therefore, that there are no exemptions from the antifraud provisions of Section 501; those apply to all securities and transactions involving the offer, sale, or purchase of a security.

The exemptions also must be considered in light of the power of the Administrator under Section 404 to revoke certain of the security exemptions under Section 401 or any of the transaction exemptions under Section 402.

2. Subsection (a) [Prior Provision: USA 401(e)]. The purpose of subsection (a) is to identify the extent of the guaranty or insurance coverage needed in order to be eligible for exempt security status under certain subparagraphs of Section 401(b). In order to be an exempt guaranteed security, the guaranty or insurance obligation must extend to "all or substantially all" of the principal and interest or dividends of the underlying security. A partially guaranteed or insured security, *e.g.*, of 75% of the principal, is not eligible for any of the specified exemptions under Section 401(b).

This section does not concern whether or not a guarantee, whether whole or partial, is itself a security. That issue is addressed in Section 101(16).

3. Paragraph (b)(1) [Prior Provision: USA 402(a)(1)] exempts governmental securities generally. The bracketed language may be adopted by a state which desires to deny the exemption to the issue of industrial development bonds by persons whose securities are not otherwise exempt under other clauses of Section 401. A small number of jurisdictions presently require the registration of IDB's or other revenue bond securities.

The reference to guaranteed would include transactions backed by a letter of credit from a depository institution if the terms satisfy the percentage requirements of Section 401(a)(2).

4. Paragraph (b)(2) [Prior Provision: USA 402(a)(2)] extends exempt status to governmental securities of Canadian (including provincial and municipal subdivisions) and other foreign governmental entities. The comparable subsection of the 1956 Act has been expanded to include special governmental entities with whom the United States maintains diplomatic relations, *e.g.*, the European Economic Community (Common Market).

5. Paragraph (b)(3) [Prior Provision: USA 402(a)(3), (4), and (6)] combines three previous subsections in the 1956 Act and treats all types of depository institutions in the same fashion. In the intervening years since the 1956 Act was proposed, the substantive differences among the various types of depository institutions largely have been eroded. The types of financial institutions within the term "depository institution" are identified in Section 101(3).

The underlying premise for this exemption is that these issuers are subject to extensive regulation by other state agencies, which typically includes regulation over the issuance of securities by such institutions.

A parent holding company which owns the stock of one or more depository institutions is not exempt under this subsection unless itself a depository institution.

The Committee intends that letter of credit issued by depository institution be treated as securities and exempt under this subparagraph.

6. Paragraph (b)(4) [Prior Provision: USA 402(a)(5)]. As with depository institutions, the issuance of capital stock or other securities by insurance companies is extensively regulated by other state agencies, usually the state insurance commissioners.

With respect to the status of insurance policies and annuities, see the COMMENT relating to the exception from the definition of security in Section 101(16). By virtue of that exception, the ordinary insurance policy or annuity is not a security.

A variable annuity policy, on the other hand, is a security under that definition but would be exempt under this subsection, as are any other securities issued by insurance companies. The result is the latter securities are not required to be registered under this Act but are subject to the antifraud provisions of Section 501.

7. Paragraph (b)(5) [Prior Provision: USA 402(a)(7)] is substantially unchanged from the 1956 Act. In each of the applicable instances some federal or state agency exercises significant control over the operations of the issuer through regulation of rates or the issuance of securities.

8. 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.

9. Paragraph (b)(7) [Prior Provision: USA 402(a)(8)]. The provisions relating to exchange-listed securities are carried over from the 1956 Act, with the important exception that the language relating to the existence of prior trading has been added to provide that the exemption will not be available for securities issued in initial public offerings (IPO's). In light of the qualitative listing criteria which the New York Stock Exchange and the American Stock Exchange currently apply, a state might choose to adopt the exemption for IPO's with respect to those exchanges only if the state foresaw that future weakening of the listing criteria was likely. With respect to the regional exchanges, on the other hand, the present standards applicable to initial public offerings provide little or no investor protection and the IPO exclusion definitely is appropriate.

The bracketed words may be included when a state intends to exempt one or more regional exchanges in addition to the national exchanges listed, *e.g.*, the Boston, PBW, or Pacific Stock Exchanges.

10. Paragraph (b)(8) [Prior Provision: None]. This exemption has been proposed to reflect the development of the National Association of Securities Dealers, Inc.'s National Market System as a major market for securities of significant companies. The designation criteria used for National Market System securities together with the corporate governance proposals being considered by the NASD Board of Governors convinced the Committee that these securities should generally be treated on a parity with exchange-listed securities insofar as exemption from securities registration is concerned.

11. Paragraph (b)(9) also is new and reflects the development of the options trading markets. As with other subsections, the premise is that the option security will be exempt from registration if the underlying security to which the option relates is either registered under this Act, exempt from registration under this Section 401, or not required to be registered under this Act. A common example of the latter category would be nonissuer transactions in the underlying security, currency, commodity, or other interest exempt under Section 402(2), (3), or (4).

12. Paragraph (b)(10) [Prior Provision: USA 402(a)(9)]. Exemptions for the securities of nonprofit organizations are found in almost every state, although there are some variations in the scope of the exemption, particularly as to the purposes specified. The most common purposes are religious, educational, charitable, benevolent, fraternal, and reformatory. There are literally thousands of such issuers in the United States today, ranging from hospitals, churches, and other common organizations to specialized or unique fraternal organizations.

This has been an area where occasional abuses have occurred. A state concerned with practices of some nonprofit issuers has two options open to it under this Act. The legislature can choose to adopt the bracketed language for some or all such issuers and require a pre-sale filing in order for the exemption to be available. Alternatively, the Administrator is given power under

Section 404 to revoke this specific exemption if, pursuant to Section 705(c), the Administrator finds that it is in the public interest to do so.

13. Paragraph (b)(11) [Prior Provision: USA 402(a)(10)]. The provision in the 1956 Act for "commercial paper" followed the counterpart provision in the Securities Act of 1933. The latter has been the subject of considerable, and often changing, administrative interpretation. The approach in the present subsection is to identify certain objective criteria which must be satisfied in order for the exemption to be applicable.

The requirements are that the instrument have a maturity of nine months or less, be issued in denominations of at least \$50,000, and receive a rating in one of the three highest ratings from a nationally recognized statistical rating agency (such as Fitch, Standard & Poor's, Moody's, or Best).

14. Paragraph (b)(12) [Prior Provision: USA 402(a)(11)] exempts all employee benefit plans which involve the issuance of securities of the employer or of a right or benefit which may otherwise separately constitute a security.

The 1956 Act's pre-sale notice provisions have been dropped. However, it should be noted that, as with paragraph (10) above, the Administrator is granted authority under Section 404 to revoke this exemption if appropriate for the protection of investors.

15. Paragraph (b)(13) [Prior Provision: None]. A number of states presently exempt securities issued by cooperatives. This paragraph proposes an exemption for such securities as long as they are not traded to the public generally.

16. Paragraph (b)(14) [Prior Provision: None]. Unlike most other issuers, investment companies are subject not only to the disclosure requirements of the federal Securities Act of 1933 but also to substantive regulation under the Investment Company Act of 1940. The Committee therefore has proposed a "blue chip" exemption for established investment companies or companies sponsored or serviced by an established investment adviser.

## **SECTION 402. EXEMPT TRANSACTIONS.**

The following transactions are exempt from Sections 301 and 405:

- (1) an isolated nonissuer transaction, whether or not effected through a broker-dealer;
- (2) a nonissuer transaction in an outstanding security if the issuer of the security has a class of securities subject to registration under Section 12 of the Securities Exchange Act of 1934 and has been subject to the reporting requirements of Sections 13 or 15(d) of the Securities

Exchange Act of 1934 for not less than 90 days next preceding the transaction; or has filed and maintained with the [Administrator] for not less than 90 days next preceding the transaction information, in such form as the [Administrator] by rule specifies, substantially comparable to the information the issuer would be required to file under Section 12(b) or Section 12(g) of the Securities Exchange Act were the issuer to have a class of its securities registered under Section 12 of the Securities Exchange Act of 1934, and paid a fee with the filing of [\$150];

(3) a nonissuer transaction in a security of a class outstanding in the hands of the public for not less than 90 days next preceding the transaction if a nationally recognized securities manual designated by the [Administrator] by rule or order contains:

(i) the names of the issuer's officers and directors;

(ii) a statement of financial condition of the issuer as of a date within the last 18 months; and

(iii) a statement of income or operations (a) for either the last fiscal year before that date or the most recent year of operation each of the two years next preceding the date of the statement of condition or (b) for the period as of the date of the statement of financial condition if the period of existence is less than two years;

(4) a nonissuer transaction in a security that has a fixed maturity or a fixed interest or dividend provision and there has been no default during the current fiscal year or within the three next preceding years, or during the existence of the issuer, and any predecessors if less than three years, in the payment of principal, interest, or dividends on the security;

(5) a nonissuer transaction effected by or through a registered broker-dealer pursuant to an unsolicited order or offer to purchase;

(6) a transaction between the issuer or other person on whose behalf the offering of a

security is made and an underwriter, or a transaction among underwriters;

(7) a transaction in a bond or other evidence of indebtedness secured by a real estate mortgage, deed of trust, personal property security agreement, or by an agreement for the sale of real estate or personal property, if the entire mortgage, deed of trust, or agreement, together with all the bonds or other evidences of indebtedness secured thereby, is offered and sold as a unit;

(8) a transaction by an executor, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian, or conservator;

(9) a transaction executed by a bona fide secured party without a purpose of evading this [Act];

(10) an offer to sell or sale of a security to a financial or institutional investor or to a broker-dealer;

(11) a transaction pursuant to an offer to sell securities of an issuer, if the transaction is part of an issue in which there are no more than 25 purchasers in this State, other than those designated in paragraph (10), during any 12 consecutive months; no general solicitation or general advertising is used in connection with the offer to sell or sale of the securities; and no commission or other similar compensation is paid or given, directly or indirectly, to a person, other than a broker-dealer licensed or not required to be licensed under this [Act], for soliciting a prospective purchaser in this State; and either (i) the seller reasonably believes that all the purchasers in this State, other than those designated in paragraph (10), are purchasing for investment; or (ii) immediately before and immediately after the transaction, the issuer reasonably believes that the securities of the issuer are held by 50 or fewer beneficial owners, other than those designated in paragraph (10), and the transaction is part of an aggregate offering that does not exceed [\$500,000] during any 12 consecutive months; but the [Administrator] by



rule or order as to a security or transaction or a type of security or transaction, may withdraw or further condition this exemption or waive one or more of the conditions in this paragraph;

(12) an offer to sell or sale of a preorganization certificate or subscription if no commission or other similar compensation is paid or given, directly or indirectly, for soliciting a prospective subscriber; no public advertising or general solicitation is used in connection with the offer to sell or sale; the number of subscribers does not exceed ten; and no payment is made by a subscriber;

(13) an offer to sell or sale of a preorganization certificate or subscription issued in connection with the organization of a depository institution if that organization is under the supervision of an official or agency of a state or of the United States which has and exercises the authority to regulate and supervise the organization of the depository institution. For purpose of this paragraph, supervision of the organization by an official or agency means that the official or agency by law has authority to require disclosures to prospective investors similar to that required under Section 304, impound proceeds from the sale of a preorganization certificate or subscription until organization of the depository institution is completed, and require refund to investors if the depository institution does not obtain a grant of authority from the appropriate official or agency;

(14) a transaction pursuant to an offer to sell to existing security holders of the issuer, including persons who at the time of the transaction are holders of transferable warrants exercisable within not more than 90 days after their issuance, convertible securities, or nontransferable warrants, if:

(i) no commission or other similar compensation other than a standby commission, is paid or given, directly or indirectly, for soliciting a security holder in this State; or

(ii) the issuer first files a notice specifying the terms of the offer to sell and the [Administrator] does not by order disallow the exemption within the next five full business days;

(15) a transaction involving an offer to sell, but not a sale, of a security not exempt from registration under the Securities Act of 1933 if:

(i) a registration or offering statement or similar document as required under the Securities Act of 1933 has been filed, but is not effective;

(ii) a registration statement, if required, has been filed under this [Act], but is not effective; and

(iii) no stop order of which the offeror is aware has been entered by the [Administrator] or the Securities and Exchange Commission, and no examination or public proceeding that may culminate in that kind of order is known by the offeror to be pending;

(16) a transaction involving an offer to sell, but not a sale, of a security exempt from registration under the Securities Act of 1933 if:

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

(ii) 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]

(17) 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, if:

(i) the securities to be distributed are registered under the Securities Act of 1933 before the consummation of the transaction; or

(ii) the securities to be distributed are not required to be registered under the Securities Act of 1933, written notice of the transaction and a copy of the materials, if any, by which approval of the transaction will be solicited is given to the [Administrator] at least ten days before the consummation of the transaction and the [Administrator] does not disallow by order the exemption within the next ten days [.] [; and]

[(18) (i) a transaction involving the offer to sell or sale of one or more promissory notes each of which is directly secured by a first lien on a single parcel of real estate, or a transaction involving the offer to sell or sale of participation interests in the notes if the notes and participation interests are originated by a depository institution and are offered and sold subject to the following conditions:

(A) the minimum aggregate sales price paid by each purchaser may not be less than \$250,000;

(B) each purchaser must pay cash either at the time of the sale or within 60 days after the sale; and

(C) each purchaser may buy for that person's own account only;

(ii) a transaction involving the offer to sell or sale of one or more promissory notes directly secured by a first lien on a single parcel of real estate or participation interests in the notes, if the notes and participation interests are originated by a mortgagee approved by the Secretary of Housing and Urban Development under Sections 203 and 211 of the National Housing Act and are offered or sold, subject to the conditions specified in paragraph (i), to a depository institution or insurance company, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association; and

(iii) a transaction between any of the persons described in paragraph (ii) involving a

nonassignable contract to buy or sell the securities described in paragraph (i) which contract is to be completed within two years, if:

(A) the seller of the securities pursuant to the contract is one of the parties described in paragraph (i) or (ii) who may originate securities;

(B) the purchaser of securities pursuant to a contract is any other person described in paragraph (ii); and

(C) the conditions described in paragraph (i) are fulfilled.]

### COMMENT

Prior Provision: USA 402(b).

1. Paragraphs (1) through (5) are available only for nonissuer transactions, i.e., what is thought of as secondary transactions. There may well be other exemptions available for other nonissuer transactions, *e.g.*, Sections 402(6), (7), (8), (9), or (10) or the security involved may be exempt under some provision of Section 401. If no exemption fully covers, however, the security proposed to be sold, even if by someone other than the issuer, has to be registered. See COMMENT 14 to Section 305.

2. Paragraph (1) [Prior Provision: USA 402(b)(1)]. The term "isolated transaction" is not defined in this Act, but rather left to the Administrator to spell out the appropriate dimensions. In general, this subsection is intended to cover the occasional or casual sale by an individual. It is not intended to extend to repeated and successive transactions by the same person or by an affiliated group of persons or to transactions which otherwise would constitute a "distribution" as that term is understood for purposes of the federal securities laws.

3. New Paragraph (2) is intended to authorize secondary trading for the securities of issuers who have become subject to the reporting requirements under the Securities Exchange Act of 1934. The 90-day period has been inserted to bar immediate secondary trading in nonregistered initial public offering (IPO) securities. If securities have been registered under Part III, Section 305(m) operates to authorize secondary trading in all the securities of that class for a period of at least a year. At that time, reliance then would have to be placed upon either this paragraph, the following paragraph, or some other exemptive provision.

A company not subject to the reporting requirements of the 1934 Act can voluntarily make its securities eligible for secondary trading by filing comparable information, together with the appropriate fee, with the Administrator.

4. Paragraphs (3) and (4) [Prior Provision: USA 402(b)(2)]. This Act carries over the

prior exemptions for securities listed in nationally recognized securities manuals or for certain fixed maturity or interest or dividend securities, which exemptions have been followed in a large majority of the states. The manual exemption is conditioned upon certain minimal financial and other information regarding the issuer being available in the manual. Paragraph (3) adds a 90-day waiting period, which, as in the preceding paragraph, is intended to bar immediate secondary trading of nonregistered IPO securities.

5. Paragraph (5) [Prior Provision: USA 402(b)(3)] also follows the 1956 Act, except that the language authorizing the Administrator to require specific forms of acknowledgement has been deleted. Current practice in the industry is that each confirmation slip delivered to a customer notes whether or not the transaction was unsolicited.

The Administrator, of course, may flesh out this exemption by use of the rule-making power under Section 705, including authority to define what constitutes solicitation.

6. Paragraph (6) [Prior Provision: USA 402(b)(4)].

7. Paragraph (7) [Prior Provision: USA 402(b)(5)]. The key restriction here is that the debt instrument and the mortgage be both offered and sold as a unit. If that is done, it does not matter to whom the entire unit is sold. Obviously, the antifraud provisions still apply to any such sale.

The term "bond" includes a promissory note and other forms of indebtedness.

8. Paragraph (8) [Prior Provision: USA 402(b)(6)].

9. Paragraph (9) [Prior Provision: USA 402(b)(7)].

10. Paragraph (10) [Prior Provision: USA 402(b)(8)]. Since the term "financial or institutional investor" is now defined in Section 101(5), the exemption is briefer. The substance, however, remains unchanged.

The term "institutional buyer" in the definition is broad enough to include, among others, a college endowment fund or other comparable investor. The Administrator is, of course, free to add to the scope of the term "financial or institutional investor" through ad hoc interpretations or declaratory rulings under Section 706.

11. Paragraph (11) [Prior Provision: USA 402(b)(9)]. The limited offering exemption in the 1956 Act has been altered by many of the states adopting that Act. Some states look to the number of offerees, some to the number of purchasers. The numbers vary among 10, 15, 25, and 35.

This paragraph proceeds on the premise that it is important that a limited offering exemption be available to cover several differing situations. The three basic ground rules are that the offering result in no more than 25 purchasers in this State, that no commissions be paid

to anyone other than a broker-dealer who is licensed or not required to be licensed, and that no general solicitation or advertising is permitted. Beyond these, the offering then can be used in a typical private placement, or in a true limited offering context, i.e., where the total offering is for no more than \$500,000, and there are no more than 50 shareholders of the issuer, wherever located, following the sale.

In light of possible future changes in aggregate amount limitation under the corresponding federal exemption, Rule 504, the \$500,000 amount has been bracketed.

The requirement relative to the former type of offering that "the seller reasonably believes that all the purchasers in this State . . . are purchasing for investment" is meant to connote both that the individuals are acquiring for investment and not with a view to distribution and that they have the ability to bear the risks of such investment.

While that same language is not used with respect to the other form of offering, or limited offering, the Committee does not intend that the exemption can be relied upon when there are 50 or less immediately after the offering, and then those persons promptly proceed to resell their shares so that a number of shareholders greater than 50 results. If those resales are found to be part of the initial offering, the "transaction" should not be deemed completed until after the resales, in which case the exemption would not be available. An issuer intending to rely upon these numerical limitations should take reasonable precautions to satisfy itself that the limitations are not being exceeded or evaded.

The integration doctrines which have been developed under the Securities Act of 1933 continue to be relevant in determining whether a transaction "is part of an issue."

The Administrator is granted authority to withdraw or further condition the exemption or to waive one or more of the conditions. The standards set forth in Section 705(c) should be consulted.

12. Paragraph (12) [Prior Provision: USA 402(b)(10)] basically postpones registration rather than exempting securities from registration. The purpose is to enable a new enterprise to obtain the minimum number of subscriptions required by the applicable corporation law. Thus, there may be a publicly advertised offering of preorganization certificates. But no payment is allowed until the securities are registered unless some other exemption is available.

13. Paragraph (13) is similar to the immediately preceding paragraph except that it creates a special rule if the organization being established is a depository institution. Various SEC interpretations have held that a depository institution does not become a "bank" for purposes of the federal securities laws until it has obtained the minimum capital which the applicable banking agency has specified. Under that interpretation, without this paragraph, the solicitation of subscriptions to raise the minimum specified would require registration, even though any securities thereafter issued would be exempt under Section 401(b)(3).

14. Paragraph (14) [Prior Provision: USA 402(b)(11)]. Substantially all states have had

some comparable provision in their securities acts for many years.

The "standby commission" referred to permits payment to an underwriter for agreeing to purchase any portion of the securities offered to existing shareholders which are not taken down by the shareholders.

If any other commission or remuneration is to be paid, the issuer must use the alternative notice procedure in order to claim the exemption. The Administrator ordinarily would disallow the exemption only if the commissions or other compensation appeared unreasonable in light of the risks and obligations being undertaken.

15. Paragraphs (15) and (16) [Prior Provision: USA 402(b)(12)]. Since the 1956 Act was proposed, there has been an easing of some of the restrictions on the nature of preliminary offers which can be made, typically with a red herring prospectus or preliminary official statement. These paragraphs allow pre-effective offers, but not sales, to be made.

16. Paragraph (17). With the adoption of Rule 145 in 1972 and the abandonment of the former "no sale" rule, merger, consolidation, and statutory sale of asset transactions involving the issue of securities by the acquiring company now require registration under the federal securities laws.

Since those transactions, however, do require shareholder approval ordinarily and shareholders often have appraisal rights if they choose to dissent, the potential for abuse is much less than in a direct offering of securities for cash. Accordingly, these transactions are afforded an exemption from registration under this Act if the securities to be issued are registered under the Securities Act of 1933.

If the securities are not registered under the Securities Act of 1933, an issuer can seek to claim the exemption by pre-filing copies of the proxy or other solicitation materials being sent to the shareholders of the company being acquired.

In order to disallow the exemption, the Administrator, in addition to finding it in the public interest under Section 705(c) to do so, presumably would determine that the protection afforded investors by either the disclosures being made or the applicable corporation laws are insufficient.

17. Paragraph (18) is needed only if a state has elected to opt out from the pre-emption of Blue Sky regulation for "mortgage-related securities" or Section 4(5) securities effected by Public Law 98-440. Those sections primarily concern various mortgage passthrough and other secondary mortgage instruments. Hence, this paragraph has been bracketed in entirety. If a state chooses to opt out (and thus require registration for such securities), it will need to state expressly that it is doing so and reference the above federal legislation.

### **SECTION 403. ADDITIONAL EXEMPTIONS.**

(a) The [Administrator] by rule may exempt any other security or transaction or class of securities or transactions from Sections 301 and 405.

(b) The [Administrator] by rule may adopt a limited offering transactional exemption that will further the objectives of compatibility with the exemptions from securities registration authorized by the Securities Act of 1933 and uniformity among the states.

### COMMENT

Prior Provision: None.

1. The Administrator is given express authority to exempt additional securities, transactions, or classes of securities or transactions from the registration requirements of Part III. Obviously, any such action must be based upon a determination in accord with the standards set forth in Section 705(c).

2. Subsection (b), together with Section 705(b), is intended as specific enabling authority to enable an Administrator to adopt the Uniform Limited Offering Exemption (ULOE) and any other comparable coordinated exemption provisions.

The Committee did not attempt to incorporate ULOE as part of the Act due both to its complex structure and the possibility for continual change and updating of its provisions. The Committee believes that ULOE can be most effectively implemented by rule rather than by statute. It does strongly encourage each state to adopt that provision.

### SECTION 404. REVOCATION OF EXEMPTIONS.

(a) The [Administrator] by order may deny or revoke an exemption specified in paragraph (7), (8), (10), or (12) of Section 401(b) or in Section 402, with respect to a specific security or transaction.

(b) ~~A stop~~ An order issued under this section is not retroactive. A person does not violate Section 301 or 405 by reason of an offer to sell or sale effected after the entry of an order under this section if the person did not know, and in the exercise of reasonable care could not have known, of the order.



## **COMMENT**

Prior Provision: USA 402(c).

1. The Administrator may revoke the exemption for certain securities and for any transaction, but in each case only for a specific security or transaction and only in accordance with the standards set forth in Section 705(c).

2. No such order can be issued except after compliance with all applicable requirements of the state administrative procedures act, including the right to prior notice, opportunity for hearing, written findings of fact, and conclusions of law. See Sections 710 through 712.

### **SECTION 405. FILING OF SALES AND ADVERTISING LITERATURE.**

The [Administrator] by rule or order may require the filing of a 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, unless the security or transaction is exempt under Section 401 or 402 or the investment adviser is exempt under Section 204.

## **COMMENT**

Prior Provision: USA 403.

1. This section allows an Administrator flexibility to determine when and under what conditions sales and advertising literature must be filed, i.e., whether before, concurrently with, or after use and whether or not subject to the approval of the Administrator.

2. Unlike the 1956 Act, this section does apply to sales literature and advertising sent to prospective and actual clients of investment advisers.

## **PART V**

### **FRAUDULENT AND OTHER PROHIBITED PRACTICES**

## **SECTION 501. OFFER, SALE, AND PURCHASE.**

In connection with an offer to sell, sale, offer to purchase, or purchase, of a security, a person may not, directly or indirectly:

(1) employ a device, scheme, or artifice to defraud;

(2) make an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made not misleading, in the light of the circumstances under which they are made; or

(3) engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon a person.

### **COMMENT**

Prior Provision: USA 101.

1. Section 501 is substantially the same as Rule 10b-5 under the Securities Exchange Act of 1934. It broadly applies to the activities of any person "in connection with the offer to sell, sale, offer to purchase, or purchase of a security." There are no exceptions or exclusions.

2. The possible consequences of violating Section 501 are many. Sanctions include denial, suspension, or revocation of a license under Section 212, denial or suspension of the registration of securities under Section 306, various administrative or civil sanctions or proceedings under Section 602 or 603, criminal prosecution under Section 604, and, in certain instances, civil liability under Section 605.

The latter section imposes civil liability only for violations by sellers of Section 501(2), a pattern continued from Section 410 of the 1956 Act.

3. The federal courts have promulgated a variety of requirements which must be satisfied by persons seeking to recover damages under the federal Rule 10b-5 counterpart. These include showings: of scienter (*Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976)); that the violative conduct involved misrepresentation or deception (*Santa Fe Industries v. Green*, 430 U.S. 462 (1977)); and that the party seeking damages be either a purchaser or seller of the securities involved (*Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975)). While the latter requirement also appears appropriate with respect to this section, the Committee did not intend that state courts be bound to follow the other federal court doctrines referenced. The Committee has noted that various state courts have split, for example, on the necessity of showing scienter in order to state a cause of action under the 1956 Act version of this section.

Activity which constitutes "aiding and abetting" also is actionable under the federal Rule 10b-5. See, e.g., *Metge v. Baehler*, 762 F.2d 621 (8 Cir. 1985) and *Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004 (11 Cir. 1985). In order to establish a violation, three elements must be shown as follows:

(1) there has been a violation of the principal section by a primary wrongdoer;

(2) the party to be liable as an aider or abettor must have known of the violation by the primary wrongdoer; and

(3) the party liable as an aider or abettor must have rendered substantial assistance to the violation by the primary wrongdoer.

Assuming comparable elements are established, this section should also support an aiding and abetting theory of liability. While civil liability to third persons would only infrequently result in light of the limitations of Section 605(a), this theory would support administrative sanctions against an aider or abettor under this section.

4. While no private right of action to defrauded sellers is recognized under Section 605, fraudulent activities by buyers are otherwise within the scope of this section and the various sanctions provided under other sections, such as Section 602 or 603, are available. The shareholder who is persuaded to sell by a corporate insider's bearish representations is defrauded just as much as the shareholder who is persuaded to buy by bullish representations.

## **SECTION 502. MANIPULATION OF MARKET.**

(a) Without limiting the general applicability of Section 501, a person may not:

(1) quote a fictitious price with respect to a security;

(2) effect a transaction in a security which involves no change in the beneficial ownership of the security for the purpose of creating a false or misleading appearance of active trading in a security or with respect to the market for the security;

(3) enter an order for the purchase of a security with the knowledge that an order of substantially the same size and at substantially the same time and price for the sale of the security has been, or will be, entered by or for the same, or affiliated, person for the purpose of creating a false or misleading appearance of active trading in a security or with respect to the

market for the security;

(4) enter an order for the sale of a security with knowledge that an order of substantially the same size and at substantially the same time and price for the purchase of the security has been, or will be, entered by or for the same, or affiliated, person for the purpose of creating a false or misleading appearance of active trading in a security or with respect to the market for the security; or

(5) employ any other deceptive or fraudulent device, scheme, or artifice to manipulate the market in a security.

(b) A transaction effected in compliance with or conduct that does not violate, the applicable provisions of the Securities Exchange Act of 1934 and the rules and regulations of the Securities and Exchange Commission thereunder is not ~~a manipulation of the market under violation of~~ subsection (a).

## COMMENT

Prior Provision: None.

1. Although the coverage of the preceding section is comprehensive, Section 502 has been added to the Act to specifically delineate the elements of market manipulation. Like Section 501, violations of this section can give rise to a variety of sanctions, including, with respect to securities primarily of an intrastate nature, civil liability under Section 605(c).

2. Subsections (a)(2) through (4) are substantially identical to what appears in Section 9(a)(1) of the Securities Exchange Act of 1934. They specifically relate to willful conduct aimed at creating false or misleading appearances of trading in a security or with respect to the market for the security. Paragraph (1) deals with fictitious quotations and paragraph (5) is a catchall provision which confers liability on any person who takes action to manipulate the market in a security.

Subsection (b) has been added to assure that the extensive rules and regulations and practices which have built up under the Securities Exchange Act, governing, for example, stabilization activities, repurchases of stock by issuers and the like, are not disregarded.

3. "Affiliated" has the same meaning as under Section 401(b)(14), namely, a person

controlling, controlled by, or under common control with another.

### **SECTION 503. PROHIBITED TRANSACTIONS BY INVESTMENT ADVISERS.**

An investment adviser or person who represents an investment adviser in performing an act that requires licensing as an investment adviser under this [Act] may not, directly or indirectly:

(1) employ a device, scheme, or artifice to defraud a client; or

(2) engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon a client.

### **COMMENT**

Prior Provision: USA 102(a).

1. This provision is modelled on Section 206(1) and (2) of the Investment Advisers Act of 1940, except that this section excludes any reference to dealings with a prospective client.

2. To the extent that the fraudulent activity of an investment adviser or person who represents an investment adviser occurs in connection with the purchase or sale of a security, there may also be a violation of Section 501 with all the attendant consequences.

3. The Committee chose not to grant a private right of action for violations of Section 503, primarily because of the difficulties in determining the appropriate measure of damages. A violation, of course, would be subject to a wide variety of administrative, civil, and criminal proceedings and sanctions otherwise applicable. Furthermore, nothing contained in this Act derogates from whatever remedy a person may have under traditional common law fraud theories.

### **SECTION 504. MISLEADING FILINGS.**

A person may not make or cause to be made, in a document filed with the [Administrator] or in a proceeding under this [Act], a statement that the person knows or has reasonable grounds to know is, at the time and in the light of the circumstances under which it is made, false or misleading in a material respect.

### **COMMENT**

Prior Provision: USA 404.

This section adds the language "the person knows or has reasonable grounds to know" as a condition to liability. This modification thus removes the strict liability standard that existed under the Section 404 in the 1956 Act.

**SECTION 505. UNLAWFUL REPRESENTATION CONCERNING LICENSING,  
REGISTRATION, OR EXEMPTION.**

(a) Neither the fact that an application for licensing or a registration statement has been filed under this [Act] nor the fact that a person is licensed or a security is registered under this [Act] constitutes a finding by the [Administrator] that a document filed under this [Act] is true, complete, and not misleading. Neither of those facts nor the fact that an exemption or exception is available for a security or a transaction means that the [Administrator] has passed upon the merits or qualifications of, or recommended or given approval to, a person, security, or transaction.

(b) A person may not make, or cause to be made, to a purchaser, customer, or client a representation inconsistent with subsection (a).

**COMMENT**

Prior Provision: USA 405.

Every registration of securities statute contains language of some kind disclaiming any governmental agency approval or recommendation. This section follows the 1956 Act in stating that any misrepresentation as to the effect of registration or licensing by the Administrator is unlawful.

**PART VI**

**ENFORCEMENT AND CIVIL LIABILITY**

## **SECTION 601. INVESTIGATION; SUBPOENA POWER.**

(a) The [Administrator] may make any investigation, within or without this State, the [Administrator] finds necessary to determine whether a person has violated or is about to violate this [Act] or a rule or order of the [Administrator] under this [Act] or to aid in enforcement of this [Act].

(b) Except as provided in Section 703(c), the [Administrator] may publish information concerning a violation of this [Act] or a rule or order of the [Administrator] under this [Act] or concerning types of securities or acts or practices in the offer to sell, sale, offer to purchase, or purchase of types of securities which may operate as a fraud or deceit.

(c) For purposes of an investigation or proceeding under this [Act], the [Administrator] or an officer or employee designated by the [Administrator] by rule or order may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production, by subpoena or otherwise, of books, papers, correspondence, memoranda, agreements, other documents, and records the [Administrator] considers to be relevant and material to the investigation or proceeding. The [Administrator] may require or permit a person to file a statement, under oath or otherwise as the [Administrator] directs, as to the facts and circumstances concerning the matter to be investigated.

(d) If the activities constituting an alleged violation for which the information is sought would be a violation of this [Act] had the activities occurred in this State, the [Administrator] may issue and apply to enforce subpoenas in this State at the request of a securities agency or administrator of another state.

(e) If a person does not testify or produce the documents required by the [Administrator] or a designated officer or employee pursuant to subpoena, the [Administrator] or

designated officer or employee may apply to the court for an order compelling compliance.

(f) A request for an order of compliance may be addressed to:

(1) the [designate court having general trial jurisdiction] Court if the person is subject to service of process in this State; or

(2) 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.

(g) Not later than the time the [Administrator] requests an order for compliance, the [Administrator] shall either send notice of the request by registered or certified mail, return receipt requested, to the respondent at the last known address or take other steps reasonably calculated to give the respondent actual notice.

#### **COMMENT**

Prior Provision: USA 407(a) and (b); New.

1. Subsections (a) and (b) are modelled generally on the comparable provisions of Section 21 of the Securities Exchange Act of 1934.

2. The former subpoena subsection has been expanded to set forth the power of the Administrator to issue subpoenas and the means by which to obtain compliance, if necessary.

3. Subsection (d) authorizes reciprocal enforcement of subpoenas, but only if the activities for which the information is sought by another administrator would constitute a violation under this Act had the activities occurred in this State.

#### **SECTION 602. ENFORCEMENT.**

(a) If the [Administrator] reasonably believes, whether or not based upon an investigation conducted under Section 601, that (i) the sale of a security is subject to registration under this [Act] and the security is being offered or has been offered or sold by the issuer or another person in violation of Section 301 or (ii) a person is acting as a broker-dealer or



investment adviser in violation of Section 201 or 203, the [Administrator], in addition to any specific power granted under this [Act] and subject to compliance with the requirements of Section 712, may issue, without a prior hearing, an order against the person engaged in the prohibited activities, directing the person to desist and refrain from further activity until the security is registered or the person is licensed under this [Act]. The cease and desist order must state the section of this [Act] or rule or order of the [Administrator] under this [Act] which the [Administrator] reasonably believes has been or is being violated.

(b) If the [Administrator] reasonably believes, whether or not based upon an investigation conducted under Section 601, that a person has violated this [Act] or a rule or order of the [Administrator] under this [Act], the [Administrator], in addition to any specific power granted under this [Act], after notice and hearing in an administrative proceeding unless the right to notice and hearing is waived by the person against whom the sanction is imposed, may:

(1) issue a cease and desist order against the person;

(2) censure the person, if the person is a licensed broker-dealer, sales representative, or investment adviser;

(3) bar or suspend the person from association with a licensed broker-dealer or investment adviser in this State;

(4) issue an order against an applicant, licensed person, or other person who knowingly violates this [Act] or a rule or order of the [Administrator] under this [Act], imposing a civil penalty up to a maximum of [\$2,500] for a single violation or of [\$25,000] for multiple violations in a single proceeding or a series of related proceedings; or

(5) initiate one or more applicable actions specified in Section 603.

(c) Imposition of the sanctions under this section is limited as follows:

(1) if the [Administrator] revokes the license of a broker-dealer, sales representative, or investment adviser or bars a person from association with a licensed broker-dealer or investment adviser under this section or Section 212, the imposition of that sanction precludes imposition of the sanction specified in paragraph (4) of subsection (b); and

(2) the imposition by the [Administrator] of one or more sanctions under subsection (b) with respect to a specific violation precludes the [Administrator] from later imposing any other sanctions under paragraphs (1) through (4) of subsection (b) with respect to the violation.

(d) For purposes of determining any sanction to be imposed under paragraphs (1) through (4) of subsection (b), the [Administrator] shall consider, among other factors, the frequency and persistence of the conduct constituting a violation of this [Act] or a rule or order of the [Administrator] under this [Act], the number of persons adversely affected by the conduct, and the resources of the person committing the violation.

### **COMMENT**

Prior Provision: None.

1. 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.

While changed from the 1956 Act, most of the proposed provisions are not alien to current practice. A large number of state administrators currently have cease and desist authority, either by amendment of the 1956 Act or through their administrative procedure law. A lesser number have provisions for bar. On the other hand, most administrators have no present authority to levy civil penalties.

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.

2. With one exception, none of the above sanctions can be imposed without the person affected having the right to prior notice and opportunity for hearing. The exception concerns the sale of unregistered securities or activities by an unlicensed person who should be licensed and if there is a finding under Section 712 that the situation involves an immediate danger to the public welfare. See subsection (a). In that instance, the Administrator may issue the cease and desist order first and then promptly grant a hearing if requested under Section 712.

Imposition of any of these sanctions is by order of the Administrator which is subject to the applicable provisions of Part VII ("Administration").

3. Subsection (d) borrows from the Truth-in-Lending Act and sets forth the criteria to be considered in levying a civil penalty under this section.

4. All of the remedies in this section are administrative in nature. As provided in subsection (b)(5), the Administrator also can choose to seek directly or subsequently various court-ordered relief under Section 603.

### **SECTION 603. POWER OF COURT TO GRANT RELIEF.**

(a) Upon a showing by the [Administrator] that a person has violated or is about to violate this [Act] or a rule or order of the [Administrator] under this [Act], the [designate the appropriate court] may grant or impose one or more of the following appropriate legal or equitable remedies:

(1) upon a showing of a violation of this [Act] or a rule or order of the [Administrator] under this [Act]:

(i) a temporary restraining order, permanent or temporary prohibitory or mandatory injunction, or a writ of prohibition or mandamus;

(ii) a civil penalty up to a maximum of [\$2,500] for a single violation or of [\$25,000] for multiple violations in a single proceeding or a series of related proceedings;

(iii) a declaratory judgment;

(iv) restitution to investors;

(v) the appointment of a receiver or conservator for the defendant or the defendant's assets; and

(vi) other relief the court considers just.

(2) upon a showing that the defendant is about to violate this [Act] or a rule or order of the [Administrator] under this [Act] only:

(i) a temporary restraining order;

(ii) a temporary or permanent injunction; or

(iii) a writ of prohibition or mandamus.

(b) In determining the appropriate relief under subsection (a), the court shall consider enforcement actions taken and sanctions imposed by the [Administrator] under Section 602 in connection with the transactions constituting violations of this [Act] or a rule or order of the [Administrator] under this [Act].

(c) The [Administrator] is not required to post a bond in an action under this section.

(d) Upon a showing by the securities agency or administrator of another state that a person has violated the securities act of that state or a rule or order of the securities agency or administrator of that state, the court, in addition to any other legal or equitable remedies, may impose one or more of the following remedies:

(1) appointment of a receiver, conservator, or ancillary receiver or conservator for the defendant or the defendant's assets located in this State; and

(2) other relief the court considers just.

#### **COMMENT**

Prior Provision: USA 408; New.

1. This provision has been expanded to match and reflect the various administrative remedies now provided under Section 602.

2. While many of the remedies enumerated in this section may well be authorized under some other statute of this State, it was determined to list them here to make clear the range of authority a state court has in acting upon violations of this Act.

3. The remedies with respect to prospective conduct are limited in subsection (a)(2) to injunctive forms of relief.

#### **SECTION 604. CRIMINAL PENALTIES.**

(a) A person who willfully violates a provision of this [Act], except Section 504, or a rule of the [Administrator] under this [Act], or who violates Section 504, knowing the statement made to be false or misleading in any material respect, is guilty of a [insert the language for felony under applicable state law].

(b) A person who willfully violates a stop order or a cease and desist order issued by the [Administrator] under this [Act] is guilty of a [insert the language for misdemeanor under applicable state law].

(c) A person convicted of violating a rule or order under this [Act] may be fined, but may not be imprisoned, if the person proves lack of knowledge of the rule or order.

(d) A criminal prosecution may not be instituted under this section more than [five] years after the alleged violation.

(e) The [Administrator] may refer evidence concerning violations of this [Act] or a rule or order of the [Administrator] under this [Act] to the [Attorney General or District Attorney] who, with or without a reference, may institute appropriate criminal prosecutions under this [Act].

(f) This [Act] does not limit the power of this State to punish a person for conduct

constituting a crime under other law.

## COMMENT

Prior Provision: USA 409.

1. Unlike the 1956 Act provision, this section now distinguishes between offenses on the basis of felony and misdemeanor classifications. The individual states will need to insert the appropriate terms and fines according to their own criminal law classifications.

2. Criminal liability ordinarily attaches only when a person willfully violates a provision of the Act, a rule promulgated by the Administrator, or a stop or cease and desist order issued by the Administrator. On the meaning of willfully, see comment 4 to Section 212.

3. The provision that no person may be imprisoned for violations of a rule or order if he or she proves lack of knowledge of the rule or order is comparable to that found in most of the federal securities laws.

## SECTION 605. CIVIL LIABILITY.

(a) A person who offers to sell or sells a security in violation of Section 201(a), 301, 305(k), 501(2), or 505(b) or of a condition imposed under Section 305(g), (h), or (i) is liable to one who purchases the security from that person. Upon tender of the security, the purchaser may recover the consideration paid for the security and interest at the legal rate of this State from the date of payment, costs, and reasonable attorney's fees as determined by the court, less the amount of income received on the security. Tender requires only notice 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 the legal rate of this State from the date of disposition of the security, costs, and reasonable attorney's fees determined by the court.

(b) A person who offers or sells a security in violation of Section 501(2) is not liable under subsection (a) if:

(1) the purchaser knew of the untrue statement of a material fact or misleading omission of a statement of a material fact; or

(2) the seller did not know and in the exercise of reasonable care could not have known of the untrue statement or misleading omission.

(c) A person who willfully participates in an act or transaction in violation of Section 502 is liable to a person who purchases or sells a security, other than a security traded on a national securities exchange or quoted on a national automated quotation system administered by a self-regulatory organization, at a price that was affected by the act or transaction for the damages sustained as a result of the act or transaction. Damages are the difference between the price at which the securities were purchased or sold and the market value the securities would have had at the time of the person's purchase or sale in the absence of the act or transaction, plus interest at the legal rate of this State from the date of the act or transaction, costs, and reasonable attorney's fees determined by the court.

(d) A person who directly or indirectly controls another person who is liable under subsection (a) or (c), a partner, officer, or director of the person liable, a person occupying a similar status or performing similar functions, an employee of the person liable if the employee materially aids in the act, omission, or transaction constituting the violation, and a broker-dealer or sales representative who materially aids in the act, omission, or transaction constituting the violation, are also liable jointly and severally with and to the same extent as the other person, but it is a defense that the person did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by which the liability is alleged to exist. With respect to a person who, directly or indirectly, controls another person who is liable under subsection (c), it is also a defense that the controlling person acted in good faith and did not, directly or indirectly,

induce the act, omission, or transaction constituting the violation. Contribution among the several persons liable is the same as in cases arising out of breach of contract.

## COMMENT

Prior Provision: USA 410(a) and (b); New.

1. This section has been rewritten, but, with the exception of subsection (c), is not intended to alter significantly existing law.

2. The sections of this Act which, if violated, give rise to civil liability are fundamental provisions. Sections 201(a) and 301 are the provisions which require the licensing of broker-dealers, sales representatives, and investment advisers and the registration of securities. Sections 305(g), (h), (i), and (k) have to do, respectively, with rules requiring the escrow of securities, impounding of proceeds, and the delivery of a prospectus. Section 505(b) prohibits misrepresentations concerning the effect of registration of particular securities or the availability of an exemption indicating any official approval.

Section 501(2) follows closely Section 12(2) of the Securities Act of 1933 which imposes liability for material misstatements or omissions in the disclosures given to buyers. As is the case with the latter, liability may be imposed on a person in addition to the immediate seller if the person's participation was a substantial contributive factor in the violation. See, *e.g.*, *Davis v. Avco Financial*, 739 F.2d 1057 (6 Cir., 1984).

3. Subsection (a) imposes civil liability when an offer violates one of the specified provisions even though the following sale does not. This is consistent with comparable federal securities law provisions.

4. The measure of damages under subsection (a) is intended to be the substantial equivalent of rescission.

5. Subsection (c) is new. While adequate remedies may lie under the Securities Exchange Act of 1934 and through the efforts of the self-regulatory organizations with respect to market manipulation activity in exchange-listed or most OTC securities, there are no remedies currently available with respect to market manipulation of local securities. The subsection attempts to provide a damages remedy which would put injured persons in the same position they would have been but for the manipulation.

6. The defense of lack of knowledge in subsection (d) is patterned after Section 15 of the Securities Act of 1933. The next to last sentence in subsection (d) makes available to controlling persons a "good faith" defense comparable to that found in Section 20(a) of the Securities Exchange Act of 1934.

The last sentence regarding contribution is intended to avoid the common law rule



which prohibits contribution among joint tortfeasors.

#### **SECTION 606. STATUTE OF LIMITATIONS.**

A person may not obtain relief under Section 605 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.

#### **COMMENT**

Prior Provision: USA 410(e), first sentence.

There appears to be a split among the states today between using a two-year or three-year outside statute of limitation. The Committee opted for the longer three-year limit.

#### **SECTION 607. OFFER OF RESCISSION OR SETTLEMENT.**

(a) Relief may not be obtained under Section 605(a) if, before suit is commenced, the purchaser:

(1) receives a written offer:

(i) stating the respect in which liability under Section 605 may have arisen and fairly advising the purchaser of the purchaser's rights of rescission;

(ii) if the basis for relief under Section 605(a) is 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 the legal rate of this State 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 Section 605(a); 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 three days, the [Administrator] by order prescribes; and

(2) fails to accept the offer in writing within the period specified under paragraph (1)(iv).

(b) The [Administrator] by rule may prescribe the form in which the information specified in subsection (a) must be contained in an offer made under subsection (a).

(c) An offer under subsection (a) must be delivered to the offeree or sent in a manner which assures actual receipt by the offeree.

(d) If, after acceptance, a rescission offer is not performed in accordance with either its terms or this section, the offeree may obtain relief under Section 605 without regard to this section.

## COMMENT

Prior Provision: USA 410(e).

1. The Committee has attempted to create a self-executing procedure by which a person who discovers that there may be liability under Section 605 by reason of a violation of this Act may take steps to offer rescission to the buyer which, if not accepted, will cut off that person's exposure. This is intended to be used most often when a person inadvertently has violated some provision, *e.g.*, nondelivery of a prospectus. It is not meant to be a means by which unregistered securities can be sold and then liability avoided by proceeding with a rescission offer as a result of which the buyers never receive the disclosures required under this Act.

Where the actionable conduct is a violation of Section 501(2), *i.e.*, either misleading disclosure or nondisclosure of material information, the rescission offer in that instance must include disclosures necessary to correct the information previously given to the buyer.

A person seeking to obtain the benefit of this procedure must make a bona fide offer, i.e., possess the financial and other capabilities to carry out the repurchase of securities, if so requested.

2. The Administrator may prescribe the form by which rescission offers generally may be made, but this section does not contemplate that the Administrator will be involved in formulating the content of any specific offer.

3. As an offer to purchase, a rescission offer under this section is subject to the prohibitions of Section 501.

### **SECTION 608. BURDEN OF PROOF.**

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

(b) In a criminal proceeding, the burden of going forward with evidence of a claim of exemption or exception from a definition is on the person claiming it.

### **COMMENT**

Prior Provision: USA 402(d).

1. Subsection (a) codifies existing law.

2. Subsection (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.

### **SECTION 609. LIABILITY; GENERAL PROVISIONS.**

(a) Except as provided in Section 607, a tender required under this [Act] may be made before entry of judgment.

(b) The rights and remedies provided by this [Act] are in addition to any other rights or

remedies that exist at law or in equity, but this [Act] does not create any [claim for relief] [cause of action] not specified in this Part.

(c) A [claim for relief] [cause of action] under this [Act] survives the death of a person who might have obtained relief as a plaintiff or defendant.

### **COMMENT**

Prior Provision: USA 410(c), (d), and (h).

1. Subsections (a) and (c) continue the codification of law made under the 1956 Act.
2. The philosophy of this Act is that where civil liabilities are to be imposed, they should be made as specific as possible and exist only to the extent stated. The last clause thus bars implied rights of action under this Act.

## **PART VII**

### **ADMINISTRATION**

### **COMMENT**

In general, Part VII has been drafted on the assumption that each state adopting the Uniform Securities Act (1985) has some comprehensive administrative procedure act. There is no overwhelming pattern of uniformity with respect to such provisions, however. Over half of the state jurisdictions apparently have adopted the 1961 version of the Model State Administrative Procedure Act or its equivalent. Those states should be able to adopt Part VII substantially as an entirety without the need for significant revision.

To date only a few states have yet adopted the 1981 version of the Model State Administrative Procedure Act. A state which has done so will be able to delete Sections 705(a) and (d), 706, 710, and 712 of this Act.

If a state has no comprehensive administrative procedure act in place, it may wish to consult the Model State Administrative Procedure Act (1981). A principle which has been critical to the administration of the 1956 Act and will continue to be important to this Act is that a party against which an order may be issued or a sanction imposed ordinarily is entitled to an administrative proceeding that affords procedural due process, i.e., notice and opportunity for hearing.

**SECTION 701. ADMINISTRATION OF [ACT].**

The [Administrator] shall administer this [Act] in accordance with [insert any related provision on method of selection, salary, term of office, budget, selection and compensation of personnel, annual report to the Legislature or Governor, which are appropriate to the particular state].

**COMMENT**

Prior Provision: USA 406(a).

**SECTION 702. PROHIBITIONS ON USE OF INFORMATION.**

Neither the [Administrator] nor an employee of the [Administrator] may use for personal gain or benefit information filed with or obtained by the [Administrator] which is not public information. Neither the [Administrator] nor an employee of the [Administrator] may conduct securities dealings based upon information filed with or obtained by the [Administrator], even though public, if there has not been sufficient time for the securities markets to assimilate the information.

**COMMENT**

Prior Provision: USA 406(b).

**SECTION 703. PUBLIC INFORMATION; CONFIDENTIALITY.**

(a) Except as provided in subsection (b), information and documents filed with or obtained by the [Administrator] are public information and are available for public examination under the [freedom of information or open records laws of this State].

(b) The following information and documents do not constitute public information

under subsection (a):

(1) information or documents obtained by the [Administrator] in connection with an investigation under Section 601; and

(2) information or documents filed with the [Administrator] in connection with a registration statement under Part III or a report under Section 209 and constituting trade secrets or commercial or financial information of a person for which that person is entitled to, and has asserted, a claim of confidentiality or privilege authorized by law.

(c) The [Administrator] may disclose:

(1) information obtained in connection with an investigation under Section 601(a) to the extent provided in Section 601(b) subject to the restrictions of subsection (b)(2); and

(2) information obtained in connection with an investigation under Section 601(a), if disclosure is for the purpose of a civil, administrative, or criminal investigation or proceeding by a securities agency, law enforcement agency, or administrator specified in Section 704(a), and the receiving agency or administrator represents in writing that under applicable law protections exist to preserve the integrity, confidentiality, and security of the information.

(d) This [Act] does not create any privilege or diminish any privilege existing at common law, by statute, rule, or otherwise.

### **COMMENT**

Prior Provision: USA 406(b); 413(c).

1. This section reflects the extensive development of freedom of information and open records laws since the 1956 Act was adopted. The general rule represented by subsection (a) is that all information is public information unless expressly provided otherwise. The bracketed language contemplates a reference to the adopting state's freedom of information or open records law where applicable.

2. If the adopting state's freedom of information or open records law contains fully

comparable exceptions, subsection (b) will not be needed. The Committee believes that confidential treatment should be accorded to information in the two categories noted in subsection (b).

3. Subsection (c) authorizes an Administrator to share information obtained in an investigation with an Administrator or law enforcement agency in another jurisdiction conducting a similar investigation, if comparable protections exist under the second state's law to assure confidentiality and security of the information exchanged. In the absence of express statutory authority to share such information, an Administrator releasing such information may be acting at his or her peril.

This requirement could be met by two or more states entering into reciprocal agreements to maintain the confidentiality of the information exchanged.

4. Subsection (d) makes it clear that nothing in the Act affects the question of evidentiary privilege one way or the other. That question is left to the general law in the particular state.

#### **SECTION 704. 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, any self-regulatory organization, any national or international organization of securities officials or agencies, and any governmental law enforcement or regulatory agency.

(b) The cooperation authorized by subsection (a) includes:

(1) establishing a central depository for licensing or registration under this [Act] and for documents or records required or allowed to be maintained under this [Act];

(2) making a joint license or registration examination or investigation;

(3) holding a joint administrative hearing;

- (4) filing and prosecuting a joint civil or administrative proceeding;
- (5) sharing and exchanging personnel;
- (6) sharing and exchanging information and documents subject to the restrictions of [Section 703(b) and (c)] [cite other applicable state law]; and
- (7) formulating, in accordance with the [administrative procedure act of this State], rules or proposed rules on matters such as statements of policy, guidelines, and interpretative opinions and releases.

### **COMMENT**

Prior Provision: None.

1. Uniformity of regulation among the states to the maximum extent appropriate is one of the principal objectives of this Act. To effectuate that objective, it is desirable to authorize expressly significant efforts at cooperation among the securities agencies and administrators at the state, federal, and even international level.

2. Subsection (b) enumerates some of the joint or coordinated efforts which might be undertaken. The CRD system referenced in the COMMENT to Section 205 is an example of subsection (b)(1) already in place.

3. In cooperating with one another, Administrators obviously still must follow and comply with their state's own laws and rules, particularly with respect to administrative procedures.

### **SECTION 705. RULES, FORMS, AND ORDERS.**

(a) In addition to specific authority otherwise granted by this [Act], the [Administrator]:

(1) shall adopt as a rule a description of the organization of the [Administrator's] office which states the general course and method of its organization and where and how a person may obtain information or make a submission or request;

(2) shall adopt rules of practice setting forth the nature and requirements of all



formal and informal procedures available to a person, including a description of all forms and instructions that are to be used by a person dealing with the [Administrator];

(3) may adopt rules, in addition to those otherwise required by this [Act], embodying appropriate standards, principles, and procedural safeguards that the [Administrator] applies in the administration of this [Act]; and

(4) may adopt rules defining any term, whether or not used in this [Act], insofar as the definition is not inconsistent with this [Act].

(b) To keep rules adopted by the [Administrator] in harmony with the regulations adopted by the Securities and Exchange Commission under the federal securities laws and to encourage uniformity with the rules of securities agencies and administrators in other states, the [Administrator], so far as is consistent with this [Act], shall take into consideration the regulations adopted by the Securities and Exchange Commission and the rules of securities agencies and administrators in other states that enact a law comparable to this [Act].

(c) Unless specifically provided in this [Act] to the contrary, a rule or order may not be adopted, amended, or repealed unless the [Administrator] determines that the action is:

(1) in the public interest and appropriate for the protection of investors; and

(2) consistent with the purposes fairly intended by the policy and provisions of this [Act].

(d) The [Administrator] may use his [or her] own experience, technical competence, specialized knowledge, and judgment in the adoption of a rule.

(e) 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 a required financial statement must be certified and by whom. Unless the [Administrator] by rule or order provides otherwise, a financial statement required under this [Act] must be prepared in accordance with generally accepted accounting principles or other accounting principles as are prescribed for the issuer of the financial statement by the Securities and Exchange Commission.

(f) The [Administrator] shall file [in the office of the Secretary of State or other location required by law] and in the [Administrator's] office each rule adopted or amended and all rules existing on the effective date of this [Act] that have not been previously filed. The filing must be done as soon after adoption or amendment of the rule as is practicable. The [Administrator] shall affix to each rule a certification of the time and date of filing and keep a permanent register open to public inspection of all filed rules.

### **COMMENT**

Prior Provision: USA 412.

1. Subsection (a) follows generally Section 2-104 of the Model State Administrative Procedure Act (1981) in specifying what the Administrator must do and what he or she may do. As noted in the introductory COMMENT to this Part, it is expected that the adopting state will have an administrative procedure act which includes specific rule-making and adjudication procedures.

2. Subsection (b) follows the general objectives of Section 704 and encourages consideration of uniformity in the adoption of additional exemptive provisions.

3. Subsection (c) specifies the standards which must be followed by the Administrator when adopting, amending, or repealing any rule or order under this Act. These standards are substantially the same as appear in various places throughout the 1956 Act.

4. An order is directed to one or more particular persons while a rule or form is intended to be of general application.

5. Subsection (d) is new and is based upon Section 3-106(a) of the Model State

Administrative Procedure Act (1981).

6. Subsection (e) follows existing Section 412(c), but adds an exception from generally accepted accounting principles to the extent some other principles are permitted under the accounting rules adopted by the Securities and Exchange Commission. Section 19(a) of the Securities Act of 1933 gives the SEC special power to prescribe accounting rules and requirements.

7. Subsection (f) continues the practice under Section 412(d) of the 1956 Act, but the language is patterned after Section 3-114(a) of the Model State Administrative Procedure Act (1981). If the appropriate state official with whom rules are filed is other than the Secretary of State, the language in brackets should be modified.

### **SECTION 706. DECLARATORY ORDERS AND RULINGS.**

(a) Any person may petition the [Administrator] for a declaratory order as to the applicability to specified circumstances of a statute, rule, or order under this [Act]. The [Administrator] may issue a declaratory order in response to a petition for that order unless the [Administrator] determines that the petition fails to comply with the [Administrator's] rules or, if the order were issued, would substantially prejudice the rights of a person who would be a necessary party and who does not consent to the determination of the matter by a declaratory order.

(b) The [Administrator], upon application by an interested party, may conduct a hearing and issue a declaratory ruling as to the applicability of this [Act] or a rule or order of the [Administrator] under this [Act] to a person, security, or transaction, or as to the meaning of a term used in this [Act].

### **COMMENT**

Prior Provision: USA 413(a); New.

1. The 1956 Act simply provides that the Administrator may issue interpretive opinions. Subsection (a) expands the concept, following Section 2-103(a) of the Model State Administrative Procedure Act (1981). As noted in the comment to the latter section, the purpose

is "to provide an inexpensive and generally available means by which persons may obtain fully reliable information as to the applicability of agency administered laws to their particular circumstances."

2. A declaratory order may be relied upon by the parties filing the petition. A declaratory ruling under subsection (b) is intended to have general applicability and may be relied upon by all persons subject to the jurisdiction of the Administrator under this Act.

#### **SECTION 707. GOOD FAITH RELIANCE.**

No provision of this [Act] imposing liability applies to an act done or omitted in good faith in conformity with:

(1) a rule or order adopted by the [Administrator], notwithstanding that the rule or order is later amended, repealed, or determined by judicial or other authority to be invalid; or

(2) a declaratory order or ruling issued by the [Administrator] under Section 706.

#### **COMMENT**

Prior Provision: USA 412(e).

This section is not intended to preclude an Administrator from utilizing a "no-action" procedure similar to that used by the staff of the Securities and Exchange Commission, but a no-action letter is not a "rule or order" entitled to the benefits of this section. The protection afforded by this section extends only to an administrative position formally expressed in a rule, form or order, or a declaratory order or ruling.

#### **SECTION 708. CONSENT TO SERVICE OF PROCESS.**

(a) An applicant for licensing or registration under this [Act] or an issuer who proposes to offer a security in this State through an agent shall file with the [Administrator], in the form the [Administrator], by rule, prescribes, 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 or order of the [Administrator] under this [Act] after the consent is filed, with the same force and validity as if

served personally on the person filing the consent.

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

(c) If a person, including a nonresident of this State, engages in conduct prohibited or made actionable by this [Act] or a rule or order of the [Administrator] under this [Act] and the person has not filed a consent to service of process under subsection (a), the engaging in the conduct constitutes the appointment of the [Administrator] as the person's agent for service of process in a noncriminal proceeding against the person, a successor, or personal representative which grows out of the conduct.

(d) A consent to service filed on behalf of an issuer organized or domiciled under the laws of a foreign country whose securities are being offered in this State other than by or through underwriters, must be accompanied by an opinion of counsel stating that a judgment of United States courts will be recognized by the courts of the country in which the issuer is organized or domiciled.

(e) Service under subsection (a) or (c) 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 no consent to service of process has been filed, at the last-known address, or takes other steps reasonably calculated to give actual 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 such further time as the

court, or the [Administrator] in a proceeding before the [Administrator], allows.

(f) Service as provided in subsection (e) may be used in a proceeding before the [Administrator] or by the [Administrator] in a proceeding in which the [Administrator] is the moving party.

(g) If the process is served under subsection (e), the court, or the [Administrator] in a proceeding before the [Administrator], shall order continuances as may be necessary to afford the defendant or respondent reasonable opportunity to defend.

### **COMMENT**

Prior Provision: USA 414(g), (h), and (i).

1. A provision requiring nonresidents to file a consent to service of process is quite common. As with the 1956 Act, this requirement is extended to every applicant for licensing since a resident may become a nonresident after filing.

The issuer does not have to file a consent to service of process unless it proposes to offer the security in the state through somebody acting on an agency basis. Since the civil liability provisions of Section 605(a) do not apply except in a suit by a buyer against the seller, the issuer in a firm commitment underwriting is civilly liable only to the underwriter, who in turn is liable to the selling dealer, who in turn is liable to the buyer. In other words, it is only when the security is sold on an agency basis that title passes directly from the issuer to the final buyer.

2. Subsections (c), (e), (f), and (g) substantially follow Section 414(h) and (i) of the 1956 Act. The purpose is to provide for substituted service of process when a seller in one state directs an offer into a second state either in violation of the registration provisions of the second state or fraudulently. Under this section, the buyer may sue the seller in the buyer's own state and then bring suit on the judgment in the second state. The constitutionality of such statutes has been sustained long ago.

3. Subsection (d) is intended to give some assurances to investors when the issuer is a foreign corporation. There should be no concern in an underwritten offering because the buyer at least will have the underwriters and the local dealer available to sue.

### **SECTION 709. ADMINISTRATIVE FILES AND RECORDS.**

(a) The [Administrator] shall keep one or more registers of:

- (1) all applications for licensing and registration under this [Act];
- (2) all licenses and registration statements that become effective under this [Act];
- (3) all disciplinary and enforcement orders issued and reports of investigation made under this [Act];
- (4) all declaratory orders and rulings issued under this [Act]; and
- (5) all other orders issued under this [Act].

[ (b) The [Administrator] shall maintain records consistent with applicable law. ]

[ (b) The [Administrator] shall retain:

(1) all licenses and related applications and all registration statements currently effective or that have been effective within the last [five] years;

(2) all licenses and related applications and all registration statements that have been denied, suspended, or revoked within the last [five] years, and the order of suspension, denial, or revocation;

(3) all investigatory files under this [Act] that are open or that have been closed within the last [five] years, and any disciplinary or file-closure order pertaining to the file;

(4) the transcript or record of all administrative hearings held during the last [five] years; and

(5) any other orders of the [Administrator] entered under this [Act]. ]

(c) All records required to be maintained by subsections (a) and (b) may be maintained in any form of data storage.

(d) Upon request, the [Administrator] shall certify under the seal of office a copy as being a true and correct copy of the records maintained by the office. The [Administrator] by rule may establish reasonable charges for furnishing or certifying copies. In an investigation or

proceeding under this [Act], a copy so certified is prima facie evidence of the contents of the records certified.

### **COMMENT**

Prior Provision: USA 413(b), (d).

1. Substantially all states have some provisions of this type.
2. If a state has a comprehensive records retention law, it need adopt only the first brief alternative subsection (b). If it does not, it should consider the second alternative (b).
3. The records required to be maintained under this section may be in computer or microform format or any other form of data storage.

### **SECTION 710. ADMINISTRATIVE PROCEEDINGS.**

The [Administrator] may commence an administrative proceeding at any time with respect to a matter within the [Administrator's] jurisdiction. The [Administrator] shall commence an administrative proceeding upon the application of a person, unless:

- (1) the [Administrator] lacks jurisdiction over the subject matter;
- (2) resolution of the matter requires the [Administrator] to exercise discretion to determine whether or not to issue an order;
- (3) a statute vests the [Administrator] with discretion to conduct or not to conduct an administrative proceeding before issuing an order to resolve the matter and, in the exercise of discretion, the [Administrator] determines not to conduct an administrative proceeding;
- (4) resolution of the matter does not require the [Administrator] to issue an order that determines the person's legal rights, duties, privileges, immunities, or other legal interests;
- (5) the matter is not timely submitted to the [Administrator]; or
- (6) the matter is not submitted in a form substantially complying with the rules of the



[Administrator].

### **COMMENT**

Prior Provision: None.

This section is based upon Section 4-102 of the Model State Administrative Procedure Act (1981). It states when the Administrator may and when the Administrator must commence an administrative proceeding.

### **SECTION 711. PROVISIONS APPLICABLE TO ADMINISTRATIVE PROCEEDINGS.**

(a) All actions of the [Administrator] including administrative proceedings, adoption of rules, and issuance of orders are governed by [state administrative procedure act], but:

(1) the issue of a stop order under Section 303(e) is governed by Section 303(e);

(2) the issue of an order pursuant to an emergency administrative proceeding is governed by Section 712; and

(3) the issue of a declaratory order or ruling is governed by Section 706.

(b) All rules and orders issued under this [Act] are subject to judicial review [in accordance with the state administrative procedure act].

### **COMMENT**

Prior Provision: None.

1. The purpose of this section is to require that all administrative proceedings by the Administrator under this Act be subject to the requirements for notice and prior hearing under the state administrative procedure act, except as provided otherwise in this Act or in connection with emergency action authorized under Section 712.

2. 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.

### **SECTION 712. EMERGENCY ADMINISTRATIVE PROCEEDINGS.**

(a) The [Administrator] may use emergency administrative proceedings in a situation involving an immediate danger to the public welfare requiring immediate action.

(b) The [Administrator] may take only such action as is necessary to prevent or avoid the immediate danger to the public welfare that justifies use of emergency administrative proceedings.

(c) The [Administrator] shall 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 and the [Administrator's] decision to take the specific action.

(d) The [Administrator] shall give such notice as is practicable to persons who are required to comply with the order. The order is effective when issued.

(e) After issuing an order under this section, the [Administrator] shall proceed as quickly as feasible to complete proceedings that would be required [under the state administrative procedures act] if the matter did not involve an immediate danger.

(f) The record of the [Administrator] consists of the documents regarding the matter that were considered or prepared by the [Administrator]. The [Administrator] shall maintain these documents as the official record.

(g) Unless otherwise required by law, the [Administrator's] record need not constitute the exclusive basis for the [Administrator's] action in emergency administrative proceedings or for judicial review of the action.

(h) An order issued under this section is subject to judicial review [in accordance with the state administrative procedure act].

#### **COMMENT**

Prior Provision: None.

1. This section follows closely the emergency adjudicative proceedings provision of the Model State Administrative Procedure Act (1981).

2. The instances in which the Administrator needs to proceed under this section rather than after notice and prior hearing should be extraordinary. The principal example in this Act of such instances is set forth in Section 602(a).

## PART VIII

### MISCELLANEOUS PROVISIONS

#### **SECTION 801. SCOPE OF [ACT].**

(a) Sections 201, 301, 501, 502, 505, and 605 apply to a person who sells or offers to sell a security if:

- (1) an offer to sell is made in this State; or
- (2) an offer to purchase is made and accepted in this State.

(b) Sections 201, 501, 502, and 505 apply to a person who purchases or offers to purchase a security if:

- (1) an offer to purchase is made in this State; or
- (2) an offer to sell is made and accepted in this State.

(c) For the purpose of this section, an offer to sell or to purchase is made in this State, whether or not either person is present in this State, if the offer:

- (1) originates in this State; or
- (2) is directed by the offeror to a destination in this State and received where it is directed, or at a post office in this State if the offer is mailed.

(d) For the purpose of this section, an offer to purchase or to sell is accepted in this State if acceptance is communicated to the offeror in this State and has not previously been communicated to the offeror, orally or in writing, outside this State. Acceptance is communicated to the offeror in this State, whether or not either person is present in this State, if the offeree directs it to the offeror in this State reasonably believing the offeror is in this State and it is received where it is directed, or at a post office in this State if an acceptance is mailed.

(e) For the purpose of subsections (a) through (d), an offer to sell or to purchase made in a newspaper or other publication of general, regular, and paid circulation is not made in this State if the publication:

(1) is not published in this State; or

(2) is published in this State, but has had more than two-thirds of its circulation outside this State during the last 12 months.

(f) For the purpose of subsection (e), if a publication is published in editions, each edition is a separate publication except for material common to all editions.

(g) For the purpose of subsections (a) through (d), an offer to sell or to purchase made in a radio or television program or other electronic communication received in this State which originates outside this State is not made in this State.

(h) For the purpose of subsection (g), 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.

### COMMENT

Prior Provision: USA 414(a) through (f).

1. This section defines the application of the Act in multistate or international transactions where only some of the elements occur in this State. It is not limited in its impact to the civil liability provisions of Section 605. It does determine the scope of the Act for all types of proceedings - administrative, civil, and criminal. The law is well settled that a person may violate the law of a particular state without ever being within the state or performing within the state every act necessary to complete the violations of law.

2. Section 801 perhaps can best be explained in the context of a civil action under Section 605(a) by a buyer in State X against a selling broker-dealer in State Y:

i. The basic approach of subsection (a)(1) is to apply the specified sections when "an offer to sell is made in this State."

ii. Subsection (c) provides that an offer which originates in State Y and is directed to State X is made in both states. Hence, the statute of State X applies under subsection (c)(2). By the same token, the statute of State Y also applies under subsection (c)(1). The theory is that State Y should not be used as a base of operations for defrauding persons in other states. It thus is possible and indeed often likely that more than one statute will apply to any single transaction.

iii. Subsection (e)(1) concerns the problem of offers in the form of newspaper and magazine advertisements. It provides basically that an advertisement in a regular newspaper, magazine, or periodical is not an offer in any state other than the state of publication. Publication means the acts of assembling and printing the newspaper or periodical (as distinct from the acts of distributing or circulating the newspaper or periodical). In the case of magazines or newspapers of national circulation, the place of publication may be purely fortuitous so far as the purposes of this section are

concerned. Accordingly, subsection (e)(2) also includes a publication which is published within the state but has more than two-thirds of its circulation outside the state.

iv. Subsections (g) and (h) establish rules of radio and television programs originating outside the state. A program generally is considered to originate in the state where the broadcast studio or the originating source of transmission is located.

v. Subsection (a)(2) completes the circuit for subsection (e), since the former provides that a person in State X who makes an offer to buy as a result of an advertisement he sees in a paper published in State Y (or a radio or television program originating in State Y) may cause the statute to be applicable if the seller then accepts the offer "in this State," i.e., State X. Subsection (d) specifies when an offer is "accepted in this State."

vi. If the selling broker-dealer in State Y merely sends a confirmation or delivers the security into State X, or the buyer in State X sends a check in payment from within State X, the statute of State X does not apply except when under subsection (d) the confirmation or delivery constitutes the seller's acceptance of the buyer's offer to buy.

3. The applicability of the statute to buyers as distinct from sellers is covered by subsection (b), which is the converse of subsection (a). However, there is no civil liability under Section 605(a) as to the violative acts of buyers.

## **SECTION 802. CONTRACT PROVISIONS.**

(a) A person subject to this [Act] who makes or engages in the performance of a contract in violation of this [Act] or a rule or order of the [Administrator] under this [Act], or who acquires a right under a contract with knowledge of the facts by which its making or performance is in violation of this [Act], may not obtain relief on the contract.

(b) A provision in a contract entered into or effective in this State, binding a person acquiring a security to waive compliance with this [Act] or a rule or order of the [Administrator] under this [Act] is nonenforceable. A provision in a contract containing (i) an agreement to arbitrate or (ii) a choice of law provision in a contract between persons engaged in the securities business is not a provision waiving compliance with this [Act] and is enforceable in accordance

with its terms.

### **COMMENT**

Prior Provision: USA 410(f) and (g).

1. Subsection (a) carries over from the 1956 Act the general concept of both federal and state securities law that one who makes an unlawful contract will not be allowed to enforce it. See, for example, *Byrnes v. Faulkner, Dawkins & Sullivan*, 550 F.2d 1303 (2 Cir. 1977).

2. In general, contractual provisions waiving compliance with this Act are unenforceable. The two exceptions are agreements to arbitrate, as to which the Federal Arbitration Act overrides contrary state law, and agreements solely among persons engaged in the securities business specifying a particular choice of law.

### **SECTION 803. UNIFORMITY OF APPLICATION AND CONSTRUCTION.**

This [Act] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [Act] among states enacting it and to coordinate the interpretation and administration of this [Act] with the related federal laws and regulations.

### **COMMENT**

Prior Provision: USA 415.

The first part of this section is the standard language used by the National Conference of Commissioners on Uniform State Laws. The second part recognizes that a principal objective is to coordinate securities regulation at the federal and state levels insofar as practicable.

### **SECTION 804. SHORT TITLE.**

This [Act] may be cited as the Uniform Securities Act (1985).

### **COMMENT**

Prior Provision: USA 416.

### **SECTION 805. SEVERABILITY CLAUSE.**

If any provision of this [Act] or its application to any person or circumstance 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.

#### **COMMENT**

Prior Provision: USA 417.

#### **SECTION 806. EFFECTIVE DATE.**

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

#### **COMMENT**

Prior Provision: USA 419.

#### **SECTION 807. REPEAL AND SAVING PROVISIONS.**

(a) The [identify the existing act or acts] is [are] repealed except as saved in this section.

(b) Law repealed by this [Act] exclusively governs a suit, action, prosecution, or proceeding that is pending on the effective date of this [Act] or may be initiated on the basis of facts or circumstances occurring before the effective date of this [Act], but a civil action or proceeding may not be maintained to enforce any liability under law repealed by this [Act] unless brought within the earlier of the period of limitation that applied when the [claim for relief] [cause of action] accrued or two years after the effective date of this [Act].

(c) All effective registrations under law repealed by this [Act], all administrative orders relating to those registrations, and all conditions imposed upon those registrations remain in effect for as long as they would have remained in effect if this [Act] had not been enacted. They



are considered to have been filed, issued, or imposed under this [Act], but are governed by the law repealed by this [Act].

(d) A law repealed by this [Act] applies to an offer to sell or sale made within one year after the effective date of this [Act] pursuant to an offering begun in good faith before the effective date of this [Act] on the basis of an exemption available under the repealed law.

(e) Judicial review of all administrative orders as to which review proceedings have not been instituted before the effective date of this [Act] are governed by [state administrative procedure act] but a review proceeding may not be instituted unless the petition for review is filed within the earlier of the period of limitation that applied to a review proceeding when the order was entered or 60 days after the effective date of this [Act].

#### **COMMENT**

Prior Provision: USA 418.

1. The purpose of this section is to facilitate the transition from whatever existing securities act the adopting state has to this Act.

2. Existing regulations are not automatically saved under this provision. An Administrator desiring to continue in effect prior regulations which are not inconsistent with this Act will need to take affirmative action under Section 705 to do so.