IN THE SUPREME COURT
APPEAL FROM THE MICHIGAN COURT OF APPEALS
(Shapiro, P.J., and Letica and Feeney, JJ.)

LA DEVELOPERS, LLC, AND DAVID BYKER, Petitioners-Appellants,	MSC No. 165824
v.	COA No. 358656
DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS—CORPORATIONS, SECURITIES, AND COMMERCIAL LICENSING BUREAU, Respondent-Appellee.	Trial Ct. No. 20-002976-AA Kent County Circuit Court

APPENDIX TO AMICUS CURIAE BRIEF OF THE BUSINESS LAW SECTION OF THE STATE BAR OF MICHIGAN

9. Analysis of Substitute Senate Bill 834

10. The Economic Realities of a Security Is There a More Meaningful Formula

11. Securities Regulation 6th Edition

12. Michigan Securities Regulation 2nd Edition

Exhibit 1

SEC Sues Coinbase, SBM Business Law Section

STATE BAR OF MICHIGAN
BLS
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SEC Sues Coinbase to Establish Jurisdiction Over Cryptocurrencies and Crypto Exchanges

By Matthew P. Allen

The U.S. Securities and Exchange Commission sued Coinbase, Inc., alleging the crypto assets Coinbase made available for trading on its exchange met the definition of "securities." Because Coinbase did not register the assets as securities, and because it did not itself register as a securities broker or exchange operator, the SEC alleges it has jurisdiction to prosecute Coinbase for these securities registration violations. If the court accepts the SEC's position that the SEC has jurisdiction to regulate crypto assets, it could broadly impact the trajectory of crypto as an accepted currency, investment, and trading medium.

The SEC Says the Test for Investment Contracts Set Forth in the 1946 U.S. Supreme Court Opinion *SEC v WJ Howey Co*[1] Applies to Determine Whether Crypto Assets Are Securities

In a June 6, 2023, federal court complaint filed in the Southern District of New York, the SEC alleges that Coinbase, Inc. operated a trading platform for the purchase, sale, and trading of crypto asset securities without registering as a securities broker, as a securities exchange, or as a clearing agency.[2] The Coinbase complaint takes the position that Coinbase's crypto assets are "investment contracts" under the U.S. Supreme Court's test set forth in *SEC v WJ Howey Co*.[3] Based on this finding, the SEC alleges it has jurisdiction to require Coinbase to register as an exchange under Section 5 of the 1934 Exchange Act, a broker under Section 15(a) of the Exchange Act, and a clearing agency under Section 17A(b) of the Exchange Act.[4] By failing to register, and combining the activities of a broker, exchange, and clearing agency in one entity, the SEC alleges Coinbase puts investors at significant risk by avoiding the registration, disclosure, inspection, and anti-conflict of interest protections of the securities laws.[5]

General Overview of Cryptocurrency and Cryptocurrency Markets

Cryptocurrencies are digital currencies that trade through an exchange medium that does not rely on a central governmental or banking authority to uphold or maintain its value. These decentralized systems eliminate the need for traditional intermediaries, like banks, to validate cryptocurrency transfers. Speaking very generally, a cryptocurrency is a digital currency represented by a "coin" or "token," whose ownership is tracked by a "blockchain." Blockchains act as ledgers of sorts to track the issuance or transfer of coins. Blockchains are so named because their list of records—or blocks—are linked and secured using cryptographic encryption. A coin owner can access, receive, trade, or transfer her coins using her "wallet," which allows her to access the blockchains that hold her coins using her private keys. Owners of cryptocurrency assets can buy and trade them for money or other digital currencies on cryptocurrency exchanges.

Cryptocurrency transactions that are processed by the coin's exchange medium[6] are validated by a process called "mining." If a miner successfully validates a transaction, the miner receives cryptocurrency as a reward. This validation process is important because it is the way blocks are added to a blockchain, thus providing a consensus among users as to the existence and ownership of their cryptocurrencies, and because the rewards to miners increase the supply of currency. The two main mining mechanisms in blockchains are "proof of work" or "proof of stake." Proof of work uses computers called "validator nodes" to "mine" crypto transactions in a block by using trial and error to solve a difficult mathematical problem. The first miner that finds a solution to this problem and has other miners validate and accept it can update the blockchain and, in return, receive the blockchain's native crypto asset as a reward. Proof of stake involves se-

lecting "validators" for a block from crypto asset owners who then "stake" a minimum number of crypto assets as collateral for their mining performance. A company may use an "initial coin offering (ICO)" as a means to raise funds for its crypto venture.[7]

Because proof of work cryptocurrency mining involves solving very complicated mathematical problems, it requires complex computers and consumes significant electrical power. Thus, the cost of computing equipment and electricity can be a significant expense. Miners have to gauge whether the expense is worth the payoff of receiving cryptocurrency rewards if their mining efforts are successful. This has caused miners to pool assets and resources to "split" the cost of mining. The *Audet v Fraser* case, discussed below, analyzed the *Howey* test to determine whether the value of the mining process was predominantly derived from the company hosting the mining computers, or whether the value was in the process of the miners—who bought shares in the computers—in successfully mining for new currencies. If the value was mainly born from the efforts of the company, the assets are more likely securities. If the value is driven mainly from the efforts of the miners, then the assets are less likely securities. The *Audet* court decided differently as to various assets in that case.

SEC's Application of *Howey* to the Coinbase Assets in the Coinbase Complaint

Coinbase operates a trading platform through which consumers can buy, sell, and trade cryptocurrency. The Coinbase platform has 108 million users and trades hundreds of crypto assets and accounts for billions of dollars of trading per day. Coinbase also offers a broker product for routing orders though the Coinbase platform (Coinbase Prime), and a wallet which routes orders through third-party platforms (Coinbase Wallet).[8] Central to the SEC's liability theory is its definition of 13 crypto assets that trade on the Coinbase platform as securities using the *Howey* test (crypto asset securities). The crypto asset securities are generally different native tokens available on different blockchains. The SEC alleges that Coinbase solicits its customers and facilitates their trading of cryptocurrency assets on its platform. These securities are made available on the Coinbase platform and through Coinbase Prime and Coinbase Wallet. The SEC applies the *Howey* test to these crypto asset securities in paragraph 126 by calling them "investment contracts" based on statements by the crypto asset issuers, promotors, and Coinbase that have led reasonable investors to expect profits from the "managerial or entrepreneurial" efforts of the issuers and promotors.[9]

The SEC also applied the "common enterprise" element in *Howey* to a different class of crypto asset securities in which Coinbase allowed investors to take "stakes." Blockchains that rely on proof of stake for adding blocks use "validators" to reach agreement about which transactions on the blockchain are valid. This is done by validators committing—or "staking"—a set amount of the blockchain's native asset, which is held as collateral. If the validator succeeds in proposing new blocks, voting on proposed blocks, or other consensus activities, then the validator receives rewards such as added amounts of native assets. If the validator underperforms, he loses his collateral of staked assets. But staking is expensive. Besides having to stake minimum amounts of native assets to participate, validators also have to have access to and run a "validator node"—which is computing software and hardware to run staking activities full time.[10]

Coinbase's staking program allowed investors to pool their assets to meet minimum staking amounts for five crypto asset securities. Coinbase also offers and operates its own validator node that it uses for staking activities. In exchange for providing stake program investors with the ability to pool stakes and use of its validator nodes, Coinbase charges a 25% or 35% commission based on the total rewards obtained from the staking activity, which Coinbase distributes *pro rata* to stake program investors. The SEC devotes almost 30 paragraphs in the Coinbase complaint describing how the staking program, as it applies to the five stakeable crypto asset securities, satisfies the elements of the *Howey* test.[11] The Coinbase complaint alleges 3 elements of the *Howey* test: 1) "Participants in the Coinbase Staking Program Invest Money;" 2) "Coinbase Staking Investors Participate in a Common Enterprise;" and 3) "Coinbase Staking Program Investors Reasonably Expect to Profit from Coinbase's Efforts."[12]

The Coinbase complaint defines each of these elements consistent with the analysis of these elements in the *Audet v Fraser* deci-

The Coinbase complaint takes the position that Coinbase's crypto assets are "investment contracts" under the U.S. Supreme Court's test set forth in *SEC v WJ Howey Co*.

sion, discussed below. For example, the SEC alleges that staking eligible crypto assets meets the "investment of money" prong of the *Howey* test.[13] And although the Coinbase complaint does not mention them by name, it describes the two ways a plaintiff can meet the common enterprise element as defined in the *Audet* opinion:

- *Horizontal commonality*—the fortunes of staking program investors are tied to those of other investors because all their assets are pooled into a Coinbase staking wallet and returns are delivered *pro rata*;[14] and
- *Vertical commonality*—the fortunes of the investors in the five staking crypto asset securities are tied to the fortunes of Coinbase because Coinbase's commissions increase with the increase of the rewards from the staking activities.[15]

Finally, the SEC alleges satisfaction of the third *Howey* factor because public statements made by Coinbase in its marketing and investor materials cause investors "to reasonably expect that they may obtain investment returns generated by Coinbase's efforts with respect to the Staking Program."[16]

Because the allegations in the Coinbase complaint are just that, it helps to understand how a court may apply the *Howey* elements to crypto assets and facts somewhat akin to those in the Coinbase complaint.

The Coinbase platform has 108 million users and trades hundreds of crypto assets and accounts for billions of dollars of trading per day.

Audet v Fraser —A Template for the *SEC v Coinbase* Analysis

A 2022 federal trial court decision from Connecticut, *Audet v Fraser*,[17] illustrates how a court has analyzed similar crypto assets under the *Howey* test. In *Audet*, the court overturned part of a federal jury verdict which found that cryptocurrency-related assets of a crypto mining company were not "securities" under the federal *Howey* test for investment contracts. GAW Miners, LLC ("GAW") sold and marketed several crypto products: 1) "Hashlets," which were computers used by GAW to mine for cryptocurrency; 2) "Paycoin," GAW's cryptocurrency; 3) "Paybase," which was a platform funded with the goal of having merchants adopt consumer payment methods to use Paycoin at their stores more quickly and seamlessly; 4) "Hashpoints," which served like a GAW credit-card on which owners of the Hashlet machines could earn "Hashpoint" credits they could trade for Paycoin; and 5) "HashStakers," which served as a wallet where owners could lock their Paycoins for a time and gain interest. A federal jury found that none of these crypto assets met the *Howey* test for investment contract securities. The court upheld the jury verdict as to all of the crypto assets except Paycoin, which the court found was a security and thus granted a new trial as to the securities fraud claims related to Paycoin.

The *Audet* court instructed the jury as to three main elements of the *Howey* test: "(1) an investment of money, (2) in a common enterprise; (3) with profits to be derived solely from the efforts of others."[18] The Court analyzed each of these factors for the Hashlet and Paycoin crypto products.[19]

Investment of Money

The court held that cash is not the only form of investment that will meet this *Howey* factor. The defendant argued that the plaintiffs did not invest money because they paid for their Paycoin by using Hashpoint credits they earned, rather than with money or other cryptocurrency. The court rejected this argument, collecting cases that held that "cash is not the only form of contribution or investment that will create an investment contract … [T]he 'investment' may take the form of 'goods and services' or some other 'exchange of value.'"[20] The court found that exchanging Hashpoints for Paycoin was an adequate exchange of value because plaintiffs gave up rights to receive Bitcoin or mining payouts in exchange for Hashpoints, which they used to acquire Paycoin. "In turn, GAW retained the Bitcoin or other cryptocurrency it would have paid out to the plaintiffs and ultimately gave the plaintiffs Paycoin in exchange for Hashpoints."[21]

Common Enterprise – Horizontal and Vertical Commonality

The court found that the common enterprise element requires a finding of either "horizontal commonality or strict vertical commonality."[22] Horizontal commonality exists when the fortunes of investors are tied to each other. Vertical commonality exists when the fortunes of investors are linked to the fortunes of the company.

The court found there was no horizontal commonality for the Hashlet owners because they could make profits or sustain losses "independent of the fortunes of other purchas-

ers."[23] This was because the Hashlet owners could receive vastly different payouts depending on which pools each owner mined each day. Even if two owners were mining in the same pool, one owner could "boost" his or her Hashlets to generate a larger payout. Because owners could receive different payouts depending on which pools they mined, or whether they boosted their Hashlets, the court found support for the jury verdict that the fortunes of one Hashlet owner were not tied to those of fellow owners.

The court also found there was no vertical commonality for Hashlet owners because their fortunes were not tied to GAW's fortunes. Owners paid an upfront, flat fee for their Hashlet. GAW did not profit directly from an owner's mining activities or the use of mining power in various mining pools. In other words, "GAW's profit was not proportional to that of the Hashlet owner—it earned the same amount regardless of whether the Hashlet owner earned a huge profit or a small one."[24]

But the court did find horizontal commonality among the Paycoin owners. GAW's promotional materials said it created a "Coin Adoption Fund" as part of its initial coin offering that was used to facilitate widespread adoption of the use of Paycoin.[25] When a purchaser received their Paycoin, the price of the Paycoin rose and fell at one time across the board, such that Paycoin owners gained or lost profit and value in proportion to the amount of Paycoin they owned. The court found this similar to other crypto cases in which courts found horizontal commonality where investors paid money to receive cryptocurrencies whose value was tied to the companies' success of developing a blockchain or other parts of a "digital ecosystem," which if successful would increase the value of the cryptocurrency.[26] Here, investors in Paycoin pooled their assets for GAW's use with the Coin Adoption Fund to promote Paycoin, which if successful would increase the owner's Paycoin value. Because the court found horizontal commonality for Paycoin, it didn't need to analyze vertical commonality.

Expectation of Profit from the Efforts of Others

The court found a reasonable jury could conclude that the profits an owner of Hashlets earned were not "derived primarily from the entrepreneurial or managerial efforts of GAW … ."[27] The court found that GAW's activity was limited to housing the physical mining equipment and providing sufficient electricity for the equipment. But the Hashlet owners selected the mining pools and how they allocated their mining power. As a result, some Hashlet owners did much better than other owners based on their mining decisions. GAW's role as the court saw it was limited to housing and operating the mining equipment the owners used. So a Hashlet owner's profits were not primarily based on GAW's managerial or entrepreneurial efforts. The court distinguished other cases were the value of the crypto assets depended almost entirely on the company's success in launching and operating a blockchain or digital ecosystem.[28]

The court did find that the profits an owner of Paycoin earned were based largely on the efforts of GAW. The value of Paycoin was tied to the company's unique efforts to drive the adoption of Paycoin in the market and with merchants. The more merchants adopted Paycoin as a payment method, and the more consumers who used Paycoin, the more valuable Paycoin became. GAW used three rounds of initial coin offerings to create the "world's first" Coin Adoption Fund as a value-generation process for Paycoin. There was no evidence that general Paycoin purchasers with no affiliation with GAW had any control or role in this value-creation process for Paycoin. The court rejected the argument that Paycoin did not depend on GAW's efforts because it used open-source software that anyone could recommend changes to, which Bitcoin and other owners can't do. The court pointed out that GAW still controlled what changes were made to the Paycoin software, and that these software changes did not impact the growth in value of Paycoin as much as the merchant adoption efforts of GAW.[29] The court also rejected the argument that because Paycoin was traded on public exchanges its value was not tied to GAW's efforts as much as market forces. The court said this ignored evidence of GAW's "essential role" of establishing the market for Paycoin.[30]

Finally, the defendants argued that GAW failed to promote Paycoin as an investment. Rather, the defendants argued purchasers of Paycoin were mainly interested in consuming Paycoin as a medium to make purchases from merchants. The court pointed out that while some Paycoin owners may have had "consumptive intent," the merchant adop-

Because the allegations in the Coinbase complaint are just that, it helps to understand how a court may apply the *Howey* elements to crypto assets and facts somewhat akin to those in the Coinbase complaint.

tion efforts undertaken by GAW for Paycoin were attempts to build an ecosystem that would add value to Paycoin that owners could realize by holding Paycoin and trading it following a public launch for a profit.[31] Thus, the evidence predominantly showed that purchasers of Paycoin were interested in the profits tied to its value and "not because they were excited at the prospect of using it to buy groceries."[32]

Conclusion

While human beings and machines may increasingly find ingenious ways to leverage technology to create and use capital for investment, the tests employed to determine whether those sophisticated assets are securities have stood the test of time. It will be interesting to see whether securities regulators and the courts use cases like *Coinbase* to develop additional or different standards to determine whether cryptocurrency assets should be treated as securities, and if so, whether the existing securities laws and regulations are sufficient.

NOTES

1. 328 US 293 (1946).
2. *U.S. Securities and Exchange Commission v. Coinbase, Inc. and Coinbase Global, Inc.*, Case No. 23-Civ-4738 (SDNY June 6, 2023), found at http://www.sec.gov/news/press-release/2023-102, *SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency*.
3. *See id.* at ¶¶6, 18, 103-10, 126.
4. The SEC also sued Coinbase's public holding company, Coinbase Global, Inc, as a "control person" of its wholly owned subsidiary Coinbase, Inc. *See id.* at ¶16, 381-85.
5. *See id.* at ¶¶1-3.
6. Exchanges often obtain cryptocurrency tokens for their own account and allow their users to trade amongst themselves. As these transactions are not processed on the cryptocurrency's exchange medium, they are referred to as "off chain transactions."
7. *See generally* Coinbase complaint, ¶¶44-59.
8. *See id.* at ¶¶1-6.
9. *See id.* at ¶126.
10. *See id.* at ¶¶309-21.
11. *See id.* at ¶¶339-67.
12. *See id.* at pp. 89-90, 93.
13. *See id.* at ¶¶340-45.
14. *See id.* at ¶¶346-53.
15. *See id.* at ¶¶353-56.
16. *Id.* at ¶361.
17. 605 F Supp 3d 372 (D Conn 2022).
18. *Id.* at 389.
19. The court noted the "scant" evidence presented at trial as to whether the Hashpoint or Hashstaker products were securities, and in a paragraph upheld the jury's verdict on those products. *See id.* at 399.
20. *Id.* at 395 n6 (cleaned up).
21. *Id.* at 389.
22. *Id.* at 394 n5.
23. *Id.* at 390.
24. *Id.* at 392.
25. *See id.* at 394.
26. *See id.* at 394-95.
27. *Id.* at 393.
28. *See id.* at 393-94.
29. *See id.* at 395-97.
30. *See id.* at 397.
31. *See id.* at 397-98.
32. *Id.* at 398 n7. The court noted that the subjective intent of the purchasers was not determinative of whether Paycoin buyers has a reasonable expectation of profit. Instead, the *Howey* test focuses on the objective test of what purchasers were led to expect. However, the subjective intent of a purchaser "is probative on the issue of what a reasonable purchase would have expected." *Id.*

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Exhibit 2

UNIFORM SECURITIES ACT, 2002

UNIFORM SECURITIES ACT

(Last Revised or Amended in 2002)

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 ONE-HUNDRED-AND-ELEVENTH YEAR
IN TUCSON, ARIZONA
JULY 26 - AUGUST 2, 2002

WITH PREFATORY NOTE AND COMMENTS

Approved by the American Bar Association
Seattle, Washington, February 10, 2003

January 21, 2003

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UNIFORM SECURITIES ACT

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UNIFORM SECURITIES ACT (2002)

Prefatory Note

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

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

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

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

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

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

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

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

Nonetheless several sections of this Act are identical or substantively identical to sections of the 1956 Act or RUSA. It is not intended that adoption of a new Uniform Securities Act will reject earlier case decisions interpreting identical or substantively identical sections of the 1956 Act or RUSA unless specifically so stated in the Official Comments.

The Act is solely a new Uniform Securities Act. It does not codify or append related regulations or guidelines. The Act also authorizes state administrators in Section 203 to adopt further exemptions without statutory amendment. The Drafting Committee did not address state tender offer or control share provisions in its preparation of this Act.

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

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

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

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

The Act is in seven Articles:

1. General Provisions
2. Exemptions from Registration of Securities
3. Registration of Securities and Notice Filing of Federal Covered Securities

4. Broker-Dealers, Agents, Investment Advisers, Investment Adviser Representatives, and Federal Covered Investment Advisers
5. Fraud and Liabilities
6. Administration and Judicial Review
7. Transition

There are has three overarching themes of the Act.

First, Section 608 articulates in greater detail than the 1956 Act's Section 415 the objectives of uniformity, cooperation among relevant state and federal governments and self-regulatory organizations, investor protection and, to the extent practicable, capital formation. Section 608 is the reciprocal of the instruction on these subjects given by Congress in 1996 to the Securities and Exchange Commission in Section 19(c) of the Securities Act of 1933. The theme of uniformity and the aspiration of coordination of federal and state securities law is particularly stressed in the Act and Official Comments. Section 602(f), consistent with the Federal Securities Litigation Uniform Standard Act of 1998, is a new provision encouraging reciprocal state enforcement assistance.

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

A third theme of the Act involves facilitating electronic records, signatures, and filing. New definitions were added to address filing (Section 102(8)), record (Section 102(25)), and sign (Section 102(30)). Section 105 expressly permits the filing of electronic signatures and records. Collectively these provisions are intended to permit electronic filing in central information depositories such as the Web-CRD (Central Registration Depository), the Investment Adviser Registration Depository (IARD), the Securities and Exchange Commission's Electronic Data Gathering, Analysis and Retrieval System (EDGAR) or successor institutions. Electronic communication also has led to an amplification of the jurisdiction Section 610.

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

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

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

(2) Nineteen new definitions were added to define "bank" (Section 102(3)), "depository institution" (Section 102(5)), "federal covered investment adviser" (Section 102(6)), "federal covered security" (Section 102(7)), "filing" (Section 102(8)), "institutional investor" (Section 102(11)), "insurance company" (Section 102(12)), "insured" (Section 102(13)), "international banking institution" (Section 102(14)), "investment adviser representative" (Section 102(16)), "offer to purchase" (Section 102(19)), "place of business" (Section 102(21)), "predecessor act" (Section 102(22)), "price amendment" (Section 102(23)), "principal place of business" (Section 102(24)), "record" (Section 102(25)), "Securities and Exchange Commission" (Section 102(27)), "self-regulatory organization" (Section 102(29)), and "sign" (Section 102(30)). The growth in definitions is suggestive of the increased complexity and detail of several revised provisions in the new Act.

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

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

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

The options exemption in Section 201(6) was broadened; the "manual" exemption in Section

202(2) has been modernized for an electronic age; a broadened exemption has been provided for specified foreign securities in Section 202(3); a new exemption has been added for nonissuer transactions in securities subject to Securities Exchange Act reporting in Section 202(4); a new exemption has been added for nonissuer transactions rated at the time of a transaction by a nationally recognized statistical rating organization in one of the four highest rating categories in Section 202(5)(A); and new exemptions were added for specified exchange transactions in Section 202(9), control transactions in Section 202(18), specified out-of-state offers or sales in Section 202(20), specified sales transactions in Section 202(22), and specified foreign issuers whose securities are traded on designated securities markets in Section 202(23).

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

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

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

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

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

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

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

(5) Article 4, which concerns broker-dealers, agents, investment advisers, investment adviser representatives, and federal covered investment advisers was substantially revised to take into

account NSMIA and significant changes in administrative practice such as those occasioned by the electronic WEB-CRD and the IARD. New developments had an impact on the definitions of "agent" (Section 102(2)), "broker-dealer" (Section 102(4)), "investment adviser" (Section 102(15)), and "investment adviser representative" (Section 102(16)). NSMIA led also to the new federal covered investment adviser notice filing procedure in Section 405.

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

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

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

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

proposals for an absolute immunity.

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

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

Significant changes were made in the statute of limitations Section 509(j). Current state law provides a wide range of statutes of limitations. The 1956 Act contained a "two years after the contract of sale" statute of limitations. The new Act has two statute of limitations provisions. Section 509(j)(1) limits violations of registration provisions to "one year after the violation occurred." Section 509(j)(2) follows the pattern of federal securities law statutes of limitations, as amended in July 2002 by the Sarbanes-Oxley Act, and limits fraud violations to the earlier of "two years after the discovery of the facts constituting the violation or five years after such violation."

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

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

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

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

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

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

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

UNIFORM SECURITIES ACT

Legislative Note

Each state, the District of Columbia, Guam, and Puerto Rico have enacted an administrative procedure act. The procedural provisions of the Act in some instances are intended to augment the state administrative procedure act. In so doing, this Act differs from other uniform acts promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in that it contains procedural provisions on topics such as administrative rulemaking and adjudication, service of process, judicial review of administrative adjudications, public records, public hearings, and use immunity. Normally a uniform act promulgated by NCCUSL defers to existing state procedural provisions on such matters. This Act reflects a policy decision that these matters should be addressed in this Act to promote uniformity in securities regulation. When a conflict exists between this Act and a state administrative procedure act, this Act is intended to supersede the state administrative procedure act. When, however, a reference is made in this Act to the state administrative procedure act, this Act is intended to follow the state's existing administrative procedure act.

In general in this Act a rule will apply generally and an order will apply to a specific individual, transaction, or matter, although the term order may also apply generally in those states that permit orders of general applicability.

[ARTICLE] 1

GENERAL PROVISIONS

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

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

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

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

(3) "Bank" means:

(A) a banking institution organized under the laws of the United States;

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

(C) any other banking institution, whether incorporated or not, doing business under the laws of a State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to be exercised by national banks under the authority of the Comptroller of the Currency pursuant to Section 1 of

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

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

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

(A) an agent;

(B) an issuer;

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

(D) an international banking institution; or

(E) a person excluded by rule adopted or order issued under this [Act].

(5) "Depository institution" means:

(A) a bank; or

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

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

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

(ii) a Morris Plan bank; or

(iii) an industrial loan company.

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

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

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

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

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

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

(A) a depository institution or international banking institution;

(B) an insurance company;

(C) a separate account of an insurance company;

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

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

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

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

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

(I) an organization described in Section 501(c)(3) of the Internal Revenue Code (26 U.S.C. Section 501(c)(3)), corporation, Massachusetts trust or similar business trust, limited liability company, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $10,000,000;

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

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

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

(M) a "qualified institutional buyer" as defined in Rule 144A(a)(1), other than Rule 144A(a)(1)(H), adopted under the Securities Act of 1933 (17 C.F.R. 230.144A);

(N) a "major U.S. institutional investor" as defined in Rule 15a-6(b)(4)(i) adopted under the Securities Exchange Act of 1934 (17 C.F.R. 240.15a-6);

(O) any other person, other than an individual, of institutional character with total assets in excess of $10,000,000 not organized for the specific purpose of evading this [Act]; or

(P) any other person specified by rule adopted or order issued under this [Act].

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

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

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

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

(A) an investment adviser representative;

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

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

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

(E) a federal covered investment adviser;

(F) a bank or savings institution;

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

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

(16) "Investment adviser representative" means an individual employed by or associated

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

(A) performs only clerical or ministerial acts;

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

(C) is employed by or associated with a federal covered investment adviser, unless the individual has a "place of business" in this State as that term is defined by rule adopted under Section 203A of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-3a) and is

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

(ii) not a "supervised person" as that term is defined in Section 202(a)(25) of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-2(a)(25)); or

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

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

(A) The issuer of a voting trust certificate, collateral trust certificate, certificate of

deposit for a security, or share in an investment company without a board of directors or individuals performing similar functions is the person performing the acts and assuming the duties of depositor or manager pursuant to the trust or other agreement or instrument under which the security is issued.

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

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

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

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

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

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

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

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

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

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

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

(25) "Record," except in the phrases "of record," "official record," and "public record," means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

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

include:

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

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

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

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

(28) "Security" means a note; stock; treasury stock; security future; bond; debenture; evidence of indebtedness; certificate of interest or participation in a profit-sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting trust certificate; certificate of deposit for a security; fractional undivided interest in oil, gas, or other mineral rights; put, call, straddle, option, or privilege on a security, certificate of deposit, or group or index of securities, including an interest therein or based on the value thereof; put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; or, in general, an interest or instrument commonly known as a "security"; or a certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. The term:

(A) includes both a certificated and an uncertificated security;

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

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

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

(E) includes as an "investment contract," among other contracts, an interest in a limited partnership and a limited liability company and an investment in a viatical settlement or similar agreement.

(29) "Self-regulatory organization" means a national securities exchange registered under the Securities Exchange Act of 1934, a national securities association of broker-dealers registered under the Securities Exchange Act of 1934, a clearing agency registered under the Securities Exchange Act of 1934, or the Municipal Securities Rulemaking Board established under the Securities Exchange Act of 1934.

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

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

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

process.

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

Official Comments

Prior Provisions: 1956 Act Section 401; RUSA 101.

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

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

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

4. Section 102(2): Agent: Prior Provisions: 1956 Act Section 401(b); RUSA Section 101(14). Section (102)(2), in part, follows the 1956 Act definition. The 1956 Act used the term "agent" while the RUSA Section 101(14) used the term "sales representative." Given the broader enactment of the 1956 Act, this Act also uses the term "agent." Certain exclusions from the 1956 Act are exemptions in this Act. See Section 402(b).

Whether a particular individual who represents a broker-dealer or issuer is an "agent" depends upon much the same factors that create an agency relationship at common law. See, e.g., Norwest Bank Hastings v. Clapp, 394 N.W.2d 176, 179 (Minn. Ct. App. 1986) (following Official Comment that establishing agency under the Uniform Securities Act "depends upon much the same factors which create an agency relationship at common law"); Shaughnessy &

Co., Inc. v. Commissioner of Sec., 1971-1978 Blue Sky L. Rep. (CCH) ¶71,348 (Wis. Cir. Ct. 1977) (unlicenced person who took information relevant to securities transactions and turned it over to securities agents was himself an agent).

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

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

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

An individual whose acts are solely clerical or ministerial would not be an agent under Section 102(2). Cf. Section 402(b)(8). Ministerial or clerical acts might include preparing written communications or responding to inquiries.

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

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

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

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

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

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

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

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

States that promptly adopt this Act should consider whether it is appropriate to provide banks a transition period to comply with the Act's new activity focused exceptions. The activity focused exceptions for banks in the Gramm-Leach-Bliley Act were originally to become effective at the federal level on May 12, 2001. However, the Securities and Exchange Commission has delayed the effective date of these activity focused exceptions and thus continued the blanket exemption for banks beyond May 12, 2001, and commenced a rulemaking designed to clarify and define the scope of the bank exceptions in the Gramm-Leach-Bliley Act. See Sec. Ex. Act Rels. 44,291, 74 SEC Dock. 2155 (2001) (proposal); 45,897, 77 SEC Dock. 1555 (2002) (proposal). To avoid disrupting the activities of banks, states should consider delaying implementation of the activity focused exceptions in this Act until these exceptions are implemented at the federal level.

Section 15(h)(1) of the Securities Exchange Act of 1934, as amended by the National Securities Markets Improvement Act of 1996, preempts state law from "[establishing] capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements for brokers, dealers, municipal securities dealers, government securities brokers, or government securities dealers that differ from, or are in addition to the

requirements in those areas established under [the Securities Exchange Act]." These preemptions are recognized in the substantive broker-dealer provisions in Article 4.

7. Section 102(5): Depository institution: No Prior Provision. A depository institution's securities are addressed by the exemption in Section 201(3). A depository institution is an institutional investor in Section 102(11)(A).

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

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

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

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

(2)(B) any proxy statement, report to shareholders, or other disclosure document relating to a covered security or its issuer that is required to be filed with the SEC or any national securities association registered under Section 15A of the Securities Exchange Act such as the National Association of Securities Dealers (NASD); or

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

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

(1) Securities listed or authorized for listing on the New York Stock Exchange (NYSE), the American Stock Exchange (Amex); the National Market System of the Nasdaq stock market; or securities exchanges registered with the Securities and Exchange Commission (SEC) (or any tier or segment of their trading) if the SEC determines by rule that their listing standards are substantially similar to those of the NYSE, Amex, or Nasdaq National Market System, which the

SEC has done through Rule 146; and any security of the same issuer that is equal in seniority or senior to any security listed on the NYSE, Amex, or Nasdaq National Market System;

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

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

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

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

(B) Section 4(4) (unsolicited brokerage transactions);

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

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

Section 18(c)(1) preserves state authority "to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions."

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

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

applicable to federal covered securities.

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

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

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

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

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

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

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

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

Sections 102(11)(A) through (K) are based on Rule 501(a) of the Securities Act of 1933, but do not include the paragraphs of Rule 501(a) that address individuals. Given the significant period of time since Rule 501(a) was adopted, this Act has used a $10 million minimum for several categories of institutional investor rather than $5 million minimum used in Rule 501(a).

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

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

Section 102(11)(O) is meant to reach persons similar to those listed in Sections 102(11)(A) through (N), but not otherwise listed. Under Section 503, if challenged in a proceeding, the burden of proving the availability of an exemption is on the person claiming it. An interpretive opinion may be sought from the administrator under Section 605(d).

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

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

16. Section 102(14): International banking institution: No Prior Provision. Securities issued or guaranteed by the International Bank for Reconstruction and Development, 22 U.S.C. Section 286k-1(a); the Inter-American Development Bank, 22 U.S.C. Section 283h(a); the Asian Development Bank, 22 U.S.C. Section 285h(a); the African Development Bank, 22 U.S.C. Section 290i-9; and the International Finance Corporation, see 22 U.S.C. Section 282k; are treated as exempt securities under Section 3(a)(2) of the Securities Act of 1933, see generally 3 Louis Loss & Joel Seligman, Securities Regulation 1191-1194 (3d ed. rev. 1999), and are within this term.

17. Section 102(15): Investment adviser: Prior Provisions: 1956 Act Section 401(f); RUSA Section 101(7). This term generally follows the definition in Section 202(a)(11) of the Investment Advisers Act of 1940, but has been updated to take into account new media such as the Internet.

The first sentence in Section 102(15) is identical to the first sentence in the 1956 Act Section

401(f) and the counterpart language in Section 202(a)(11). The RUSA definition deleted the phrases "either directly or through publications or writings" and "regular" before business. These terms have been returned to Section 102(15) because of the intention that this definition be construed uniformly with the definition in Section 202(a)(11) of the Investment Advisers Act of 1940. This first sentence would not reach the author of a book who did not receive compensation as part of a regular business for providing investment advice.

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

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

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

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

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

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

investment advisers.

The 1956 Act definition added the word "paid" in Section 401(f)(4) to the counterpart exclusion in Section 202(a)(11) of the Investment Advisers Act "to emphasize," as the Official Comment explained, "that a person who periodically distributes a 'tipster sheet' free as a way to get paying clients is not excluded from the definition as a 'publisher.'"

After the 1956 Act was published, the United States Supreme Court construed the definition of investment adviser in Lowe v. SEC, 472 U.S. 181 (1985), and concluded:

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

Id. at 185.

Responsive to this language RUSA rewrote this exclusion to provide:

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

Recent experience at the federal and state levels suggest that the 1956 Act and RUSA approaches may be too broad. The retention of the Investment Advisers Act approach provides a better balance between First Amendment concerns and protection of investors from non-"bona fide" publicizing of investment advice. The exclusion in Section 102(15)(D) is intended to exclude publishers of Internet or electronic media, but only if the Internet or electronic media publication or website satisfies the "bona fide" and "publication of general and regular circulation" requirements. Cf. SEC v. Park, 99 F. Supp. 2d 889, 895-896 (N.D. Ill. 2000) (court declined to dismiss complaint against an Internet website when there were allegations that the website was not "bona fide" or of "general and regular circulation").

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

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

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

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

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

20. Section 102(18): Nonissuer transaction or nonissuer distribution: Prior Provisions: 1956 Act Section 401(h); RUSA Section 101(9). This definition is relevant to several exempt transactions in Section 202.

In TechnoMedical Labs, Inc. v. Utah Sec. Div., 744 P.2d 320 (Utah Ct. App. 1987), the court declined to limit the term benefit to monetary benefits and instead held a spinoff transaction could provide direct or indirect benefits to an issuer. Id. at 323-324, *following* SEC v. Datronics Eng'r, Inc., 490 F.2d 250 (4th Cir. 1973), *cert. denied*, 416 U.S. 937; SEC v. Harwin Indus. Corp., 326 F. Supp. 943 (S.D.N.Y. 1971). In a similar fashion, transactions by officers, directors, promoters, and other insiders of the issuer may benefit the issuer and may not qualify as nonissuer transactions.

21. Section 102(19): Offer to purchase: No Prior Provision: A rescission offer under Section 510 would be an offer to purchase with respect to a security that earlier had been sold.

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

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

24. Section 102(23): Price amendment: Prior Provision: RUSA Section 101(11). A price

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

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

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

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

This term is intended to embrace new forms of records that are created or popularized in the future. A record would include, but not be limited to, a registration statement, report, application, book, publication, account, paper, correspondence, memorandum, agreement, document, computer file, or disk, microfilm, photograph, or audio or visual tape.

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

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

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

The most recent amendments to Section 2(a)(1) of the Securities Act of 1933 were added by the Commodities Futures Modernization Act of 2000 which added or revised language in the

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

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

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

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

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

The Drafting Committee recognized that the decision whether to exclude variable annuities from the definition of security will be made on a state-by-state basis. Those states which intend to exclude variable products from the definition of security should add the words "or variable" to Section 102(28)(B) so that it will read:

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

In the view of the American Council of Life Insurers:

> The brackets around the words "or variable" should be removed to follow the

majority of jurisdictions. Thirty-seven jurisdictions [including Guam] currently exclude all insurance, endowment and annuity contracts from the definition of security. Removal of the brackets around the words "or variable," therefore, would incorporate the approach taken in the majority of jurisdictions. The removal of these brackets also prevents a statutory conflict with [up to] 48 jurisdictions that grant the insurance commissioner exclusive jurisdiction to regulate the issuance and sale of variable contracts. Moreover, this approach recognizes that the issuance and sale of variable contracts is comprehensively regulated by the Securities and Exchange Commission, the National Association of Securities Dealers, 50 state insurance departments, and in the case of group life and annuities, the Department of Labor. Like all other financial products, this approach imposes only one, rather than two, levels of regulation in each state and reflects the philosophy of financial services modernization.

In the view of the North American Securities Administrators Association variable products should be exempted from registration, not excluded from the definition of securities:

One of the goals of this Act is to align state and federal law. The United States Supreme Court ruled that a variable annuity is a security in SEC v. Variable Annuity Life Insurance Company of America, 359 U.S. 65 (1959). More recently, it has been confirmed that variable insurance products are "covered securities" as defined in the National Securities Markets Improvement Act of 1996 (NSMIA) and in the Securities Litigation Uniform Standards Act of 1998 (SLUSA), see Lander v. Hartford Life Annuity Ins., 251 F.3d 101 (2d Cir. 2001).

When variable products are included in the definition of security and exempted from registration, state securities administrators can bring enforcement actions concerning variable insurance sales practices. This approach toward functional regulation is supported by the National Association of Securities Dealers as evidenced by a February 2001 letter from Mary Schapiro, President of Regulatory Policy & Oversight: "Based on our experience, we have found that variable products' sales-related problems parallel those of mutual funds and other securities . . . Because of the substantial similarities between variable contracts and other securities products, we believe it is incongruous for agents and sales practices involved in variable annuities not to be covered by state securities laws."

State securities regulators support the functional regulation of agents because: 1) insurance companies are not affected since state securities regulators are preempted from requiring the registration of variable products; 2) the vast majority of broker-dealer subsidiaries of insurance companies are already registered to sell securities in most states; and 3) the vast majority of agents are already dually licensed to sell insurance and securities in most states.

Section 102(28)(C) includes the exclusion in RUSA from the 1956 definition of security for

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

The first clause in Section 102(28)(D) is derived from the leading case of SEC v. W.J. Howey Co., 328 U.S. 293 (1946), which has been widely followed by federal and state courts. The second clause in Section 102(28)(D) is based, in part, on the leading case of SEC v. Glenn W. Turner Enter., Inc., 474 F.2d 476, 482 n.7 (9th Cir. 1973), *cert. denied*, 419 U.S. 900 (1974).

The courts have divided over the interpretation of the "common enterprise" element of an investment contract. The courts generally recognize that "horizontal" commonality (for example, the pooling of an investment by two or more investors) is a common enterprise. A small minority of the federal circuits will also find a common enterprise in a "vertical" relationship when a single investor is dependent upon the expertise of a single commodities broker. Since two or more persons do not share in the profitability of an undertaking, it is difficult to argue that there is a common enterprise. Section 102(28)(D) follows a significantly larger number of federal circuits and adopts a more restrictive form of vertical commonality that occurs only when there is profit sharing between two persons even if, for example, one is a conventional investor and one is a promoter. See generally 2 Louis Loss & Joel Seligman, Securities Regulation 989-997 (3d ed. Rev. 1999).

In interpreting all elements of the investment contract, the courts have emphasized substance, not form. A conventional partnership involving two individuals who actively participate in its management and who each own 50 percent interest of its profits has consistently not been viewed as an investment contract because profits do not come from the efforts of others. On the other hand, investments in limited partnership interests which are traded on stock exchanges consistently have been held to be investment securities because profits do come substantially from the efforts of others. Indeed, interests in an entity called a general partnership may be a security when the general partnership functions like a limited partnership. See, e.g., Williamson v. Tucker, 645 F.2d 404, 424 (5th Cir. 1981), *cert. denied*, 454 U.S. 897 (1981); see generally 2 Loss & Seligman, supra, at 1019-1033.

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

Judicial construction of the term "investment contract" has been the most frequently litigated

issue concerning the term "security." See Gabaldon, A Sense of Security: An Empirical Study, 25 J. Corp. L. 307 (2000), explaining that there had been 792 cases decided to that date in which the definition of a security played a prominent role. Id. at 308. Some 461 of the 792 cases (58 percent) concerned investment contracts. Id. at 322. A number of states, by statute, rule, or case law have also adopted the "risk capital" test to find a security when an investment is subject to the risks of an enterprise with the expectation of profit or other valuable benefit and the investor has no direct control over the management of the enterprise. See, e.g., 2 Loss & Seligman, supra, at 939-940 n.50.

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

30. Section 102(30): Sign: No Prior Provision. This definition is intended to facilitate electronic signatures, to the extent permitted by Section 105.

31. Section 102(31): State: Prior Provisions: 1956 Act Section 401(m); RUSA Section 101(18). This is the standard definition used by the National Conference of Commissioners on Uniform State Laws. It does include territories and possessions of the United States, as well as the District of Columbia and Puerto Rico, but does not include foreign governments, their territories, or their possessions. In this Act "foreign" always refers to activity, a government, or person outside of the United States, not a different state within the United States.

SECTION 103. REFERENCES TO FEDERAL STATUTES."Securities Act of 1933" (15 U.S.C. Section 77a et seq.), "Securities Exchange Act of 1934" (15 U.S.C. Section 78a et seq.), "Public Utility Holding Company Act of 1935"(15 U.S.C. Section 79 et seq.), "Investment Company Act of 1940" (15 U.S.C. Section 80a-1 et seq.), "Investment Advisers Act of 1940" (15 U.S.C. Section 80b-1 et seq.), "Employee Retirement Income Security Act of 1974" (29 U.S.C. Section 1001 et seq.), "National Housing Act" (12 U.S.C. Section 1701 et seq.), "Commodity Exchange Act" (7 U.S.C. Section 1 et seq.), "Internal Revenue Code" (26 U.S.C. Section 1 et seq.), "Securities Investor Protection Act of 1970" (15 U.S.C. Section 78aaa et seq.), "Securities

Litigation Uniform Standards Act of 1998" (112 Stat. 3227), "Small Business Investment Act of 1958" (15 U.S.C. Section 661 et seq.), and "Electronic Signatures in Global and National Commerce Act" (15 U.S.C. Section 7001 et seq.) mean those statutes and the rules and regulations adopted under those statutes, as in effect on the date of enactment of this [Act] [, or as later amended].

Official Comments

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

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

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

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

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

SECTION 104. REFERENCES TO FEDERAL AGENCIES.

A reference in this [Act] to an agency or department of the United States is also a reference to a successor agency or department.

Official Comment

No Prior Provision.

SECTION 105. ELECTRONIC RECORDS AND SIGNATURES. This [Act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, but does not modify, limit, or supersede Section 101(c) of that act (15 U.S.C. Section 7001(c)) or authorize electronic delivery of any of the notices described in Section 103(b) of that act (15 U.S.C. Section 7003(b)). This [Act] authorizes the filing of records and signatures, when specified by provisions of this [Act] or by a rule adopted or order issued under this [Act], in a manner consistent with Section 104(a) of that act (15 U.S.C. Section 7004(a)).

Official Comment

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

[ARTICLE] 2

EXEMPTIONS FROM REGISTRATION OF SECURITIES

Official Comments

Section 201 includes exempt securities and Section 202 includes exempt transactions. Both exempt securities and exempt transactions are exempt from the securities registration, notice filing requirement of Section 302, and the filing of sales literature Section 504 of this Act. Neither Section 201 nor Section 202 provides an exemption from the Act's antifraud provisions in Article 5, nor the broker-dealer, agent, investment adviser, or investment adviser registration requirements in Article 4.

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

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

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

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

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

(1) a security, including a revenue obligation or a separate security as defined in Rule 131 (17 C.F.R. 230.131) adopted under the Securities Act of 1933, issued, insured, or guaranteed by the United States; by a State; by a political subdivision of a State; by a public authority, agency, or instrumentality of one or more States; by a political subdivision of one or more States; or by a person controlled or supervised by and acting as an instrumentality of the United States under

authority granted by the Congress; or a certificate of deposit for any of the foregoing;

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

(3) a security issued by and representing or that will represent an interest in or a direct obligation of, or be guaranteed by:

(A) an international banking institution;

(B) a banking institution organized under the laws of the United States; a member bank of the Federal Reserve System; or a depository institution a substantial portion of the business of which consists or will consist of receiving deposits or share accounts that are insured to the maximum amount authorized by statute by the Federal Deposit Insurance Corporation, the National Credit Union Share Insurance Fund, or a successor authorized by federal law or exercising fiduciary powers that are similar to those permitted for national banks under the authority of the Comptroller of Currency pursuant to Section 1 of Public Law 87-722 (12 U.S.C. Section 92a); or

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

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

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

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

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

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

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

(7) a security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, social, athletic, or reformatory purposes, or as a chamber of commerce, and not for pecuniary profit, no part of the net earnings of which inures to the benefit of a private stockholder or other person, or a security of a company that is excluded

from the definition of an investment company under Section 3(c)(10)(B) of the Investment Company Act of 1940 (15 U.S.C. Section 80b-3(c)(10)(B)); except that with respect to the offer or sale of a note, bond, debenture, or other evidence of indebtedness issued by such a person, a rule may be adopted under this [Act] limiting the availability of this exemption by classifying securities, persons, and transactions, imposing different requirements for different classes, specifying with respect to paragraph (B) the scope of the exemption and the grounds for denial or suspension, and requiring an issuer:

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

(B) to file a request for exemption authorization for which a rule under this [Act] may specify the scope of the exemption, the requirement of an offering statement, the filing of sales and advertising literature, the filing of consent to service of process complying with Section 611, and grounds for denial or suspension of the exemption; or

(C) to register under Section 304;

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

(9) an equipment trust certificate with respect to equipment leased or conditionally sold to

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

Official Comments

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

1. Section 201(1): United States government and municipal securities: Prior Provisions: 1956 Act Section 402(a)(1); RUSA Section 401(b)(1). This exemption generally follows the 1956 Act except that it adds securities "insured" by a specified government to those "issued" or "guaranteed." RUSA, in contrast, also addressed foreign governments, which in this Act are treated separately in Section 201(2). Rule 131 issued under the Securities Act of 1933 defines separate securities issued under governmental obligations.

A significant minority of states have excluded from the Section 201(1) exemption industrial revenue bonds. Interest on these securities is solely repayable from revenues received from a nongovernmental industrial or commercial enterprise. Typically this exclusion will not operate if (A) the payments are made or unconditionally guaranteed by a person whose securities are exempt from registration under Section 18(b)(1) of the Securities Act of 1933, or (B) in accordance with a rule under this [Act], the issuer first files a notice in a record specifying the terms of the proposed offer or sale and a copy of the offering statement and the administrator does not disallow the exemption within the time period established by the rule.

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

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

Banks specified in Section 3(a)(2) of the Securities Act of 1933 issue federal covered securities under Section 18(b)(4)(C) of the Securities Act of 1933. Section 201(3)(C) applies to securities issued by depository institutions without depository insurance. Under Section 204, the administrator will have the ability to revoke or limit this exemption.

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

Under this Act insurance, endowment policies, or annuity contracts under which an insurance company promises to pay fixed sums are excluded from the definition of a security in Section 102(28)(B).

Unless brackets are removed from the words "or variable" in Section 102(28)(B), a variable annuity or other variable insurance product would be considered a security under this Act and under federal securities law. See SEC v. Variable Annuity Life Ins. Co. of Am., 359 U.S. 65 (1959); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967).

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

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

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

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

RUSA essentially retained this exemption in Section 401(b)(7) and added securities designated for inclusion in the National Market System by the National Association of Securities

Dealers in Section 401(b)(8) and specified options issued by a clearing agency registered under the Securities Exchange Act of 1934 in Section 401(b)(9).

In 1996 Congress enacted the National Securities Markets Improvement Act and provided in Section 18(b)(1) that securities listed on the New York, American or Nasdaq Stock Exchange, or designated by rule of the Securities and Exchange Commission, as well as any security of the same issuer that is equal in seniority or senior to any of these securities will be a federal covered security. Under Rule 146 the SEC has designated as federal covered securities under Section 18(b)(1) Tier I of the Pacific Exchange; Tier I of the Philadelphia Stock Exchange; and The Chicago Board Options Exchange on condition that the relevant listing standards continue to be substantially similar to those of the New York, American, or Nasdaq stock markets. See Reporter's Note to Section 102(7). A federal covered security subject to Section 18(b)(1) of the Securities Act of 1933 will not be subject to the securities registration requirements of Sections 301 and 303 through 306.

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

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

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

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

Securities issued under Section 3(a)(4) of the Securities Act of 1933 are not treated as federal covered securities in Section 18(b)(4)(C), although a separate Section 3(a)(13) exemption which addresses certain church plan securities are federal covered securities under Section 18(b)(4)(C).

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

The nonprofit exemption is of particular concern to state securities administrators. See, e.g., State Regulators Announce Dramatic Rise in Religious Scams; Tens of Thousands Lured, 33 Sec. Reg. & L. Rep. (BNA) 1189 (2001).

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

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

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

The 1956 Act Section 402(a)(12) had instead provided: "insert any desired exemption for cooperatives." The Reporter for the 1956 Act had found such sharp variation among the 18 states that then had adopted a cooperative exemption that "no common pattern can be found."

Louis Loss, Commentary on the Uniform Securities Act 118 (1976).

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

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

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

(1) an isolated nonissuer transaction, whether effected by or through a broker-dealer or not;

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

(A) the issuer of the security is engaged in business, the issuer is not in the organizational stage or in bankruptcy or receivership, and the issuer is not a blank check, blind pool, or shell company that has no specific business plan or purpose or has indicated that its primary business plan is to engage in a merger or combination of the business with, or an acquisition of, an unidentified person;

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

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

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

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

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

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

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

(E) the issuer of the security has a class of equity securities listed on a national securities exchange registered under the Securities Exchange Act of 1934 or designated for trading on the National Association of Securities Dealers Automated Quotation System, unless the issuer of the security is a unit investment trust registered under the Investment Company Act of 1940; or the issuer of the security, including its predecessors, has been engaged in continuous

business for at least three years; or the issuer of the security has total assets of at least $2,000,000 based on an audited balance sheet as of a date within 18 months before the date of the transaction or, in the case of a reorganization or merger when the parties to the reorganization or merger each had the audited balance sheet, a pro forma balance sheet for the combined organization;

(3) a nonissuer transaction by or through a broker-dealer registered or exempt from registration under this [Act] in a security of a foreign issuer that is a margin security defined in regulations or rules adopted by the Board of Governors of the Federal Reserve System;

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

(5) a nonissuer transaction by or through a broker-dealer registered or exempt from registration under this [Act] in a security that:

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

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

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

(ii) the issuer is engaged in business, is not in the organizational stage or in bankruptcy or receivership, and is not and has not been within the previous 12 months a blank check, blind pool, or shell company that has no specific business plan or purpose or has indicated

that its primary business plan is to engage in a merger or combination of the business with, or an acquisition of, an unidentified person;

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

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

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

(9) a transaction in a security, whether or not the security or transaction is otherwise exempt, in exchange for one or more bona fide outstanding securities, claims, or property interests, or partly in such exchange and partly for cash, if the terms and conditions of the issuance and exchange or the delivery and exchange and the fairness of the terms and conditions have been approved by the administrator after a hearing;

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

(11) a transaction in a note, bond, debenture, or other evidence of indebtedness secured by a mortgage or other security agreement if:

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

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

(C) a commission or other remuneration is not paid or given, directly or indirectly, to

a person not registered under this [Act] as a broker-dealer or as an agent;

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

(13) a sale or offer to sell to:

(A) an institutional investor;

(B) a federal covered investment adviser; or

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

(14) a sale or an offer to sell securities of an issuer, if part of a single issue in which:

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

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

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

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

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

(16) an offer to sell, but not a sale, of a security not exempt from registration under the

Securities Act of 1933 if:

(A) a registration or offering statement or similar record as required under the Securities Act of 1933 has been filed, but is not effective, or the offer is made in compliance with Rule 165 adopted under the Securities Act of 1933 (17 C.F.R. 230.165); and

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

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

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

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

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

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

(19) a rescission offer, sale, or purchase under Section 510;

(20) an offer or sale of a security to a person not a resident of this State and not present in

this State if the offer or sale does not constitute a violation of the laws of the State or foreign jurisdiction in which the offeree or purchaser is present and is not part of an unlawful plan or scheme to evade this [Act];

(21) employees' stock purchase, savings, option, profit-sharing, pension, or similar employees' benefit plan, including any securities, plan interests, and guarantees issued under a compensatory benefit plan or compensation contract, contained in a record, established by the issuer, its parents, its majority-owned subsidiaries, or the majority-owned subsidiaries of the issuer's parent for the participation of their employees including offers or sales of such securities to:

(A) directors; general partners; trustees, if the issuer is a business trust; officers; consultants; and advisors;

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

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

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

(22) a transaction involving:

(A) a stock dividend or equivalent equity distribution, whether the corporation or other business organization distributing the dividend or equivalent equity distribution is the

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

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

(C) the solicitation of tenders of securities by an offeror in a tender offer in compliance with Rule 162 adopted under the Securities Act of 1933 (17 C.F.R. 230.162); or

(23) a nonissuer transaction in an outstanding security by or through a broker-dealer registered or exempt from registration under this [Act], if the issuer is a reporting issuer in a foreign jurisdiction designated by this paragraph or by rule adopted or order issued under this [Act]; has been subject to continuous reporting requirements in the foreign jurisdiction for not less than 180 days before the transaction; and the security is listed on the foreign jurisdiction's securities exchange that has been designated by this paragraph or by rule adopted or order issued under this [Act], or is a security of the same issuer that is of senior or substantially equal rank to the listed security or is a warrant or right to purchase or subscribe to any of the foregoing. For purposes of this paragraph, Canada, together with its provinces and territories, is a designated foreign jurisdiction and The Toronto Stock Exchange, Inc., is a designated securities exchange. After an administrative hearing in compliance with [the state administrative procedure act], the administrator, by rule adopted or order issued under this [Act], may revoke the designation of a securities exchange under this paragraph, if the administrator finds that revocation is necessary

or appropriate in the public interest and for the protection of investors.

Official Comments

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

1. Sections 202(1) through (8) are available only for nonissuer transactions. An issuer selling securities in an initial public offering or other offering may not rely on Sections 202(1) through (8). A nonissuer, however, can rely on any issuer transaction exemption such as Section 202(13), when the exemption would be applicable to a nonissuer. The term "nonissuer transaction or nonissuer distribution" is defined in Section 102(18); the term "issuer" is defined in Section 102(17).

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

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

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

3. Section 202(2): Nonissuer transactions in specified outstanding securities: Prior Provisions: 1956 Act Section 402(b)(2); RUSA Sections 402(3) and (4). This Section represents a modernization of the securities manual exemption which was included in both the 1956 Act and RUSA. NASAA recommended an amendment to the 1956 Act Section 402(b) after discussion with the Securities Industry Association and others in the securities industry. This Section generally follows the NASAA amendment.

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

an investment in a blank check or other entity with no identified business plan or purpose. A "shell company" is also similar and would involve an entity which, to date, has no significant business assets, plan, or purpose.

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

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

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

6. Section 202(5): Nonissuer transactions in specified fixed income securities: Prior Provisions: 1956 Act Section 402(b)(2)(B); RUSA Section 402(4). The concept of a fixed income security rated by a nationally recognized statistical rating organization in one of its four highest rating categories described in Section 202(5)(A) is well established in federal securities law in Form S-3 adopted under the Securities Act of 1933 and the net capital Rule 15c3-1(c)(2)(vi)(F) adopted under the Securities Exchange Act of 1934. See 2 Louis Loss & Joel Seligman, Securities Regulation 649-653 (3d ed. rev. 1999). Nationally recognized statistical rating organizations have been identified by the Securities and Exchange Commission and include such organizations as Moody's and Standard and Poor's. Rating categories typically begin with AAA and under this Act would include BBB as the fourth highest rating category.

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

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

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

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

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

9. Section 202(8): Nonissuer transactions with federal covered investment advisers: No Prior Provision. This exemption was added because of a recognition that federal covered investment advisers are sophisticated financial professionals capable of determining the merits of a security and do not require the protections provided by requiring registration in a particular state.

10. Section 202(9): Specified exchange transactions: No Prior Provision. Section 202(9) provides a state counterpart to the exemption in Section 3(a)(10) of the Securities Act of 1933.

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

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

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

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

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

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

(i) are the offerings part of a single plan of financing;
(ii) do the offerings involve issuance of the same class of securities;
(iii) are the offerings made at or about the same time;
(iv) is the same type of consideration to be received; and
(v) are the offerings made for the same general purpose.

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

Section 402(b)(9) of the 1956 Act and Section 402(11) of the 1985 Act provide alternative limited offering transaction exemptions. The 1956 Act was limited to offers to no more than ten persons (other than institutional investors specified in Section 402(b)(8)); all purchasers in the State had to purchase for investment; and no remuneration was given for soliciting prospective purchasers in the State. RUSA, in contrast, was limited to no more than 25 purchasers (other than financial or institutional investors); no general solicitation or advertising; and no remuneration was paid to a person other than a broker-dealer for soliciting a prospective purchaser.

This Section would apply to preorganization limited offerings as well as operating company

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

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

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

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

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

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

18. Section 202(17): Offerings when registration has been filed, but is not effective under this [Act] and exempt from the Securities Act of 1933: Prior Provisions: RUSA Section 402(16). If a rule is adopted by the administrator a solicitation of interest document must accompany a registration by qualification as specified in Section 304(b)(13).

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

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

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

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

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

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

Section 202(20) provides an exemption from securities registration and does not address an administrator's power to investigate and bring enforcement actions under Articles 5 and 6.

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

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

contributory plans are not securities. Sec. Act Rel. 6188, 19 SEC Dock. 465, 473 (1980). Both contributory and noncontributory pension or welfare plans subject to ERISA are excluded from the definition of security in Section 102(28).

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

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

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

Both the 1956 Act and RUSA, for unstated reasons, treated employee benefit plans as exempt securities, rather than exempt securities transactions. There appears to be no appropriate reason to do so.

Resale of employee benefit plan securities can occur under appropriate section 202 transaction exemptions. Section 202(21) is not intended to provide a new method of publicly issuing securities.

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

23. Section 202(22): Specified dividends and tender offers and judicially recognized reorganizations: Prior Provision: 1956 Act Section 401(j)(6)(B) and (D); RUSA Section 101(13)(vi). Section 202(22)(A) and (B) generally follow exclusions from the definition of sale in the 1956 Act and RUSA. Section 202(22)(C) is new and corresponds to Rule 162, recently adopted under the Securities Act of 1933, which allows the offeror in a stock exchange offer to solicit tenders of securities before a registration statement is effective as long as no securities are purchased until the registration statement is effective and the tender offer has expired.

24. Section 202(23): Nonissuer transactions involving specified foreign issuer securities traded on designated securities exchanges. This exemption expressly covers Toronto Stock Exchange issuers that are public reporting companies under Canadian securities law and meet the 180 day continuous reporting requirement. In conformance with the North American Free Trade Agreement (NAFTA) and General Agreement on Trade in Services (GATS), the exemption separately provides authority for the administrator to designate by rule or order other specific foreign jurisdictions and their trading exchanges upon an adequate showing. The exemption also provides authority for an administrator to revoke any designation if necessary or appropriate in the public interest and for the protection of investors.

SECTION 203. ADDITIONAL EXEMPTIONS AND WAIVERS. A rule adopted or order issued under this [Act] may exempt a security, transaction, or offer; a rule under this [Act] may exempt a class of securities, transactions, or offers from any or all of the requirements of Sections 301 through 306 and 504; and an order under this [Act] may waive, in whole or in part, any or all of the conditions for an exemption or offer under Sections 201 and 202.

Official Comments

Prior Provision: RUSA Section 403.

1. Under this type of authority, 50 of 53 jurisdictions through September 2002 had adopted the Uniform Limited Offering Exemption (ULOE) or a Regulation D exemption, and 32 jurisdictions had adopted a Rule 144A exemption. This Act does not incorporate ULOE or a Rule 144A exemption because of their complexity and the likelihood of periodic updating of their provisions. Rule 144A, and similar exemptions in ULOE, can be most effectively implemented by rule rather than statute.

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

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

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

(a) [**Enforcement related powers.**] Except with respect to a federal covered security or a transaction involving a federal covered security, an order under this [Act] may deny, suspend application of, condition, limit, or revoke an exemption created under Section 201(3)(C), (7) or (8) or 202 or an exemption or waiver created under Section 203 with respect to a specific

security, transaction, or offer. An order under this section may be issued only pursuant to the procedures in Section 306(d) or 604 and only prospectively.

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

Official Comments

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

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

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

[ARTICLE] 3

REGISTRATION OF SECURITIES AND

NOTICE FILING OF FEDERAL COVERED SECURITIES

SECTION 301. SECURITIES REGISTRATION REQUIREMENT.

It is unlawful for a person to offer or sell a security in this State unless:

(1) the security is a federal covered security;

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

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

Official Comments

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

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

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

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

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

SECTION 302. NOTICE FILING.

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

(1) before the initial offer of a federal covered security in this State, all records that are part of a federal registration statement filed with the Securities and Exchange Commission under the Securities Act of 1933 and a consent to service of process complying with Section 611 signed by the issuer and the payment of a fee of $[____];

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

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

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

Section 611 may be incorporated by reference in a renewal. A renewed notice filing becomes effective upon the expiration of the filing being renewed.

(c) [**Notice filings for federal covered securities under Section 18(b)(4)(D).**] With respect to a security that is a federal covered security under Section 18(b)(4)(D) of the Securities Act of 1933(15 U.S.C. Section 77r(b)(4)(D)), a rule under this [Act] may require a notice filing by or on behalf of an issuer to include a copy of Form D, including the Appendix, as promulgated by the Securities and Exchange Commission, and a consent to service of process complying with Section 611 signed by the issuer not later than 15 days after the first sale of the federal covered security in this State and the payment of a fee of $[____]; and the payment of a fee of $[___] for any late filing.

(d) [**Stop orders.**] Except with respect to a federal security under Section 181(b)(1) of the Securities Act of 1933 (15 U.S.C. Section 77r(b)(1)), if the administrator finds that there is a failure to comply with a notice or fee requirement of this section, the administrator may issue a stop order suspending the offer and sale of a federal covered security in this State. If the deficiency is corrected, the stop order is void as of the time of its issuance and no penalty may be imposed by the administrator.

Official Comments

No Prior Provision.

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

2. For Rule 506 offerings which are addressed by Section 18(d)(4)(D) of the Securities Act of 1933, the Securities and Exchange Commission requires the filing of Form D. See Rule 503.

When an issuer meets the conditions of Rule 506, Section 302(c) is intended to limit required state filings to no more than a requirement of filing a copy of Form D, including the Appendix, a consent to service of process, and a fee.

3. The definition of "filing" in Section 102(8) will permit states to receive electronic filing of records under this Section. An administrator may also accept under this Section a signed consent filed electronically with a designee of the administrator. See Section 105.

4. If a State prefers to have the fees in this section established by rule, replace the phrase "a fee of $[___]" in subsections (a), (b), and (c) with the phrase "a fee established by the administrator by rule". See Comment 3 to Section 410.

SECTION 303. SECURITIES REGISTRATION BY COORDINATION.

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

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

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

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

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

(4) an undertaking to forward each amendment to the federal prospectus, other than

an amendment that delays the effective date of the registration statement, promptly after it is filed with the Securities and Exchange Commission.

(c) [**Conditions for effectiveness of registration statement.**] A registration statement under this section becomes effective simultaneously with or subsequent to the federal registration statement when all the following conditions are satisfied:

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

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

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

(e) [**Effectiveness of registration statement.**] If the federal registration statement becomes effective before each of the conditions in this section is satisfied or is waived by the administrator, the registration statement is automatically effective under this [Act] when all the

conditions are satisfied or waived. If the registrant notifies the administrator of the date when the federal registration statement is expected to become effective, the administrator shall promptly notify the registrant by telegram, telephone, or electronic means and promptly confirm this notice by a record, indicating whether all the conditions are satisfied or waived and whether the administrator intends the institution of a proceeding under Section 306. The notice by the administrator does not preclude the institution of such a proceeding.

Official Comments

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

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

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

3. Section 303 is similar to the 1956 Act except that these provisions have been modernized to include electronic filing and electronic notification. Cf. Sections 102(8), 102(25), 105. It is anticipated that this will facilitate simultaneous filing with the Securities and Exchange Commission and the States which is consistent with the uniformity intended by this Act. Simultaneous or sequential filing could be administered through a designee similar to the current Web-CRD or in conjunction with the Securities and Exchange Commission's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system or otherwise.

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

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

SECTION 304. SECURITIES REGISTRATION BY QUALIFICATION.

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

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

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

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

(3) with respect to persons covered by paragraph (2), the aggregate sum of the remuneration paid to those persons during the previous 12 months and estimated to be paid

during the next 12 months, directly or indirectly, by the issuer, and all predecessors, parents, subsidiaries, and affiliates of the issuer;

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

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

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

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

(8) the kind and amount of securities to be offered; the proposed offering price or the method by which it is to be computed; any variation at which a proportion of the offering is to be

made to a person or class of persons other than the underwriters, with a specification of the person or class; the basis on which the offering is to be made if otherwise than for cash; the estimated aggregate underwriting and selling discounts or commissions and finders' fees, including separately cash, securities, contracts, or anything else of value to accrue to the underwriters or finders in connection with the offering or, if the selling discounts or commissions are variable, the basis of determining them and their maximum and minimum amounts; the estimated amounts of other selling expenses, including legal, engineering, and accounting charges; the name and address of each underwriter and each recipient of a finder's fee; a copy of any underwriting or selling group agreement under which the distribution is to be made or the proposed form of any such agreement whose terms have not yet been determined; and a description of the plan of distribution of any securities that are to be offered otherwise than through an underwriter;

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

(10) a description of any stock options or other security options outstanding, or to be

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

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

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

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

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

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

(16) a signed or conformed copy of a consent of any accountant, engineer, appraiser,

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

(17) a balance sheet of the issuer as of a date within four months before the filing of the registration statement; a statement of income and changes in financial position for each of the three fiscal years preceding the date of the balance sheet and for any period between the close of the immediately previous fiscal year and the date of the balance sheet, or for the period of the issuer's and any predecessor's existence if less than three years; and, if any part of the proceeds of the offering is to be applied to the purchase of a business, the financial statements that would be required if that business were the registrant; and

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

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

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

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

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

(d) [**Delay of effectiveness of registration statement.**] The administrator may delay effectiveness once for not more than 90 days if the administrator determines the registration

statement is not complete in all material respects and promptly notifies the applicant or registrant of that determination. The administrator may also delay effectiveness for a further period of not more than 30 days if the administrator determines that the delay is necessary or appropriate.

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

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

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

(3) payment pursuant to such a sale; or

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

Official Comments

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

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

2. Section 304(b) originally was modeled on Schedule A of the Securities Act of 1933.

3. In Section 304(b)(12) pending litigation can include litigation that has not yet been filed.

4. Section 304(b)(17) uses the same terminology as is used currently in Regulation S-X of the Securities and Exchange Commission. Under Sections 605(a) and (c) the administrator is authorized to specify the form and content of rules and forms governing registration statements

and the form and content of financial statements required under this Act.

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

SECTION 305. SECURITIES REGISTRATION FILINGS.

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

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

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

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

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

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

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

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

(f) [**Escrow and impoundment**.] A rule adopted or order issued under this [Act] may require as a condition of registration that a security issued within the previous five years or to be issued to a promoter for a consideration substantially less than the public offering price or to a person for a consideration other than cash be deposited in escrow; and that the proceeds from the sale of the registered security in this State be impounded until the issuer receives a specified amount from the sale of the security either in this State or elsewhere. The conditions of any escrow or impoundment required under this subsection may be established by rule adopted or order issued under this [Act], but the administrator may not reject a depository institution solely because of its location in another State.

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

(h) [**Effective period.**] Except while a stop order is in effect under Section 306, a registration statement is effective for one year after its effective date, or for any longer period designated in an order under this [Act] during which the security is being offered or distributed in a nonexempted transaction by or for the account of the issuer or other person on whose behalf the

offering is being made or by an underwriter or broker-dealer that is still offering part of an unsold allotment or subscription taken as a participant in the distribution. For the purposes of a nonissuer transaction, all outstanding securities of the same class identified in the registration statement as a security registered under this [Act] are considered to be registered while the registration statement is effective. If any securities of the same class are outstanding, a registration statement may not be withdrawn until one year after its effective date. A registration statement may be withdrawn only with the approval of the administrator.

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

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

Official Comments

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

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

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

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

4. This Act is intended, to the extent practicable, to be revenue neutral in its impact on existing state law, see Comment 3 to Section 608. Accordingly, Section 305(b) does not specify what fees states should provide. If a State prefers to have the fees in this section established by rule, replace the phrase "a fee of $[___]" in subsections (b) and (j) with the phrase "a fee established by the administrator by rule pursuant to the [state administrative procedure act]" and replace the phrase "$[___] of the fee" in subsection (b) with the phrase "an amount of the fee established by the administrator by rule". See Comment 3 to Section 410.

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

6. Section 305(c), like every other provision concerned with the content of the registration statement, must be read with Section 306(a)(1) which judges the accuracy and completeness of the registration statement as of its effective date unless an order denying effectiveness had been entered before the effective date. A registration statement must be kept current with changing developments until the effectiveness date, but a registration statement is not required to be amended after the effective date except to correct inaccuracies or deficiencies which existed as of the effective date. An administrator, however, separately may require under Section 305(i) or (j) periodic reports or amendments to keep reasonably current the information contained in the registration statement.

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

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

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

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

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

If no exemption is available for a nonissuer distribution, and it does not involve a federal covered security, the security must be registered under Article 3. Under the first sentence of Section 305(h) each registration statement remains effective for at least one year and for any longer period the administrator may determine. However, no registration statement is effective while a stop order with respect to it is in effect under Section 306.

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

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

12. Section 305(j) follows RUSA and a procedure limited to investment companies in the 1956 Act in allowing posteffective date amendments. Under Section 305(j), when a posteffective

amendment increases the number of securities to be offered or sold, an additional registration fee is required.

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

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

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

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

(3) the security registered or sought to be registered is the subject of a permanent or temporary injunction of a court of competent jurisdiction or an administrative stop order or

similar order issued under any federal, foreign, or state law other than this [Act] applicable to the offering, but the administrator may not institute a proceeding against an effective registration statement under this paragraph more than one year after the date of the order or injunction on which it is based, and the administrator may not issue an order under this paragraph on the basis of an order or injunction issued under the securities act of another State unless the order or injunction was based on conduct that would constitute, as of the date of the order, a ground for a stop order under this section;

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

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

(6) the applicant or registrant has not paid the filing fee, but the administrator shall void the order if the deficiency is corrected; or

(7) the offering:

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

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

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

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

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

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

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

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

(2) an opportunity for hearing; and

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

(f) [**Modification or vacation of stop order.**] The administrator may modify or vacate a

stop order issued under this section if the administrator finds that the conditions that caused its issuance have changed or that it is necessary or appropriate in the public interest or for the protection of investors.

Official Comments

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

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

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

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

4. A violation by an issuer has the same consequences whether the issuer has filed a registration statement or has had a broker-dealer file it. But this is not the case when the registration statement is filed by a broker-dealer acting independently.

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

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

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

8. Sections 306(a)(7) and (b) address merit regulation. Sections 306(E) and (F) of the 1956 Act authorized a stop order when an "offering has worked or tended to work a fraud upon purchasers or would so operate" or "the offering has been or would be made with unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters' profits or participation, or unreasonable amounts or kinds of options." By 1985 a

majority of states which had adopted the 1956 Act had adopted this approach to merit regulation rather than the earlier and broader "unfair, unjust or inequitable" standard that then applied in a minority of States.

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

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

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

An order under Section 306(b) can be adopted after a securities registration statement has been filed. Under Section 306(b) an administrator, by rule or order, for example, could adopt a standard that would provide the basis for a stop order denying effectiveness to a development stage company that has no specific business purpose or plan or has indicated that its primary business plan is to engage in a merger or acquisition with an unidentified company, entity, or person. "Blank check offerings" are subject to Rule 419 adopted under the Securities Act of 1933. See Comment 3 to Section 202.

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

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

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

12. As of September 2002 46 jurisdictions had adopted a form of Section 306(a)(7)(A) ("will tend to work a fraud or would so operate"); 34 jurisdictions had adopted a form of Section 306(a)(7)(B) ("unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoter profits or participations, or unreasonable amounts or kinds of options"); and 16 jurisdictions had adopted a form of bracketed Section 306(a)(7)(C) ("terms that are unfair, unjust, or inequitable").

SECTION 307. WAIVER AND MODIFICATION. The administrator may waive or modify, in whole or in part, any or all of the requirements of Sections 302, 303, and 304(b) or the requirement of any information or record in a registration statement or in a periodic report filed pursuant to Section 305(i).

Official Comments

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

[ARTICLE] 4

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

SECTION 401. BROKER-DEALER REGISTRATION REQUIREMENT AND EXEMPTIONS.

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

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

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

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

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

(C) an institutional investor;

(D) a nonaffiliated federal covered investment adviser with investments under management in excess of $100,000,000 acting for the account of others pursuant to discretionary authority in a signed record;

(E) a bona fide preexisting customer whose principal place of residence is not in this State and the person is registered as a broker-dealer under the Securities Exchange Act of 1934 or not required to be registered under the Securities Exchange Act of 1934 and is registered under the securities act of the State in which the customer maintains a principal place of residence;

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

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

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

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

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

(2) a person that deals solely in United States government securities and is supervised as a

dealer in government securities by the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Office of Thrift Supervision.

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

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

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

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

(B) an individual from Canada or other foreign jurisdiction who is present in this State and whose transactions are in a self-directed tax advantaged retirement plan of which the individual is the holder or contributor in that foreign jurisdiction; or

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

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

Official Comments

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

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

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

3. "Bona fide" is a much construed term particularly in the U.C.C. context. See, e.g., MCC Proceeds, Inc. v. Advest, Inc., 743 N.Y.S.2d 1 (N.Y. A.D. 2002) (comparing bona fide to good faith standard).

4. Section 401(b)(1)(D) was added to provide relief in situations where a broker-dealer is accepting orders from a sophisticated financial professional who is making the investment decisions for its customers.

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

(i.e. "snowbirds").

6. Section 401(c) prohibits a broker-dealer or issuer from employing or associating with an individual in a capacity for which that individual has been suspended by the administrator. Violation of this provision does not result in strict liability. In order for a broker-dealer or issuer to be liable, the broker-dealer or issuer must have known or should have known of the administrator's order to the individual suspended or barred. Cf. Comment 17 to Section 412.

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

8. To give effect to action taken by rule or order under Section 401(d), there must be a transaction registration exemption that will enable securities transactions to take place in customer accounts involving the broker-dealers and agents contemplated in Section 401(d). See Sections 202 and 203.

SECTION 402. AGENT REGISTRATION REQUIREMENT AND EXEMPTIONS.

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

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

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

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

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

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

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

(6) an individual who represents a broker-dealer registered in this State under Section 401(a) or exempt from registration under Section 401(b) in the offer and sale of securities for an account of a nonaffiliated federal covered investment adviser with investments under management in excess of $100,000,000 acting for the account of others pursuant to discretionary authority in a signed record;

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

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

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

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

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

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

Official Comments

Prior Provisions: RUSA Sections 201-202.

1. "Agent" is defined in Section 102(2). The scope of the Section 402(a) reference to "transact business in this State" is specified in Section 610. An administrator may by rule or order take action under Section 401(d)(2) to address an agent.

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

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

4. Under Sections 402(b)(3) and (5) an agent may be exempt if acting for an issuer and receiving compensation (for example, as a corporate executive), as long as the compensation is

not a commission or other remuneration based on transactions in the issuer's own securities. Such an agent could receive a salary with conventional benefits, including an annual bonus (related to his or her performance) as an executive, and still be within this exemption unless the agent is also being compensated directly or indirectly for participation in the specified securities transactions.

5. Section 402(b)(6) was added to provide relief in situations where an agent is accepting orders from a sophisticated financial professional who is making the investment decisions for its customers.

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

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

SECTION 403. INVESTMENT ADVISER REGISTRATION REQUIREMENT AND EXEMPTIONS.

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

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

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

(A) federal covered investment advisers, investment advisers registered under this

[Act], or broker-dealers registered under this [Act];

(B) institutional investors;

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

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

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

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

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

(d) [**Investment adviser representative registration required.**] It is unlawful for an investment adviser to employ or associate with an individual required to be registered under this

[Act] as an investment adviser representative who transacts business in this State on behalf of the investment adviser unless the individual is registered under Section 404(a) or is exempt from registration under Section 404(b).

Official Comments

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

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

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

3. Section 403(b)(2) is consistent with the National Securities Markets Improvement Act of 1996 which prohibits a State from regulating an investment adviser that does not have a place of business in this State and had fewer than six clients who were state residents during the preceding 12 months.

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

SECTION 404. INVESTMENT ADVISER REPRESENTATIVE REGISTRATION REQUIREMENT AND EXEMPTIONS.

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

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

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

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

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

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

(e) [**Limits on employment or association.**] It is unlawful for an individual acting as an investment adviser representative, directly or indirectly, to conduct business in this State on behalf of an investment adviser or a federal covered investment adviser if the registration of the individual as an investment adviser representative is suspended or revoked or the individual is barred from employment or association with an investment adviser or a federal covered investment adviser by an order under this [Act], the Securities and Exchange Commission, or a

self-regulatory organization. Upon request from a federal covered investment adviser and for good cause, the administrator, by order issued, may waive, in whole or in part, the application of the requirements of this subsection to the federal covered investment adviser.

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

Official Comments

No Prior Provision.

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

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

3. Under this Act a sole practitioner may register as an investment adviser. See Section 403. The Investment Adviser Registration Depository currently provides for entry of the legal name of the individual as the investment adviser and the entry of any name the individual is doing business under that is different from the individual's name. A sole practitioner is not required to register under Section 404 as an investment adviser representative, unless the administrator requires such registration.

4. Section 404(e) prohibits an investment adviser representative from association with a federal covered investment adviser when such association is prohibited by an order of the administrator. Unlike similar provisions in Sections 401 and 403, there is no culpability

requirement that the investment adviser representative "knows or in the exercise of reasonable care should have known" of a suspension or bar because the order should be received by the investment adviser representative. As with Sections 401 and 403, the administrator may waive this prohibition. Cf. Comment 17 to Section 412.

5. The administrator may adopt rules or orders under Section 404(f) in accordance with Section 605. The Securities and Exchange Commission has adopted a rule that addresses referral fees in Rule 206(4)-3 of the Investment Advisers Act of 1940.

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

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

SECTION 405. FEDERAL COVERED INVESTMENT ADVISER NOTICE FILING REQUIREMENT.

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

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

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

only clients in this State are:

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

(B) institutional investors;

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

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

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

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

(c) **[Notice filing procedure.]** A person acting as a federal covered investment adviser, not excluded under subsection (b), shall file a notice, a consent to service of process complying with Section 611, and such records as have been filed with the Securities and Exchange Commission under the Investment Advisers Act of 1940 required by rule adopted or order issued under this [Act] and pay the fees specified in Section 410(e).

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

Official Comments

No Prior Provision.

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

2. Section 405(b)(2) is necessitated by the National Securities Markets Improvement Act of 1996 and is intended to coordinate this Act with the Investment Advisers Act of 1940.

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

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

SECTION 406. REGISTRATION BY BROKER-DEALER, AGENT, INVESTMENT ADVISER, AND INVESTMENT ADVISER REPRESENTATIVE.

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

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

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

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

(c) [**Effectiveness of registration.**] If an order is not in effect and a proceeding is not pending under Section 412, registration becomes effective at noon on the 45th day after a completed application is filed, unless the registration is denied. A rule adopted or order issued

under this [Act] may set an earlier effective date or may defer the effective date until noon on the 45th day after the filing of any amendment completing the application.

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

(e) [**Additional conditions or waivers.**] A rule adopted or order issued under this [Act] may impose such other conditions, not inconsistent with the National Securities Markets Improvement Act of 1996. An order issued under this [Act] may waive, in whole or in part, specific requirements in connection with registration as are in the public interest and for the protection of investors.

Official Comments

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

1. Under Section 406(a), the administrator is authorized to accept standardized forms such as Form B-D for broker-dealers; Form U-4 for agents and investment adviser representatives; and Form ADV for investment advisers, which are filed today through such designees as the Web-CRD or the Investment Adviser Registration Depository (IARD). While this Act generally encourages uniformity, Sections 406(a) and (e) are intended to give the administrator authority to augment or waive disclosure requirements in appropriate cases.

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

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

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

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

(b) [**Organizational change.**] A broker-dealer or investment adviser that changes its form of organization or State of incorporation or organization may continue its registration by filing an amendment to its registration if the change does not involve a material change in its financial condition or management. The amendment becomes effective when filed or on a date designated by the registrant in its filing. The new organization is a successor to the original registrant for the purposes of this [Act]. If there is a material change in financial condition or management, the broker-dealer or investment adviser shall file a new application for registration. A predecessor registered under this [Act] shall stop conducting its securities business other than winding down transactions and shall file for withdrawal of broker-dealer or investment adviser registration within 45 days after filing its amendment to effect succession.

(c) [**Name change.**] A broker-dealer or investment adviser that changes its name may continue its registration by filing an amendment to its registration. The amendment becomes

effective when filed or on a date designated by the registrant.

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

Official Comments

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

1. Section 407 is intended to avoid unnecessary interruptions of business by specifying procedures for a successor broker-dealer or investment adviser; a broker-dealer or investment adviser to maintain its registration if it changes its form of organization or name; or, in accordance with a rule or order adopted under this Act, a change of control of a broker-dealer or investment adviser.

2. There is no filing fee under Section 407.

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

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

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

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

(2) temporarily effective as of the date of the completed filing, if the agent's Central Registration Depository record or successor record or the investment adviser representative's Investment Adviser Registration Depository record or successor record contains a new or amended disciplinary disclosure within the preceding 12 months.

(c) [**Withdrawal of temporary registration**.] The administrator may withdraw a temporary registration if there are or were grounds for discipline as specified in Section 412 and the administrator does so within 30 days after the filing of the application. If the administrator

does not withdraw the temporary registration within the 30 day period, registration becomes automatically effective on the 31st day after filing.

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

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

Official Comments

Prior Provision: 1956 Act Section 204(d).

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

2. To expedite transfer to a new broker-dealer or investment adviser, Section 408(b) provides a procedure by which agents or investment adviser representative registration will be effective immediately as of the date of new employment when there is no new or added disciplinary disclosure in the relevant Central Research Depository or Investment Adviser Registration Depository records. Both electronic systems are currently administered by the National Association of Securities Dealers. Section 408(d) is intended to ensure that the administrator has the authority to prevent immediate effectiveness in appropriate cases.

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

Official Comments

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

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

2. Ordinarily today a registrant will file a standardized form such as Form U-5, BD-W or ADV-W to withdraw registration.

SECTION 410. FILING FEES.

(a) [**Broker-dealers.**] A person shall pay a fee of $[___] when initially filing an

application for registration as a broker-dealer and a fee of $[___] when filing a renewal of registration as a broker-dealer. If the filing results in a denial or withdrawal, the administrator shall retain $[___] of the fee.

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

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

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

(e) [**Federal covered investment advisers.**] A federal covered investment adviser required to file a notice under Section 405 shall pay an initial fee of $[___] and an annual notice fee of $[___].

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

[(g) [**Dual agent/investment adviser representative.**] An investment adviser

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

Official Comments

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

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

2. Similarly each state should determine whether it wishes to remove the brackets from Section 410(g) and charge a single fee for dually registered agents and investment adviser representatives.

3. If a State prefers to have the fees in this section established by rule, amend this section to read as follows, inserting the appropriate reference to the State's administrative procedure act:

[SECTION 410. FILING FEES.

(a) [**Fee established by administrator**.] The administrator shall establish fees by rule pursuant to the [state administrative procedure act] for:

(1) an initial filing of an application as a broker-dealer and renewal of an application by a broker-dealer for registration, but, if the filing results in a denial or withdrawal, the administrator shall retain an amount of the fee established by the administrator;

(2) an application for registration as an agent and renewal of registration as an agent, but, if the filing results in a denial or withdrawal, the administrator shall retain an amount of the fee established by the administrator;

(3) an application for registration as an investment adviser and renewal of registration as an investment adviser, but, if the filing results in a denial or withdrawal, the administrator shall retain an amount of the fee established by the administrator.

(4) an application for registration as an investment adviser representative, a renewal of registration as an investment adviser representative, and a change of registration as an investment adviser representative, but, if the filing results in a denial or withdrawal, the administrator shall retain an amount of the fee established by the administrator; and

(5) an initial fee and annual notice fee for a federal covered investment adviser

required to file a notice under Section 405.

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

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

SECTION 411. POSTREGISTRATION REQUIREMENTS.

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

(b) [**Financial reports.**] Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222(b) of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22), a broker-dealer registered or required to be registered under this [Act] and an investment adviser registered or required to be registered under this [Act] shall file such financial reports as are required by a rule adopted or order issued under this [Act]. If the information contained in a record filed under this subsection is or becomes inaccurate or incomplete in a material respect, the registrant shall promptly file a correcting amendment.

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

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

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

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

(d) [**Audits or inspections.**] The records of a broker-dealer registered or required to be registered under this [Act] and of an investment adviser registered or required to be registered under this [Act] are subject to such reasonable periodic, special, or other audits or inspections by a representative of the administrator, within or without this State, as the administrator considers necessary or appropriate in the public interest and for the protection of investors. An audit or inspection may be made at any time and without prior notice. The administrator may copy, and remove for audit or inspection copies of, all records the administrator reasonably considers necessary or appropriate to conduct the audit or inspection. The administrator may assess a reasonable charge for conducting an audit or inspection under this subsection.

(e) [**Custody and discretionary authority bond or insurance.**] Subject to Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. Section 78o(h)) or Section 222 of the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-22), a rule adopted or order issued under this [Act] may require a broker-dealer or investment adviser that has custody of or

discretionary authority over funds or securities of a customer or client to obtain insurance or post a bond or other satisfactory form of security in an amount not to exceed $[___]. The administrator may determine the requirements of the insurance, bond, or other satisfactory form of security. Insurance or a bond or other satisfactory form of security may not be required of a broker-dealer registered under this [Act] whose net capital exceeds, or of an investment adviser registered under this [Act] whose minimum financial requirements exceed, the amounts required by rule or order under this [Act]. The insurance, bond, or other satisfactory form of security must permit an action by a person to enforce any liability on the insurance, bond, or other satisfactory form of security if instituted within the time limitations in Section 509(j)(2).

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

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

protection of investors and advisory clients.

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

Official Comments

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

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

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

3. The duty in Section 411(b) to correct or update information is limited to material information which a reasonable investor would continue to consider important in deciding whether to purchase or sell securities. Cf. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 444-450 (1970); Securities Act Release No. 6084, 17 SEC Dock. 1048, 1054 (1979) ("persons are continuing to rely on all or any material portion of the statements").

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

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

6. The administrator's power to copy and examine records in Section 411(d) is subject to all applicable privileges. See, e.g., 10 Louis Loss & Joel Seligman, Securities Regulation 4921-4925 n.69 (3d ed. rev. 1996). The power in Section 411(d) to conduct audits or inspections is distinguishable from the administrator's enforcement powers under Section 602. No subpoena is necessary under Section 411(d). Failure to submit to a reasonable audit or inspection is a violation of this Act which may result in an action by the administrator under Section 412(d)(8), a criminal prosecution under Section 508, or an injunction under Section 603. An unreasonable audit, inspection or demand for information or documents would be subject to challenge in an appropriate court.

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

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

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

(a) [**Disciplinary conditions-applicants.**] If the administrator finds that the order is in the public interest and subsection (d) authorizes the action, an order issued under this [Act] may deny an application, or may condition or limit registration: (1) of an applicant to be a broker-dealer, agent, investment adviser, or investment adviser representative, and (2) if the applicant is a broker-dealer or investment adviser, of any partner, officer, director, person having a similar status or performing similar functions, or person directly or indirectly controlling the broker-dealer or investment adviser.

(b) [**Disciplinary conditions – registrants.**] If the administrator finds that the order is in

the public interest and subsection (d) authorizes the action an order issued under this [Act] may revoke, suspend, condition, or limit the registration of a registrant and if the registrant is a broker-dealer or investment adviser, any partner, officer, or director, any person having a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser. However, the administrator

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

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

(c) [**Disciplinary penalties – registrants.**] If the administrator finds that the order is in the public interest and subsection (d)(1) through (6), (8), (9), (10), or (12) and (13) authorizes the action, an order under this [Act] may censure, impose a bar, or impose a civil penalty in an amount not to exceed a maximum of $[___] for a single violation or $[__] for several violations on a registrant and if the registrant is a broker-dealer or investment adviser, any partner, officer, or director, any person having similar functions or any person directly or indirectly controlling the broker-dealer or investment adviser.

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

(1) has filed an application for registration in this State under this [Act] or the predecessor act within the previous 10 years, which, as of the effective date of registration or as

of any date after filing in the case of an order denying effectiveness, was incomplete in any material respect or contained a statement that, in light of the circumstances under which it was made, was false or misleading with respect to a material fact;

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

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

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

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

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

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

representative, or federal covered investment adviser;

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

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

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

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

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

(7) is insolvent, either because the person's liabilities exceed the person's assets or because the person cannot meet the person's obligations as they mature, but the administrator may not enter an order against an applicant or registrant under this paragraph without a finding of insolvency as to the applicant or registrant;

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

inspection under Section 411(d);

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

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

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

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

(B) to have been the subject of an order of a securities regulator of a foreign jurisdiction denying, revoking, or suspending the right to engage in the business of securities as a broker-dealer, agent, investment adviser, investment adviser representative, or similar person; or

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

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

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

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

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

(f) [**Summary process.**] The administrator may suspend or deny an application summarily; restrict, condition, limit, or suspend a registration; or censure, bar, or impose a civil penalty on a registrant before final determination of an administrative proceeding. Upon the issuance of an order, the administrator shall promptly notify each person subject to the order that the order has been issued, the reasons for the action, and that within 15 days after the receipt of a

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

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

(1) appropriate notice to the applicant or registrant;

(2) opportunity for hearing; and

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

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

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

Official Comments

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

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

2. Section 412 authorizes the administrator to seek a sanction based on the seriousness of the misconduct. Under Section 412 the administrator must prove that the denial, revocation, suspension, cancellation, withdrawal, restriction, condition, or limitation both is (1) in the public interest and (2) involves one of the enumerated grounds in Section 412(d). See, e.g., Mayflower Sec. Co., Inc. v. Bureau of Sec., 312 A.2d 497 (N.J. 1973). The "public interest" is a much litigated concept that has come to have settled meanings. See generally 6 L. Loss & J. Seligman, Securities Regulation 3103.5-3103.18 (3d ed. rev. 2002) (under federal securities laws). The public interest will not require imposition of a sanction for every minor or technical violation of subsection (d).

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

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

5. In Section 412(d)(1) the completeness and accuracy of an effective application for registration is tested as of the appropriate effective date. An application that becomes incomplete or inaccurate after its effective date is not a ground for discipline under paragraph (d)(1). In an appropriate case, an action might be available under paragraph (d)(2) and Section 406(b). On the other hand, in a proceeding to deny effectiveness to a pending application for registration, the completeness and accuracy of the application is not limited to the effective date and can be judged on any date after filing.

6. The term "willfully" in Section 412(d)(2) and (11)(A) is discussed in Comment 2 to Section 508.

7. There is no time limit or statute of limitations on felony convictions in Section 412(d)(3) as a ground for disciplinary action.

8. The present tense of the verb "is" in Sections 412(d)(4) through (6) and (12) means that an injunction, order, adjudication, or determination that has expired or been vacated is no longer a ground for discipline.

9. In Sections 412(d)(5) and (6) the administrator is not required to prove the validity of the ground which led to the earlier disciplinary order.

10. Under Section 412(d)(7) the administrator may not proceed against a broker-dealer or investment adviser firm on the basis of the insolvency of a partner, officer, director, controlling person or other person specified in subsection (b), unless it is a sole proprietorship.

11. Section 412(d)(8) can be violated by a refusal to cooperate with an administrator's reasonable audit or inspection, including by withholding or concealing records, refusing to furnish required records, or refusing the administrator reasonable access to any office or location within an office to conduct an audit or inspection under this Act. However, a request by a person subject to an audit or inspection for a reasonable delay to obtain assistance of counsel does not constitute a violation of Section 412(d)(8).

12. The term "failed to supervise reasonably" in Section 412(d)(9) includes not having reasonable supervisory procedures in place as well as a proper system of supervision and internal control. Cf. Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990), *cert. denied*, 499 U.S. 976 (1991). Section 15(b)(4)(E) of the Securities Exchange Act of 1934 similarly addresses "failure to supervise reasonably." See 6 Louis Loss & Joel Seligman, Securities Regulation 3097-3101 (3d ed. rev. 2002).

13. The term "dishonest and unethical practices" in Section 412(d)(13) has been held not to be unconstitutionally vague. See, e.g., Brewster v. Maryland Sec. Comm'n, 548 A.2d 157, 160 (M.D. Ct. Spec. App. 1988) ("a broad statutory standard is not vague if it has a meaningful referent in business practice, custom or usage"); Johnson-Bowles Co. v. Division of Sec., 829 P.2d 101, 114 (Utah Ct. App. 1992) (such legislative language bespeaks a legislative intent to delegate the interpretation of what constitutes "dishonest and unethical practices" in the securities industry to the administrator). Ministerial or clerical violations of a statute or rule, if immaterial and occurring without intent or recklessness, typically would not constitute dishonest or unethical practices.

14. Under the counterparts to Section 412(d)(14) and (e) applicants to become agents of broker-dealers typically take standardized tests administered by the National Association of Securities Dealers, Inc.

15. Sections 412(f) and (g) amplify the earlier procedures found in Section 204(f) of the 1956 Act and are intended to facilitate summary disciplinary proceedings, when these are appropriate.

16. Section 412(i) parallels the language of Section 204 of the 1956 Act and Section 212(b) of RUSA with some significant changes. The time period in which the administrator can act has been extended to one year from 30 days in the 1956 Act and 90 days in RUSA. The limitation on instituting a proceeding can also be tolled by instituting a formal investigation. The addition of the word "solely" is intended to make it clear that an administrator may consider the prior history of an applicant or registrant even if that prior history had been known to the administrator for more than one year if there are additional material facts which are actually known to the administrator within the last year.

17. "Actually known" in Section 412(i) is used to signify that the mere filing of material facts in the Central Registration Depository or Investment Advisory Registration Depository systems does not constitute actual knowledge, unless that information was received by the administrator, or, but for a decision by the administrator, would have been received by the administrator.

[ARTICLE] 5

FRAUD AND LIABILITIES

SECTION 501. GENERAL FRAUD. It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly:

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

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

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

Official Comments

Prior Provisions: 1956 Act Section 101; RUSA Section 501.

1. Section 501, which was Section 101 in the 1956 Act, was modeled on Rule 10b-5 adopted under the Securities Exchange Act of 1934 and on Section 17(a) of the Securities Act of 1933. There has been significant later case development interpreting Rule 10b-5, Section 17(a), and Section 101 of the 1956 Act. Section 501 is not identical to either Rule 10b-5 or Section 17(a).

2. There are no exemptions from Section 501.

3. Section 501 applies to any securities offer, sale or purchase, including offers, sales, or purchases involving registered, exempt, or federal covered securities. It would also apply to a rescission offer under Section 510.

4. The possible consequences of violating Section 501 are many. These include denial, suspension, or revocation of securities registration under Section 306; denial, revocation, suspension, withdrawal, restriction, condition or limitation of a broker-dealer, agent, investment adviser, or investment adviser representative registration under Section 412; criminal prosecution

under Section 508; civil enforcement proceedings under Sections 603; and administrative proceedings under 604.

5. Because Section 501, like Rule 10b-5, reaches market manipulation, see 8 Louis Loss & Joel Seligman, Securities Regulation Ch.10.D (3d ed. 1991), this Act does not include the RUSA market manipulation Section 502, which had no counterpart in the 1956 Act.

6. The culpability required to be pled or proved under Section 501 is addressed in the relevant enforcement context. See, e.g., Section 508, criminal penalties, where "willfulness" must be proven; Section 509, civil liabilities, which includes a reasonable care defense; or civil and administrative enforcement actions under Sections 603 and 604, where no culpability is required to be pled or proven.

7. There is no private cause of action, express or implied, under Section 501. Section 509(m) expressly provides that only Section 509 provides a private cause of action for conduct that could violate Section 501.

SECTION 502. PROHIBITED CONDUCT IN PROVIDING INVESTMENT ADVICE.

(a) [**Fraud in providing investment advice.**] It is unlawful for a person that advises others for compensation, either directly or indirectly or through publications or writings, as to the value of securities or the advisability of investing in, purchasing, or selling securities or that, for compensation and as part of a regular business, issues or promulgates analyses or reports relating to securities:

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

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

(b) [**Rules defining fraud.**] A rule adopted under this [Act] may define an act, practice, or course of business of an investment adviser or an investment adviser representative, other than

a supervised person of a federal covered investment adviser, as fraudulent, deceptive, or manipulative, and prescribe means reasonably designed to prevent investment advisers and investment adviser representatives, other than supervised persons of a federal covered investment adviser, from engaging in acts, practices, and courses of business defined as fraudulent, deceptive, or manipulative.

(c) [**Rules specifying contents of advisory contract.**] A rule adopted under this [Act] may specify the contents of an investment advisory contract entered into, extended, or renewed by an investment adviser.

Official Comments

Prior Provisions: 1956 Act Section 102(a); RUSA Section 503.

1. Section 502(a) applies to any person that commits fraud in providing investment advice. Section 502(b) is not limited to persons registered as investment advisers or investment adviser representatives.

2. A person can violate both Section 501 and Section 502 if the person violates Section 502 in connection with the offer, purchase, or sale of a security.

3. The rulemaking authority under Sections 502(b) and (c) would provide the basis for existing NASAA rules concerning investment advisers, to the extent these rules are not preempted by the National Securities Markets Improvement Act of 1996.

4. Under Section 203A(b)(2) of the Investment Advisers Act States retain their authority to investigate and bring enforcement actions with respect to fraud or deceit against a federal covered investment adviser or a person associated with a federal covered investment adviser. Under Section 502(a), which applies to any person, a State could bring an enforcement action against a federal covered investment adviser, including a federal covered investment adviser excluded from the definition of investment adviser in Section 102(15)(E).

5. There is no private cause of action, express or implied, under Section 502. Section 509(m) expressly provides that only Section 509 provides for a private cause of action for prohibited conduct in providing investment advice that could violate Section 502.

SECTION 503. EVIDENTIARY BURDEN.

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

(b) [**Criminal.**] In a criminal proceeding under this [Act], a person claiming an exemption, exception, preemption, or exclusion has the burden of going forward with evidence of the claim.

Official Comment

Prior Provisions: 1956 Act Section 402(d); RUSA Section 608.

1. As specified in Section 503(a), in a civil or administrative action, the person claiming an exemption, exception, preemption, or exclusion has the burden of persuasion.

2. In contrast, in a criminal action under Section 503(b), the prosecutor is required to prove each element of a crime "beyond a reasonable doubt." The defendant only has the burden of producing evidence of an exemption, exception, preemption, or exclusion. Some court decisions have characterized this burden as an affirmative defense. See, e.g., United States ex. rel. Schott v. Tehan, 365 F.2d 191, 195 (6th Cir. 1966) (Ohio blue sky law constitutionally shifts burden of production to defendant); Commonwealth v. David, 309 N.E.2d 484, 488 (Mass. 1974) (exemption is an affirmative defense); State v. Frost, 387 N.E.2d 235, 238-239 (Ohio 1979) (it is not unconstitutional to require the burden of proof as an affirmative defense to prove a securities law exemption); State v. Andersen, 773 A.2d 328 (Conn. 2001) (an exemption from registration is an affirmative defense to the charge of selling unregistered securities).

SECTION 504. FILING OF SALES AND ADVERTISING LITERATURE.

(a) [**Filing requirement.**] Except as otherwise provided in subsection (b), a rule adopted or order issued under this [Act] may require the filing of a prospectus, pamphlet, circular, form letter, advertisement, sales literature, or other advertising record relating to a security or

investment advice, addressed or intended for distribution to prospective investors, including clients or prospective clients of a person registered or required to be registered as an investment adviser under this [Act].

(b) [**Excluded communications.**] This section does not apply to sales and advertising literature specified in subsection (a) which relates to a federal covered security, a federal covered investment adviser, or a security or transaction exempted by Section 201, 202, or 203 except as required pursuant to Section 201(7).

Official Comments

Prior Provisions: 1956 Act Section 403; RUSA Section 405.

1. The prospectuses, pamphlets, circulars, form letters, advertisements, sales literature or advertising communications, include material disseminated electronically or available on a web site.

2. The administrator may bring a civil enforcement action in a court under Section 603 or institute administrative enforcement under Section 604 to prevent publication, circulation or use of any materials required by the administrator to be filed under Section 504 that have not been filed.

3. Section 504(b) is meant to refer to the communications described in Section 504(a).

SECTION 505. MISLEADING FILINGS. It is unlawful for a person to make or cause to be made, in a record that is used in an action or proceeding or filed under this [Act], a statement that, at the time and in the light of the circumstances under which it is made, is false or misleading in a material respect, or, in connection with the statement, to omit to state a material fact necessary to make the statement made, in the light of the circumstances under which it was made, not false or misleading.

Official Comment

Prior Provisions: 1956 Act Section 404; RUSA Section 504.

The definition of "materiality" in TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) ("an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote") has generally been followed in both federal and state securities law. See 4 Louis Loss & Joel Seligman, Securities Regulation 2071-2105 (3d ed. rev. 2000).

SECTION 506. MISREPRESENTATIONS CONCERNING REGISTRATION OR EXEMPTION. The filing of an application for registration, a registration statement, a notice filing under this [Act], the registration of a person, the notice filing by a person, or the registration of a security under this [Act] does not constitute a finding by the administrator that a record filed under this [Act] is true, complete, and not misleading. The filing or registration or the availability of an exemption, exception, preemption, or exclusion for a security or a transaction does not mean that the administrator has passed upon the merits or qualifications of, or recommended or given approval to, a person, security, or transaction. It is unlawful to make, or cause to be made, to a purchaser, customer, client, or prospective customer or client a representation inconsistent with this section.

Official Comment

Prior Provisions: 1956 Act Section 405; RUSA Section 505.

This Section follows the 1956 Act and RUSA, as well as state securities statutes generally, in providing that a misrepresentation concerning registration or an exemption is unlawful.

SECTION 507. QUALIFIED IMMUNITY. A broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative is not liable to another broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative for defamation relating to a statement that is contained in a record required by the administrator, or designee of the administrator, the Securities and Exchange Commission, or a self-regulatory organization, unless the person knew, or should have known at the time that the statement was made, that it was false in a material respect or the person acted in reckless disregard of the statement's truth or falsity.

Official Comments

Source of Law: National Association of Securities Dealers, Inc. Proposal Relating to Qualified Immunity in Arbitration Proceedings for Statements Made in Forms U-4 and U-5.

1. In 1994 The Securities and Exchange Commission Division of Market Regulation published The Large Firm Project: A Review of Hiring, Retention, and Supervisory Practices (1994), which found that a small number of "rogue brokers" were responsible for a significant proportion of customer disciplinary complaints. These brokers in some instances moved from one broker-dealer firm to another, it was explained, without full and complete disclosure of disciplinary problems by the broker-dealer, because of broker-dealer firms' fear of state law defamation claims. See also GAO, Actions Needed to Better Protect Investors against Unscrupulous Brokers 3 (1994); Testimony of SEC Chairman Arthur Levitt Concerning the Large Firm Project, Subcomm. on Telecommunications & Fin., House Comm. on Energy & Commerce (Sept. 14, 1994), *reprinted in* 1994-1995 Fed. Sec. L. Rep. (CCH) ¶85,433 (1994).

2. In 1998, the National Association of Securities Dealers proposed qualified immunity for statements made in Forms U-4 and U-5 to address this problem. This proposal was reprinted in Securities Exchange Act Release 39,892, 66 SEC Dock. 2473 (1998). This proposal was limited to arbitration proceedings. It was not acted on by the Securities and Exchange Commission.

3. An alternative approach would be a standard providing for absolute immunity. See generally Anne Wright, Form U-5 Defamation, 52 Wash. & Lee L. Rev. 1299 (1995); Acciardo v. Millennium Sec. Corp., 83 F. Supp. 2d 413 (S.D.N.Y. 2000) (discussing both New York qualified and absolute immunity cases).

4. Securities administrators or self-regulatory organizations generally are subject to absolute or qualified immunity for actions of their employees within the course of their official duties. See 10 Louis Loss & Joel Seligman, Securities Regulation 4818-4821 (3d ed. rev. 1996).

5. As is generally the law "truth is a complete defense to a defamation action." Andrews v. Prudential Sec., Inc., 160 F.3d 304, 308 (6th Cir. 1998).

6. An agent who has been the subject of a Form U-5, Uniform Termination Notice for Securities Industry Registration, may respond to specified adverse disclosures and have her or his responses reprinted on the published version of Form U-5.

7. Through September 2002 no state had adopted an immunity provision in its securities statute. No state has rejected immunity in this context by judicial decision. A number of states have adopted qualified immunity by judicial decision. See, e.g., Eaton Vance Distrib., Inc. v. Ulrich, 692 So.2d 915 (Fla. Dist. Ct. App. 1997); Bavarati v. Josephal, Lyon & Ross, Inc., 28 F.3d 704 (7th Cir. 1994) (Illinois); Andrews v. Prudential Sec., Inc., 160 F.3d 304 (6th Cir. 1998) (Michigan); Prudential Sec., Inc. v. Dalton, 929 F. Supp. 1411 (N.D. Okla. 1996) (Oklahoma); Glennon v. Dean Witter Reynolds Inc., 83 F.3d 132 (6th Cir. 1996) (Tennessee).

SECTION 508. CRIMINAL PENALTIES.

(a) [**Criminal penalties.**] A person that willfully violates this [Act], or a rule adopted or order issued under this [Act], except Section 504 or the notice filing requirements of Section 302 or 405, or that willfully violates Section 505 knowing the statement made to be false or misleading in a material respect, upon conviction, shall be fined not more than $[___] or imprisoned not more than [___] years, or both. An individual convicted of violating a rule or order under this [Act] may be fined, but may not be imprisoned, if the individual did not have knowledge of the rule or order.

(b) [**Criminal reference not required.**] The [Attorney General or the proper prosecuting attorney] with or without a reference from the administrator, may institute criminal proceedings under this [Act].

(c) [**No limitation on other criminal enforcement**.] This [Act] does not limit the power of this State to punish a person for conduct that constitutes a crime under other laws of this State.

Official Comments

Prior Provisions: 1956 Act Section 409; RUSA Section 604; Securities Exchange Act of 1934 Section 32(a).

1. This Section follows the 1956 Act and the federal securities laws in imposing criminal penalties for any willful violation of the Act. RUSA Section 604 distinguished between felonies and misdemeanors, limiting willful violations of cease and desist orders to a misdemeanor.

2. The term "willfully" has the same meaning in Section 508 as it did in the 1956 Act. All that is required is proof that a person acted intentionally in the sense that the person was aware of what he or she was doing. Proof of evil motive or intent to violate the law or knowledge that the law was being violated is not required.

3. The final sentence of Section 508(a) is based on Section 32(a) of the Securities Exchange Act of 1934, which provides: "[N]o person shall be subject to imprisonment under this section in violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation." The "no knowledge" clause in Section 508(a) is relevant only to sentencing. The person convicted has the burden of persuasion to prove no knowledge at sentencing. Because this does not impose a burden on the defendant to disprove the elements of a crime, Section 32(a) of the Securities Exchange Act of 1934 has been held not to raise a constitutional problem. United States v. Mandel, 296 F. Supp. 1038, 1040 (S.D.N.Y. 1969).

4. The appropriate state prosecutor under Section 508(b) may decide whether to bring a criminal action under this statute, another statute, or, when applicable, common law. In certain states the administrator has full or limited criminal enforcement powers.

5. This section does not specify maximum dollar amounts for criminal fines, maximum terms for imprisonment, nor the years of limitation, but does provide for each state to specify appropriate magnitudes for criminal fines or maximum terms for imprisonment.

6. The definition of willfulness in Comment 2 to Section 508 has been followed by most courts. See, e.g., State v. Hodge, 460 P.2d 596, 604 (Kan. 1969) ("No specific intent is necessary to constitute the offense where one violates the securities act except the intent to do the act denounced by the statute"); State v. Nagel, 279 N.W.2d 911, 915 (S.D. 1979) ("[I]t is widely understood that the legislature may forbid the doing of an act and make its commission a crime without regard to the intent or knowledge of the doer"); State v. Fries, 337 N.W.2d 398, 405 (Neb. 1983) (proof of a specific intent, evil motive, or knowledge that the law was being violated is not required to sustain a criminal conviction under a state's blue sky law); People v. Riley, 708

P.2d 1359, 1362 (Colo. 1985) ("A person acts 'knowingly' or 'willfully' with respect to conduct . . . when he is aware that his conduct . . . exists"); State v. Larsen, 865 P.2d 1355, 1358 (Utah 1993) (willful implies a willingness to commit the act, not an intent to violate the law or to injure another or acquire any advantage); State v . Montgomery, 17 P.3d 292, 294 (Idaho 2001) (bad faith is not required for a violation of a state securities act; willful implies "simply a purpose or willingness to commit the act or make the omission referred to"); State v. Dumke, 901 S.W.2d 100, 102 (Mo. Ct. App. 1995) (*mens rea* not required); State v. Mueller, 549 N.W.2d 455, 460 (Wis. Ct. App. 1996) (willfulness does not require proof that the defendant acted with intent to defraud or knowledge that the law was violated); United States v. Lilley, 291 F. Supp. 989, 993 (S.D. Tex. 1968) ("no knowledge" clause in federal statute not available to defendant claiming lack of knowledge of particular SEC rule).

SECTION 509. CIVIL LIABILITY.

(a) [**Securities Litigation Uniform Standards Act.**] Enforcement of civil liability under this section is subject to the Securities Litigation Uniform Standards Act of 1998.

(b) [**Liability of seller to purchaser.**] A person is liable to the purchaser if the person sells a security in violation of Section 301 or, by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statement made, in light of the circumstances under which it is made, not misleading, the purchaser not knowing the untruth or omission and the seller not sustaining the burden of proof that the seller did not know and, in the exercise of reasonable care, could not have known of the untruth or omission. An action under this subsection is governed by the following:

(1) The purchaser may maintain an action to recover the consideration paid for the security, less the amount of any income received on the security, and interest [at the legal rate of interest] from the date of the purchase, costs, and reasonable attorneys' fees determined by the court, upon the tender of the security, or for actual damages as provided in paragraph (3).

(2) The tender referred to in paragraph (1) may be made any time before entry of

judgment. Tender requires only notice in a record of ownership of the security and willingness to exchange the security for the amount specified. A purchaser that no longer owns the security may recover actual damages as provided in paragraph (3).

(3) Actual damages in an action arising under this subsection are the amount that would be recoverable upon a tender less the value of the security when the purchaser disposed of it, and interest [at the legal rate of interest] from the date of the purchase, costs, and reasonable attorneys' fees determined by the court.

(c) [**Liability of purchaser to seller.**] A person is liable to the seller if the person buys a security by means of an untrue statement of a material fact or omission to state a material fact necessary in order to make the statement made, in light of the circumstances under which it is made, not misleading, the seller not knowing of the untruth or omission, and the purchaser not sustaining the burden of proof that the purchaser did not know, and in the exercise of reasonable care, could not have known of the untruth or omission. An action under this subsection is governed by the following:

(1) The seller may maintain an action to recover the security, and any income received on the security, costs, and reasonable attorneys' fees determined by the court, upon the tender of the purchase price, or for actual damages as provided in paragraph (3).

(2) The tender referred to in paragraph (1) may be made any time before entry of judgment. Tender requires only notice in a record of the present ability to pay the amount tendered and willingness to take delivery of the security for the amount specified. If the purchaser no longer owns the security, the seller may recover actual damages as provided in paragraph (3).

(3) Actual damages in an action arising under this subsection are the difference between the price at which the security was sold and the value the security would have had at the time of the sale in the absence of the purchaser's conduct causing liability, and interest [at the legal rate of interest] from the date of the sale of the security, costs, and reasonable attorneys' fees determined by the court.

(d) [**Liability of unregistered broker-dealer and agent.**] A person acting as a broker-dealer or agent that sells or buys a security in violation of Section 401(a), 402(a), or 506 is liable to the customer. The customer, if a purchaser, may maintain an action for recovery of actual damages as specified in subsections (b)(1) through (3), or, if a seller, for a remedy as specified in subsections (c)(1) through (3).

(e) [**Liability of unregistered investment adviser and investment adviser representative.**] A person acting as an investment adviser or investment adviser representative that provides investment advice for compensation in violation of Section 403(a), 404(a), or 506 is liable to the client. The client may maintain an action to recover the consideration paid for the advice, interest [at the legal rate of interest] from the date of payment, costs, and reasonable attorneys' fees determined by the court.

(f) [**Liability for investment advice.**] A person that receives directly or indirectly any consideration for providing investment advice to another person and that employs a device, scheme, or artifice to defraud the other person or engages in an act, practice, or course of business that operates or would operate as a fraud or deceit on the other person, is liable to the other person. An action under this subsection is governed by the following:

(1) The person defrauded may maintain an action to recover the consideration paid

for the advice and the amount of any actual damages caused by the fraudulent conduct, interest [at the legal rate of interest] from the date of the fraudulent conduct, costs, and reasonable attorneys' fees determined by the court, less the amount of any income received as a result of the fraudulent conduct.

(2) This subsection does not apply to a broker-dealer or its agents if the investment advice provided is solely incidental to transacting business as a broker-dealer and no special compensation is received for the investment advice.

(g) [**Joint and several liability**.] The following persons are liable jointly and severally with and to the same extent as persons liable under subsections (b) through (f):

(1) a person that directly or indirectly controls a person liable under subsections (b) through (f), unless the controlling person sustains the burden of proof that the person did not know, and in the exercise of reasonable care could not have known, of the existence of conduct by reason of which the liability is alleged to exist;

(2) an individual who is a managing partner, executive officer, or director of a person liable under subsections (b) through (f), including an individual having a similar status or performing similar functions, unless the individual sustains the burden of proof that the individual did not know and, in the exercise of reasonable care could not have known, of the existence of conduct by reason of which the liability is alleged to exist;

(3) an individual who is an employee of or associated with a person liable under subsections (b) through (f) and who materially aids the conduct giving rise to the liability, unless the individual sustains the burden of proof that the individual did not know and, in the exercise of reasonable care could not have known, of the existence of conduct by reason of which the

liability is alleged to exist; and

(4) a person that is a broker-dealer, agent, investment adviser, or investment adviser representative that materially aids the conduct giving rise to the liability under subsections (b) through (f), unless the person sustains the burden of proof that the person did not know and, in the exercise of reasonable care could not have known, of the existence of conduct by reason of which liability is alleged to exist.

(h) [**Right of contribution.**] A person liable under this section has a right of contribution as in cases of contract against any other person liable under this section for the same conduct.

(i) [**Survival of cause of action.**] A cause of action under this section survives the death of an individual who might have been a plaintiff or defendant.

(j) [**Statute of limitations.**] A person may not obtain relief:

(1) under subsection (b) for violation of Section 301, or under subsection (d) or (e), unless the action is instituted within one year after the violation occurred; or

(2) under subsection (b), other than for violation of Section 301, or under subsection (c) or (f), unless the action is instituted within the earlier of two years after discovery of the facts constituting the violation and five years after the violation.

(k) [**No enforcement of violative contract.**] A person that has made, or has engaged in the performance of, a contract in violation of this [Act] or a rule adopted or order issued under this [Act], or that has acquired a purported right under the contract with knowledge of conduct by reason of which its making or performance was in violation of this [Act], may not base an action on the contract.

(l) [**No contractual waiver.**] A condition, stipulation, or provision binding a person

purchasing or selling a security or receiving investment advice to waive compliance with this [Act] or a rule adopted or order issued under this [Act] is void.

(m) [**Survival of other rights or remedies.**] The rights and remedies provided by this [Act] are in addition to any other rights or remedies that may exist, but this [Act] does not create a cause of action not specified in this section or Section 411(e).

Official Comments

Prior Provisions: 1956 Act Section 410; RUSA Sections 605-607, 609, 802.

1. Under Section 509 violations of two or more sections can be proven, but the remedy is limited either to rescission or actual damages. Actual damages means compensatory damages. Punitive or "double" damages are not provided by this section which also is the standard under Section 28(a) of the Securities Exchange Act of 1934. See 9 Louis Loss & Joel Seligman, Securities Regulation 4408-4427 (3d ed. rev. 1992).

2. The Securities Litigation Uniform Standards Act of 1998 cited in Section 509(a) modifies the entire Section 509.

3. As with Section 12(a)(2) of the Securities Act of 1933, Section 509(b) contains a type of privity requirement in that the purchaser is required to bring an action against the seller. Section 509(b) is broader than Section 12(a)(2) in that it will reach all sales in violation of Section 301, not just sales "by means of a prospectus" as is the law under Section 12(a)(2). See Gustafson v. Alloyd Co., Inc., 513 U.S. 561 (1995).

4. Unlike the current standards on implied rights of action under Rule 10b-5, neither causation nor reliance has been held to be an element of a private cause of action under the precursor to Section 509(b). See Gerhard W. Gohler, IRA v. Wood, 919 P.2d 561 (Utah 1996); Ritch v. Robinson-Humprhey Co., 748 So. 2d 861 (Ala. 1999); Kaufman v. I-Stat Corp., 754 A.2d 1188 (N.J. 2000).

5. The measure of damages in Section 509(b)(3) is that contemplated by Section 12 of the Securities of 1933. See 9 Louis Loss and Joel Seligman, Securities Regulations 4242-4246 (3d ed. 1992). The measure of damages in Section 509(c)(3), however, is that contemplated by Rule 10b-5. Sec. 9 id. 4408-4427. In providing for damages as an alternative to rescission, Section 509(b)(3) follows the 1956 Act and is an improvement upon many earlier state provisions, which conditioned the plaintiff's right of recovery on his or her being in a position to make a good tender. A plaintiff is not given the right under this type of statutory formula to retain stock and also seek damages.

6. Sections 509(e) and (f) are based on a proposed NASAA amendment to the Uniform Securities Act adopted in order "to establish civil liability for individuals who willfully violate Section 102 dealing with fraudulent practices pertaining to advisory activities." Neither provision is intended to limit other state law claims for providing investment advice.

7. Broker-dealer employees, including research analysts, who receive no special compensation from third parties for investment advice would not be liable under Section 509(f).

8. The control liability provision in Section 509(g)(1) is modeled on that in the 1956 Act. On the meaning of "control," see 4 Louis Loss & Joel Seligman, Securities Regulations 1703-1727 (3d ed. rev. 2000).

9. The defense of lack of knowledge in Sections 509(g) is also modeled on the 1956 Act.

10. Under Section 509(g)(2) partners, officers, and directors are liable, subject to the defense afforded by that subsection, without proof that they aided in the sale. In Section 509(g)(2), the term "partner" is intended to be limited to partners with management responsibilities, rather than a partner with a passive investment.

11. Under 509(g)(4), the performance by a clearing broker of the clearing broker's contractual functions – even though necessary to the processing of a transaction – without more would not constitute material aid or result in liability under this subsection. See, e.g., Ross v. Bolton, 904 F.2d 819 (2d Cir. 1990).

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

13. The contribution provision in Section 509(h) is a safeguard to avoid the common law principle that prohibited contribution among joint tortfeasors.

14. The statute of limitations in Section 509(j) is a hybrid of the 1956 Act and federal securities law approaches. The 1956 Act Section 410(p) provided that: "No person may sue under this section more than two years after the contract of sale." Under this provision, the state courts generally decline to extend a statute of limitations period on grounds of fraudulent concealment or equitable tolling.

Before the July 2002 enactment of the Sarbanes-Oxley Act, Rule 10b-5 of the Securities Exchange Act as construed by the United States Supreme Court in Lampf, Pleva, Lipkind, Prepis & Petigrew v. Gilbertson, 501 U.S. 350 (1991), prohibited equitable tolling under the federal securities law one year after discovery and three years after the act formula. See generally 10 Louis Loss & Joel Seligman, Securities Regulation 4505-4525 (3d. ed. rev. 1996). The Sarbanes-Oxley Act added 28 U.S.C. §1658(b) which provides

> . . . a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of ---
>
> (1) 2 years after the discovery of the facts constituting the violation; or
>
> (2) 5 years after such violation.

Section 509(j)(1), as with the 1956 Act, is a unitary statute of repose, requiring an action to be commenced within one year after a violation occurred. It is not intended that equitable tolling be permitted.

Section 509(j)(2), in contrast, generally follows the federal securities law model. An action must be brought within the earlier of two years after discovery or five years after the violation. As with federal courts construing the statute of limitations under Rule 10b-5, it is intended that the plaintiff's right to proceed is limited to two years after actual discovery "or after such discovery should have been made by the exercise of reasonable diligence" (inquiry notice), see, e.g., Law v. Medco Research, Inc., 113 F.3d 781 (7th Cir. 1997), or five years after the violation.

The rationale for replicating the basic federal statute of limitations in this Act is to discourage forum shopping. If the statute of limitations applicable to Rule 10b-5 were to be changed in the future, identical changes should be made in Section 509(j)(2).

15. Section 509(k) is similar to Section 29(b) of the Securities Exchange Act and is intended to apply only to actions to enforce illegal contracts. See Louis Loss, Commentary on the Uniform Securities Act 150 (1976).

16. Section 509(m) follows the 1956 Act.

17. Section 509 and Section 411(e) provide the exclusive private causes of action under this Act.

SECTION 510. RESCISSION OFFERS. A purchaser, seller, or recipient of investment advice may not maintain an action under Section 509 if:

(1) The purchaser, seller, or recipient of investment advice receives in a record, before the action is instituted:

(A) an offer stating the respect in which liability under Section 509 may have arisen and fairly advising the purchaser, seller, or recipient of investment advice of that person's rights in connection with the offer, and any financial or other information necessary to correct all material misrepresentations or omissions in the information that was required by this [Act] to be furnished to that person at the time of the purchase, sale, or investment advice;

(B) if the basis for relief under this section may have been a violation of Section 509(b), an offer to repurchase the security for cash, payable on delivery of the security, equal to the consideration paid, and interest [at the legal rate of interest] from the date of the purchase, less the amount of any income received on the security, or, if the purchaser no longer owns the security, an offer to pay the purchaser upon acceptance of the offer damages in an amount that would be recoverable upon a tender, less the value of the security when the purchaser disposed of it, and interest [at the legal rate of interest] from the date of the purchase in cash equal to the damages computed in the manner provided in this subsection;

(C) if the basis for relief under this section may have been a violation of Section 509(c), an offer to tender the security, on payment by the seller of an amount equal to the purchase price paid, less income received on the security by the purchaser and interest [at the legal rate of interest] from the date of the sale; or if the purchaser no longer owns the security, an offer to pay the seller upon acceptance of the offer, in cash, damages in the amount of the difference between the price at which the security was purchased and the value the security would have had at the time of the purchase in the absence of the purchaser's conduct that may have caused liability and interest [at the legal rate of interest] from the date of the sale;

(D) if the basis for relief under this section may have been a violation of Section

509(d); and if the customer is a purchaser, an offer to pay as specified in subparagraph (B); or, if the customer is a seller, an offer to tender or to pay as specified in subparagraph (C);

(E) if the basis for relief under this section may have been a violation of Section 509(e), an offer to reimburse in cash the consideration paid for the advice and interest [at the legal rate of interest] from the date of payment; or

(F) if the basis for relief under this section may have been a violation of Section 509(f), an offer to reimburse in cash the consideration paid for the advice, the amount of any actual damages that may have been caused by the conduct, and interest [at the legal rate of interest] from the date of the violation causing the loss;

(2) the offer under paragraph 1 states that it must be accepted by the purchaser, seller, or recipient of investment advice within 30 days after the date of its receipt by the purchaser, seller, or recipient of investment advice or any shorter period, of not less than three days, that the administrator, by order, specifies;

(3) the offeror has the present ability to pay the amount offered or to tender the security under paragraph (1);

(4) the offer under paragraph (1) is delivered to the purchaser, seller, or recipient of investment advice, or sent in a manner that ensures receipt by the purchaser, seller, or recipient of investment advice; and

(5) the purchaser, seller, or recipient of investment advice that accepts the offer under paragraph (1) in a record within the period specified under paragraph (2) is paid in accordance with the terms of the offer.

Official Comments

Prior Provisions: 1956 Act Section 410(e); RUSA Section 607.

1. A rescission offer must meet the specific requirements of Section 510 for civil liability under Section 509 to be extinguished. Cf. Binder v. Gordian Sec., Inc., 742 F. Supp. 663, 666 (N.D. Ga. 1990). See generally Rowe, Rescission Offers under Federal and State Securities Law, 12 J. Corp. L. 383 (1987).

2. A rescission offer that does not comply with Section 510 is subject to civil liability, administrative enforcement, or criminal penalties under this Act. A rescission offer, for example, could violate Section 501, the general fraud provision.

3. The administrator may publish a form that would comply with Section 510, but the form would not be the only one that could be used by the parties.

4. A valid rescission offer will be exempt from securities registration. See Section 202(19).

5. If a state chooses to add a notice or filing provision, it could provide this provision in Section 510(6), which would state:

> (6) The offer [or a notice] is required to be filed with the administrator 10 business days before the offering and conform in form and content with a rule prescribed by the administrator.

[ARTICLE] 6

ADMINISTRATION AND JUDICIAL REVIEW

SECTION 601. ADMINISTRATION.

(a) [**Administration.**] The administrator shall administer this [Act] [insert any related provisions on such matters as method of selection, salary, term of office, selection and remuneration of personnel, and annual reports to the legislature or governor that are appropriate to the particular State].

(b) [**Unlawful use of records or information.**] It is unlawful for the administrator or an officer, employee, or designee of the administrator to use for personal benefit or the benefit of others records or other information obtained by or filed with the administrator that are not public under Section 607(b). This [Act] does not authorize the administrator or an officer, employee, or designee of the administrator to disclose the record or information, except in accordance with Section 602, 607(c), or 608.

(c) [**No privilege or exemption created or diminished.**] This [Act] does not create or diminish a privilege or exemption that exists at common law, by statute or rule, or otherwise.

(d) [**Investor education.**] The administrator may develop and implement investor education initiatives to inform the public about investing in securities, with particular emphasis on the prevention and detection of securities fraud. In developing and implementing these initiatives, the administrator may collaborate with public and nonprofit organizations with an interest in investor education. The administrator may accept a grant or donation from a person that is not affiliated with the securities industry or from a nonprofit organization, regardless of

whether the organization is affiliated with the securities industry, to develop and implement investor education initiatives. This subsection does not authorize the administrator to require participation or monetary contributions of a registrant in an investor education program.

(e) [**The Securities Investor Education and Training Fund.**] The Securities Investor Education and Training Fund is created to provide funds for the purposes specified in subsection (d). [All monies received by the State by reason of civil penalties pursuant to this [Act] shall be deposited in the Securities Investor Education and Training Fund. The State may insert any other provision concerning appropriations to support this fund as well as procedures for its operations.]

Official Comments

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

1. Section 601(b) should be read with Section 607. Section 601(b) prohibits the administrator or the administrator's officers and employees from using for personal benefit records or information that Section 607(b) specifies do not constitute public records. Section 601(b) is not intended to limit the operation of Section 607(a). Neither Section 601(b) nor 607(b) is intended to impede the ability of the agencies specified in Section 608(a) from sharing records or other information in connection with an examination or an investigation.

2. Section 601(c) makes clear that nothing in this Act alters the availability of evidentiary privileges. That question is left to the general law of the particular state.

3. Sections 601(d) and (e) were adopted in recognition of the importance of investor education. An increasing number of jurisdictions are earmarking specific funds for this purpose. The lack of financial acumen among public investors, seniors, and students continues to be demonstrated in recent industry and regulatory studies. The importance of investor financial literacy is increasingly crucial given the decades long shift from defined benefit retirement plans toward defined contribution plans where employees are left to direct their own retirement accounts.

SECTION 602. INVESTIGATIONS AND SUBPOENAS.

(a) [**Authority to investigate.**] The administrator may:

(1) conduct public or private investigations within or outside of this State which the administrator considers necessary or appropriate to determine whether a person has violated, is violating, or is about to violate this [Act] or a rule adopted or order issued under this [Act], or to aid in the enforcement of this [Act] or in the adoption of rules and forms under this [Act];

(2) require or permit a person to testify, file a statement, or produce a record, under oath or otherwise as the administrator determines, as to all the facts and circumstances concerning a matter to be investigated or about which an action or proceeding is to be instituted; and

(3) publish a record concerning an action, proceeding, or an investigation under, or a violation of, this [Act] or a rule adopted or order issued under this [Act] if the administrator determines it is necessary or appropriate in the public interest and for the protection of investors.

(b) [**Administrator powers to investigate.**] For the purpose of an investigation under this [Act], the administrator or its designated officer may administer oaths and affirmations, subpoena witnesses, seek compulsion of attendance, take evidence, require the filing of statements, and require the production of any records that the administrator considers relevant or material to the investigation.

(c) [**Procedure and remedies for noncompliance.**] If a person does not appear or refuses to testify, file a statement, produce records, or otherwise does not obey a subpoena as required by the administrator under this [Act], the administrator [may refer the matter to the Attorney General or the proper attorney, who] may apply to [insert name of the appropriate court] or a court of another State to enforce compliance. The court may:

(1) hold the person in contempt;

(2) order the person to appear before the administrator;

(3) order the person to testify about the matter under investigation or in question;

(4) order the production of records;

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

(6) impose a civil penalty of not less than $[__] and not greater than $[__] for each violation; and

(7) grant any other necessary or appropriate relief.

(d) [**Application for relief.**] This section does not preclude a person from applying to [insert name of appropriate court] or a court of another State for relief from a request to appear, testify, file a statement, produce records, or obey a subpoena.

(e) [**Use immunity procedure.**] An individual is not excused from attending, testifying, filing a statement, producing a record or other evidence, or obeying a subpoena of the administrator under this [Act] or in an action or proceeding instituted by the administrator under this [Act] on the ground that the required testimony, statement, record, or other evidence, directly or indirectly, may tend to incriminate the individual or subject the individual to a criminal fine, penalty, or forfeiture. If the individual refuses to testify, file a statement, or produce a record or other evidence on the basis of the individual's privilege against self-incrimination, the administrator may apply [to the name of the appropriate court] to compel the testimony, the filing of the statement, the production of the record, or the giving of other evidence. The testimony, record, or other evidence compelled under such an order may not be used, directly or indirectly, against the individual in a criminal case, except in a prosecution for perjury or contempt or otherwise failing to comply with the order.

(f) [**Assistance to securities regulator of another jurisdiction.**] At the request of the securities regulator of another State or a foreign jurisdiction, the administrator may provide assistance if the requesting regulator states that it is conducting an investigation to determine whether a person has violated, is violating, or is about to violate a law or rule of the other State or foreign jurisdiction relating to securities matters that the requesting regulator administers or enforces. The administrator may provide the assistance by using the authority to investigate and the powers conferred by this section as the administrator determines is necessary or appropriate. The assistance may be provided without regard to whether the conduct described in the request would also constitute a violation of this [Act] or other law of this State if occurring in this State. In deciding whether to provide the assistance, the administrator may consider whether the requesting regulator is permitted and has agreed to provide assistance reciprocally within its State or foreign jurisdiction to the administrator on securities matters when requested; whether compliance with the request would violate or prejudice the public policy of this State; and the availability of resources and employees of the administrator to carry out the request for assistance.

Official Comments

Prior Provisions: 1956 Act Section 407; RUSA Section 601.

1. Sections 602 (a) and (b) follow the 1956 Act, which was modeled generally on Sections 21(a) through (d) of the Securities Exchange Act of 1934 as it then read.

2. Standards for issuance of subpoenas have been generally established in federal and state securities law. See, e.g., 10 Louis Loss & Joel Seligman, Securities Regulation 4917-4937 (3d ed. rev. 1996) (discussing Oklahoma Press Pub. Co. v. Walling, 327 U.S. 186 (1946) and other cases). The scope of subpoena enforcement in each state is a general matter for judicial determination. Under Section 602, an individual subpoenaed to testify by the administrator is not compelled to testify within the meaning of these sections simply by service of a subpoena. Under Section 602(b) the individual can be subpoenaed and compelled to attend. Once in attendance an individual can assert an evidentiary privilege or exemption, see Section 601(c), including the

Fifth Amendment privilege against self-incrimination. If an individual refuses to testify or give evidence, the administrator may apply (or have the appropriate State attorney apply) to the appropriate court for the relief specified in Section 602(c). If the individual invokes the privilege against self-incrimination, Section 602(d) allows the administrator to apply to the appropriate court to compel testimony under the "use immunity" provision barring the record compelled or other evidence obtained from being used in a criminal case. See People v. District Co. of Arapahoe County, 894 P.2d 739 (Colo. 1995). The phrase "directly or indirectly" in Section 602(e) is intended to include testimony, other evidence, or other information derived from immunized testimony, statements, records, or evidence.

3. Section 602 is intended to apply generally to securities offers and sales under Article 3 and broker-dealer and investment adviser activity under Article 4, when there is noncompliance with the first sentence of Section 602(c). This subsection does not limit the powers of an administrator under other provisions of this Act.

4. A court may quash a subpoena for good cause under Section 602(d). The court may decline to enforce a subpoena that is arbitrary, capricious, or oppressive.

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

6. Section 602(f) is consistent with the Securities Litigation Uniform Standard Act of 1998 which provides in Section 102(e):

> The Securities and Exchange Commission, in consultation with State securities commissions (or any agencies or offices performing like functions), shall seek to encourage the adoption of State laws providing for reciprocal enforcement by State securities commissions of subpoenas issued by another State securities commission seeking to compel persons to attend, testify in, or produce documents or records in connection with an action or investigation by a State securities commission of an alleged violation of State securities laws.

7. There are limitations on financial institutions being subject to visitorial powers by State officials, such as those affecting national banks contained in 12 U.S.C. 484 and 12 C.F.R. Sec. 7.4000. Law outside this Act may place similar limits on state chartered financial institutions being subjected to visitorial powers. This Act does not negate these limitations.

SECTION 603. CIVIL ENFORCEMENT.

(a) [**Civil action instituted by administrator.**] If the administrator believes that a person has engaged, is engaging, or is about to engage in an act, practice, or course of business

constituting a violation of this [Act] or a rule adopted or order issued under this [Act] or that a person has, is, or is about to engage in an act, practice, or course of business that materially aids a violation of this [Act] or a rule adopted or order issued under this [Act], the administrator may maintain an action in the [insert the name of the court] to enjoin the act, practice, or course of business and to enforce compliance with this [Act] or a rule adopted or order issued under this [Act].

(b) [**Relief available.**] In an action under this section and on a proper showing, the court may:

(1) issue a permanent or temporary injunction, restraining order, or declaratory judgment;

(2) order other appropriate or ancillary relief, which may include:

(A) an asset freeze, accounting, writ of attachment, writ of general or specific execution, and appointment of a receiver or conservator, that may be the administrator, for the defendant or the defendant's assets;

(B) ordering the administrator to take charge and control of a defendant's property, including investment accounts and accounts in a depository institution, rents, and profits; to collect debts; and to acquire and dispose of property;

(C) imposing a civil penalty up to $[__] for a single violation or up to $[__] for more than one violation; an order of rescission, restitution, or disgorgement directed to a person that has engaged in an act, practice, or course of business constituting a violation of this [Act] or the predecessor act or a rule adopted or order issued under this [Act] or the predecessor act; and

(D) ordering the payment of prejudgment and postjudgment interest; or

(3) order such other relief as the court considers appropriate.

(c) [**No bond required.**] The administrator may not be required to post a bond in an action or proceeding under this [Act].

Official Comments

Prior Provisions: 1956 Act Section 408; RUSA Section 603

1. Section 408 of the 1956 Act was limited to injunctions. This Section follows RUSA in broadening the civil remedies available when the administrator believes that a violation has occurred. A primary purpose of a broad range of potential sanctions is to enable administrators to better tailor appropriate sanctions to particular misconduct.

2. The administrator alternatively may proceed to seek administrative enforcement under Section 604; to deny, suspend, or revoke a securities registration under Section 306; or to deny, suspend, revoke, or take other action against a broker-dealer, agent, investment adviser, or investment adviser representative registration under Section 412.

3. Constitutional due process considerations can also be addressed by rulemaking or incorporation of the applicable administrative procedure act provisions of each jurisdiction. The term "upon a proper showing" has a settled meaning in the federal securities laws. See, e.g., Securities Act of 1933 Section 20(b).

4. As with Sections 509(g)(3) and (4), materially aid in Section 603(a) does not include ministerial or clerical acts.

SECTION 604. ADMINISTRATIVE ENFORCEMENT.

(a) [**Issuance of an order or notice.**] If the administrator determines that a person has engaged, is engaging, or is about to engage in an act, practice, or course of business constituting a violation of this [Act] or a rule adopted or order issued under this [Act] or that a person has materially aided, is materially aiding, or is about to materially aid an act, practice, or course of business constituting a violation of this [Act] or a rule adopted or order issued under this [Act], the administrator may:

(1) issue an order directing the person to cease and desist from engaging in the act,

practice, or course of business or to take other action necessary or appropriate to comply with this [Act];

(2) issue an order denying, suspending, revoking, or conditioning the exemptions for a broker-dealer under Section 401(b)(1)(D) or (F) or an investment adviser under Section 403(b)(1)(C); or

(3) issue an order under Section 204.

(b) [**Summary process.**] An order under subsection (a) is effective on the date of issuance. Upon issuance of the order, the administrator shall promptly serve each person subject to the order with a copy of the order and a notice that the order has been entered. The order must include a statement whether the administrator will seek a civil penalty or costs of the investigation, a statement of the reasons for the order, and notice that, within 15 days after receipt of a request in a record from the person, the matter will be scheduled for a hearing. If a person subject to the order does not request a hearing and none is ordered by the administrator within 30 days after the date of service of the order, the order becomes final as to that person by operation of law. If a hearing is requested or ordered, the administrator, after notice of and opportunity for hearing to each person subject to the order, may modify or vacate the order or extend it until final determination.

(c) [**Procedure for final order.**] If a hearing is requested or ordered pursuant to subsection (b), a hearing must be held [pursuant to the state administrative procedure act]. A final order may not be issued unless the administrator makes findings of fact and conclusions of law in a record [in accordance with the state administrative procedure act]. The final order may make final, vacate, or modify the order issued under subsection (a).

(d) [**Civil penalty.**] In a final order under subsection (c), the administrator may impose a civil penalty up to $[ ] for a single violation or up to $[ ] for more than one violation.

(e) [**Costs.**] In a final order, the administrator may charge the actual cost of an investigation or proceeding for a violation of this [Act] or a rule adopted or order issued under this [Act].

(f) [**Filing of certified final order with court; effect of filing.**] If a petition for judicial review of a final order is not filed in accordance with Section 609, the administrator may file a certified copy of the final order with the clerk of a court of competent jurisdiction. The order so filed has the same effect as a judgment of the court and may be recorded, enforced, or satisfied in the same manner as a judgment of the court.

(g) [**Enforcement by court; further civil penalty.**] If a person does not comply with an order under this section, the administrator may petition a court of competent jurisdiction to enforce the order. The court may not require the administrator to post a bond in an action or proceeding under this section. If the court finds, after service and opportunity for hearing, that the person was not in compliance with the order, the court may adjudge the person in civil contempt of the order. The court may impose a further civil penalty against the person for contempt in an amount not less than $[ ] but not greater than $[ ] for each violation and may grant any other relief the court determines is just and proper in the circumstances.

Official Comments

Prior Provisions: RUSA Sections 602, 712.

1. Section 604, unlike Section 603, may be initiated by the administrator without prior judicial process or a prior hearing. The section, among other matters, empowers the administrator to act summarily in appropriate circumstances.

2. Sections 603 and 604 are intended to be available to the administrator against persons not subject to stop orders under Section 306 or proceedings against registered broker-dealers, agents, investment advisers, or investment adviser representatives under Section 412. All persons or securities not subject to Section 306 or 412 will be subject to Sections 603 and 604. A person must be covered by either (1) Sections 306 or 412 or (2) Sections 603 or 604.

3. Service of an order or notice under this Section is not effective unless made in accordance with Section 611.

SECTION 605. RULES, FORMS, ORDERS, INTERPRETATIVE OPINIONS, AND HEARINGS.

(a) [**Issuance and adoption of forms, orders, and rules.**] The administrator may:

(1) issue forms and orders and, after notice and comment, may adopt and amend rules necessary or appropriate to carry out this [Act] and may repeal rules, including rules and forms governing registration statements, applications, notice filings, reports, and other records;

(2) by rule, define terms, whether or not used in this [Act], but those definitions may not be inconsistent with this [Act]; and

(3) by rule, classify securities, persons, and transactions and adopt different requirements for different classes.

(b) [**Findings and cooperation.**] Under this [Act], a rule or form may not be adopted or amended, or an order issued or amended, unless the administrator finds that the rule, form, order, or amendment is necessary or appropriate in the public interest or for the protection of investors and is consistent with the purposes intended by this [Act]. In adopting, amending, and repealing rules and forms, Section 608 applies in order to achieve uniformity among the States and coordination with federal laws in the form and content of registration statements, applications, reports, and other records, including the adoption of uniform rules, forms, and

procedures.

(c) [**Financial statements.**] Subject to Section 15(h) of the Securities Exchange Act and Section 222 of the Investment Advisers Act of 1940, the administrator may require that a financial statement filed under this [Act] be prepared in accordance with generally accepted accounting principles in the United States and comply with other requirements specified by rule adopted or order issued under this [Act]. A rule adopted or order issued under this [Act] may establish:

(1) subject to Section 15(h) of the Securities Exchange Act and Section 222 of the Investment Advisors Act of 1940, the form and content of financial statements required under this [Act];

(2) whether unconsolidated financial statements must be filed; and

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

(d) [**Interpretative opinions.**] The administrator may provide interpretative opinions or issue determinations that the administrator will not institute a proceeding or an action under this [Act] against a specified person for engaging in a specified act, practice, or course of business if the determination is consistent with this [Act]. A rule adopted or order issued under this [Act] may establish a reasonable charge for interpretative opinions or determinations that the administrator will not institute an action or a proceeding under this [Act].

(e) [**Effect of compliance.**] A penalty under this [Act] may not be imposed for, and liability does not arise from conduct that is engaged in or omitted in good faith believing it conforms to a rule, form, or order of the administrator under this [Act].

(f) [**Presumption for public hearings.**] A hearing in an administrative proceeding under this [Act] must be conducted in public unless the administrator for good cause consistent with this [Act] determines that the hearing will not be so conducted.

Official Comments

Prior Provisions: 1956 Act Section 412; RUSA Sections 705, 707.

1. It is anticipated that the administrator will propose amendments or make rules under Section 605(a) to remain coordinate with relevant federal law, as well as appropriate rules of the National Association of Securities Dealers, and to achieve uniformity among the States.

2. Uniform forms such as Form B-D, U-4, U-5, and NF are today common in the securities industry and are authorized by Section 605(b).

3. Section 605(c) refers to generally accepted accounting principles in the United States which currently are promulgated by the Financial Accounting Standards Board and the Securities and Exchange Commission.

4. It is anticipated that the states will employ websites, e-mail or other electronic means to provide notice of proposed rulemaking or adoption of new rules, rule amendments, forms or form amendments, statements of policy or interpretations adopted by the administrator, and issuance of orders to registrants and others who have provided a current e-mail or similar address and expressed an interest in receiving such notice.

5. Section 605(e) does not apply to staff no action or interpretative opinions, but does apply to rules, forms, orders, statements of policy or interpretations adopted by the administrator.

SECTION 606. ADMINISTRATIVE FILES AND OPINIONS.

(a) [**Public register of filings.**] The administrator shall maintain, or designate a person to maintain, a register of applications for registration of securities; registration statements; notice filings; applications for registration of broker-dealers, agents, investment advisers, and investment adviser representatives; notice filings by federal covered investment advisers that are or have been effective under this [Act] or the predecessor act; notices of claims of exemption

from registration or notice filing requirements contained in a record; orders issued under this [Act] or the predecessor act; and interpretative opinions or no action determinations issued under this [Act].

(b) [**Public availability.**] The administrator shall make all rules, forms, interpretative opinions, and orders available to the public.

(c) [**Copies of public records.**] The administrator shall furnish a copy of a record that is a public record or a certification that the public record does not exist to a person that so requests. A rule adopted under this [Act] may establish a reasonable charge for furnishing the record or certification. A copy of the record certified or a certificate by the administrator of a record's nonexistence is prima facie evidence of a record or its nonexistence.

Official Comments

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

1. "Record" is defined in Section 102(25).

2. Compliance with a state records law will typically satisfy the requirements of Section 606(a).

SECTION 607. PUBLIC RECORDS; CONFIDENTIALITY.

(a) [**Presumption of public records.**] Except as otherwise provided in subsection (b), records obtained by the administrator or filed under this [Act], including a record contained in or filed with a registration statement, application, notice filing, or report, are public records and are available for public examination.

(b) [**Nonpublic records.**] The following records are not public records and are not

available for public examination under subsection (a):

(1) a record obtained by the administrator in connection with an audit or inspection under Section 411(d) or an investigation under Section 602;

(2) a part of a record filed in connection with a registration statement under Sections 301 and 303 through 305 or a record under Section 411(d) that contains trade secrets or confidential information if the person filing the registration statement or report has asserted a claim of confidentiality or privilege that is authorized by law;

(3) a record that is not required to be provided to the administrator or filed under this [Act] and is provided to the administrator only on the condition that the record will not be subject to public examination or disclosure;

(4) a nonpublic record received from a person specified in Section 608(a); [and]

(5) any social security number, residential address, and residential telephone number contained in a record that is filed[; and

(6) a record obtained by the administrator through a designee of the administrator that a rule or order under this [Act] determines has been:

(A) expunged from the administrator's records by the designee; or

(B) determined to be nonpublic or nondisclosable by that designee if the administrator finds the determination to be in the public interest and for the protection of investors].

(c) [**Administrator discretion to disclose.**] If disclosure is for the purpose of a civil, administrative, or criminal investigation, action, or proceeding or to a person specified in Section 608(a), the administrator may disclose a record obtained in connection with an audit or

inspection under Section 411(d) or a record obtained in connection with an investigation under Section 602.

Official Comments

Prior Provisions: RUSA Section 703; SEC Rule Section 200.80(b)(4); Securities Exchange Act of 1934 Sections 24(d) and (e).

1. Section 607(a) reflects the extensive development of freedom of information and open records laws since the 1956 Act was adopted.

2. Section 607(b) may insulate from public disclosure records or other information that may be available under a state freedom of information or open records act. Unless the state freedom of information or open records act implements a constitutional provision, this Act as the later and more specific enactment should control as a matter of statutory construction. A state may amend its freedom of information act, open records act or this section to eliminate any inconsistencies.

3. Records and other information obtained by an administrator in connection with an audit or inspection under subsection 411(d) or an investigation under Section 602 may be made public in the enforcement action, even if records and other information would otherwise be subject to subsection 607(b)(1).

4. An administrator may orally disclose information under Section 607(c) to a person specified in Section 608(a) for the purposes specified in Section 607(c).

SECTION 608. UNIFORMITY AND COOPERATION WITH OTHER AGENCIES.

(a) [**Objective of uniformity.**] The administrator shall, in its discretion, cooperate, coordinate, consult, and, subject to Section 607, share records and information with the securities regulator of another State, Canada, a Canadian province or territory, a foreign jurisdiction, the Securities and Exchange Commission, the United States Department of Justice, the Commodity Futures Trading Commission, the Federal Trade Commission, the Securities Investor Protection Corporation, a self-regulatory organization, a national or international organization of securities regulators, a federal or state banking and insurance regulator, and a governmental law

enforcement agency to effectuate greater uniformity in securities matters among the federal government, self-regulatory organizations, States, and foreign govemments.

(b) [**Policies to consider.**] In cooperating, coordinating, consulting, and sharing records and information under this section and in acting by rule, order, or waiver under this [Act], the administrator shall, in its discretion, take into consideration in carrying out the public interest the following general policies:

(1) maximizing effectiveness of regulation for the protection of investors;

(2) maximizing uniformity in federal and state regulatory standards; and

(3) minimizing burdens on the business of capital formation, without adversely affecting essentials of investor protection.

(c) [**Subjects for cooperation.**] The cooperation, coordination, consultation, and sharing of records and information authorized by this section includes:

(1) establishing or employing one or more designees as a central depository for registration and notice filings under this [Act] and for records required or allowed to be maintained under this [Act];

(2) developing and maintaining uniform forms;

(3) conducting a joint examination or investigation;

(4) holding a joint administrative hearing;

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

(6) sharing and exchanging personnel;

(7) coordinating registrations under Sections 301 and 401 through 404 and exemptions under Section 203;

(8) sharing and exchanging records, subject to Section 607;

(9) formulating rules, statements of policy, guidelines, forms, and interpretative opinions and releases;

(10) formulating common systems and procedures;

(11) notifying the public of proposed rules, forms, statements of policy, and guidelines;

(12) attending conferences and other meetings among securities regulators, which may include representatives of governmental and private sector organizations involved in capital formation, deemed necessary or appropriate to promote or achieve uniformity; and

(13) developing and maintaining a uniform exemption from registration for small issuers, and taking other steps to reduce the burden of raising investment capital by small businesses.

Official Comments

Prior Provisions: 1956 Act Section 415; RUSA Sections 704 and 803; 19(c) of the Securities Act of 1933.

1. Uniformity of regulation among the states and coordination with the Securities and Exchange Commission is a principal objective of this Act. Section 608 is intended to encourage such cooperation to the maximum extent appropriate. Operative phrases such as "shall, in its discretion" in Sections 608(a) and (b) are intended to be precisely coordinate with the directive that Congress gave to the Securities and Exchange Commission in Section 19(c) of the Securities Act of 1933.

2. The goals of uniformity among the states and coordination with related federal regulation, including self regulatory organizations, may be enhanced by greater use of information technology systems such as the Web-CRD, the Investment Adviser Registration Depository (IARD), or the Securities and Exchange Commission Electronic Data Gathering, Analysis and Retrieval System (EDGAR). These types of techniques are consistent with a potential system of "one stop filing" of all federal and state forms that is encouraged by this Act.

3. This Act is intended, to the extent practicable, to be revenue neutral in its impact on

existing state laws.

4. Section 608(c) lists some joint or coordinated efforts which might be undertaken. Other appropriate cooperative activities are also encouraged.

5. Court decisions interpreting the securities laws have construed these acts to achieve "broad protection to investors," a remedial approach that "embodies a flexible rather than a static principle, one that is capable of adaption to meet the countless and variable schemes devised by those who seek to use the money of others on the promise of profits." SEC v. W.J. Howey Co, 328 U.S. 293, 299, 301 (1946).

SECTION 609. JUDICIAL REVIEW.

(a) [**Judicial review of orders.**] A final order issued by the administrator under this [Act] is subject to judicial review in accordance with [the state administrative procedure act].

[(b) [**Judicial review of rules.**] A rule adopted under this [Act] is subject to judicial review in accordance with [the state administrative procedure act].]

Official Comments

Prior Provisions: 1956 Act Section 411; RUSA Section 711(b).

1. The 1956 Act Section 411 specified procedures for judicial review of orders, in part modeled on Section 12 of the Model Administrative Procedure Act, 54 Handbook of National Conference of Commissioners on Uniform State Laws 334 (1944) and partly on Section 25 of the Securities Exchange Act.

2. A rule adopted under this Act may be subject to judicial review in accordance with the state administrative procedure act.

3. In those states in which judicial review of rules is permitted, a state may choose to add Section 609(b). In those states in which judicial review of rules is not permitted, Section 609(b) should be deleted.

SECTION 610. JURISDICTION.

(a) [**Sales and offers to sell.**] Sections 301, 302, 401(a), 402(a), 403(a), 404(a), 501, 506,

509, and 510 do not apply to a person that sells or offers to sell a security unless the offer to sell or the sale is made in this State or the offer to purchase or the purchase is made and accepted in this State.

(b) [**Purchases and offers to purchase.**] Sections 401(a), 402(a), 403(a), 404(a), 501, 506, 509, and 510 do not apply to a person that purchases or offers to purchase a security unless the offer to purchase or the purchase is made in this State or the offer to sell or the sale is made and accepted in this State.

(c) [**Offers in this State.**] For the purpose of this section, an offer to sell or to purchase a security is made in this State, whether or not either party is then present in this State, if the offer:

(1) originates from within this State; or

(2) is directed by the offeror to a place in this State and received at the place to which it is directed.

(d) [**Acceptances in this State.**] For the purpose of this section, an offer to purchase or to sell is accepted in this State, whether or not either party is then present in this State, if the acceptance:

(1) is communicated to the offeror in this State and the offeree reasonably believes the offeror to be present in this State and the acceptance is received at the place in this State to which it is directed; and

(2) has not previously been communicated to the offeror, orally or in a record, outside this State.

(e) [**Publications, radio, television, or electronic communications.**] An offer to sell or to purchase is not made in this State when a publisher circulates or there is circulated on the

publisher's behalf in this State a bona fide newspaper or other publication of general, regular, and paid circulation that is not published in this State, or that is published in this State but has had more than two thirds of its circulation outside this State during the previous 12 months or when a radio or television program or other electronic communication originating outside this State is received in this State. A radio 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 communication that originates outside this State and is captured for redistribution to the general public in this State by a community antenna or cable, radio, cable television, or other electronic system; or

(4) the program or communication consists of an electronic communication that originates in this State, but which is not intended for distribution to the general public in this State.

(f) [**Investment advice and misrepresentations.**] Sections 403(a), 404(a), 405(a), 502, 505, and 506 apply to a person if the person engages in an act, practice, or course of business instrumental in effecting prohibited or actionable conduct in this State, whether or not either party is then present in this State.

Official Comments

Source of Law: 1956 Act Section 414; RUSA Section 801.

1. Section 610 defines the application of the Act to interstate or international transactions when only some of the elements of a violation occur in this State. This Section applies to all types of proceedings specified by the Act – administrative, civil, and criminal. The law is now settled that a person may violate the law of a particular state without ever being within the state or performing each act necessary to violate the law within that state.

2. Section 610 generally follows Section 414 of the 1956 Act, but has been modernized to reflect the development of the Internet and other electronic communications after 1956.

3. Section 610 can be illustrated in the context of a civil action under Section 509(b) by a purchaser in State A against a seller in State B:

Section 610(a) would apply when an "offer to sell is made in this State."

Section 610(c) provides that an offer which originates in State B and is directed to State A is made in both states. The securities act of State A would apply under Section 610(c)(2). The act of State B would apply also, under Section 610(c)(1). The intent is to prevent a seller in State B from using that state as a base of operations for defrauding person in other states.

Section 610(e) addresses offers made through publications, radio, television, or electronic communications. The subsection provides a series of safe harbors for advertisements in newspapers, magazines, radio, television, or electronic media that either originate outside State A or that originate in State A but are directed outside the state to the general public. With respect to bona fide newspapers or other publications of general, regular, and paid circulation, the safe harbor requires that more than two thirds of its circulation be outside State A. With respect to radio, television, or other electronic communications, safe harbors are specified in Sections 610(e)(1) through (4).

Section 610(d), however, provides that a person in State A who makes an offer to purchase as a result of communication described in Section 610(e) may cause the act to be applicable if the offeror accepts the offer "in this State." Section 610(d) defines when an offer is accepted "in this State."

If a selling broker-dealer in State B solely sends a confirmation into State A, or the purchaser in State A sends a check from within State A, the act will not apply unless, under Section 610(d), the confirmation or delivery constitutes the seller's acceptance of the purchaser's offer to buy in State A.

The applicability of the act to purchaser is addressed by Section 610(b) which is the converse of Section 610(a). Under Section 509(c) there can be liability of purchasers to sellers.

Section 610(f) is a new provision that specifies jurisdictions in cases involving investment advice and misrepresentations.

4. Under subsection 202(20) certain out-of-state offers or sales are exempt from securities registration.

5. The phrase "other electronic means" is coextensive with computer or other information technology permitted by subsections 102(8), 102(25).

6. Under Section 610 the administrator may adopt interpretative rules or orders to specify when particular uses of new electronic communications, including the Internet, involve an offer to sell or to purchase a security, acceptance of an order to purchase or sell a security, or an act or practice involving prohibited conduct, within a State, whether or not a purchaser, seller, or other party is then present in the State. The NASAA Interpretive Order Concerning Broker-Dealers, Agents, and Investment Adviser Representatives Using the Internet for General Dissemination of Information for Products and Services (Apr. 23, 1997) is an illustration of an interpretative order that would be in compliance with the administrator's authority under Section 610. Under this Order, broker-dealers, agents, investment advisers, and investment adviser representatives who distribute information on available products and services through communications on the Internet generally to anyone having access to the Internet such as postings on a bulletin board or home page shall not be deemed to be transacting business in a State if specified conditions are satisfied including a legend clearly stating that the broker-dealer, agent, investment adviser, or investment adviser representative may transact business in that State only if first registered, excluded or exempted from applicable registration requirements.

SECTION 611. SERVICE OF PROCESS.

(a) [**Signed consent to service of process.**] A consent to service of process complying with Section 611 required by this [Act] must be signed and filed in the form required by a rule or order under this [Act]. A consent appointing the administrator the person's agent for service of process in a noncriminal action or proceeding against the person, or the person's successor or personal representative under this [Act] or a rule adopted or order issued under this [Act] after the consent is filed, has the same force and validity as if the service were made personally on the person filing the consent. A person that has filed a consent complying with this subsection in connection with a previous application for registration or notice filing need not file an additional

consent.

(b) [**Conduct constituting appointment of agent for service.**] If a person, including a nonresident of this State, engages in an act, practice, or course of business prohibited or made actionable by this [Act] or a rule adopted or order issued under this [Act] and the person has not filed a consent to service of process under subsection (a), the act, practice, or course of business constitutes the appointment of the administrator as the person's agent for service of process in a noncriminal action or proceeding against the person or the person's successor or personal representative.

(c) [**Procedure for service of process.**] Service under subsection (a) or (b) may be made by providing a copy of the process to the office of the administrator, but it is not effective unless:

(1) the plaintiff, which may be the administrator, promptly sends notice of the service and a copy of the process, return receipt requested, to the defendant or respondent at the address set forth in the consent to service of process or, if a consent to service of process has not been filed, at the last known address, or takes other reasonable steps to give notice; and

(2) the plaintiff files an affidavit of compliance with this subsection in the action or proceeding on or before the return day of the process, if any, or within the time that the court, or the administrator in a proceeding before the administrator, allows.

(d) [**Service in administrative proceedings or civil actions by administrator.**] Service pursuant to subsection (c) may be used in a proceeding before the administrator or by the administrator in a civil action in which the administrator is the moving party.

(e) [**Opportunity to defend.**] If process is served under subsection (c), the court, or the administrator in a proceeding before the administrator, shall order continuances as are necessary

or appropriate to afford the defendant or respondent reasonable opportunity to defend.

Official Comments

Prior Provisions: 1956 Act Sections 414(g) and (h); RUSA Section 708.

1. Section 611 follows the 1956 Act and RUSA in providing for a signed consent to service of process in Section 611(a); a substituted service of process in Section 611(b); and process and opportunity to defend in Sections 611(c) through (e).

2. An issuer is not required to file a consent to service of process unless it proposes to offer a security in this State through someone acting on an agency basis. Since the civil liability provisions of Section 509(b) apply only in a suit by a purchaser against a seller, the issuer in a firm commitment underwriting is civilly liable only to the underwriter, who, in turn, may be liable to the dealer, who, in turn, may be liable to the purchaser. In contrast, in a best efforts underwriting, when the security is sold on an agency basis and title passes directly to the purchaser, the issuer can be liable to the purchaser.

3. Section 611(b) generally follows Section 414(h) of the 1956 Act and Section 708(c) of RUSA. The intent is to provide for substituted service of process when a seller in one state directs an offer into a second state either in violation of the laws of the second state or fraudulently. Under Section 611(b) the purchaser may sue the seller in the purchaser's state and then bring an action on the judgment in the seller's state. The constitutionality of this type of statute has long been sustained.

4. This section was originally based on the type of nonresident motorist statute whose constitutionality was sustained in Hess v. Pawlowski, 274 U.S. 352 (1927) and subsequently in other contexts. See, e.g., International Shoe Co. v. State of Wash., 326 U.S. 310 (1945); Travelers Health Ass'n v. Commonwealth of Va., 339 U.S. 643 (1950).

SECTION 612. SEVERABILITY CLAUSE. If any provision of this [Act] or its application to any person or circumstances is held invalid, the invalidity does not affect other provisions or applications of this [Act] that can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

Official Comments

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

[ARTICLE] 7

TRANSITION

SECTION 701. EFFECTIVE DATE. This [Act] takes effect on [insert date, which should be at least 60 days after enactment].

SECTION 702. REPEALS. The following act is repealed:

[Insert name of former State securities act].

SECTION 703. APPLICATION OF ACT TO EXISTING PROCEEDING AND EXISTING RIGHTS AND DUTIES.

(a) [**Applicability of predecessor act to pending proceedings and existing rights.**] The predecessor act exclusively governs all actions or proceedings that are pending on the effective date of this [Act] or may be instituted on the basis of conduct occurring before the effective date of this [Act], but a civil action may not be maintained to enforce any liability under the predecessor act unless instituted within any period of limitation that applied when the cause of action accrued or within five years after the effective date of this [Act], whichever is earlier.

(b) [**Continued effectiveness under predecessor act.**] All effective registrations under the predecessor act, all administrative orders relating to the registrations, rules, statements of policy, interpretative opinions, declaratory rulings, no action determinations, and conditions imposed on the registrations under the predecessor act remain in effect while they would have remained in effect if this [Act] had not been enacted. They are considered to have been filed,

issued, or imposed under this [Act], but are exclusively governed by the predecessor act.

(c) [**Applicability of predecessor act to offers or sales.**] The predecessor act exclusively applies to an offer or sale made within one year after the effective date of this [Act] pursuant to an offering made in good faith before the effective date of this [Act] on the basis of an exemption available under the predecessor act.

Official Comments

Prior Provisions: 1956 Act Section 418; RUSA Section 807.

Prior law governs all suits, actions, prosecutions, or proceedings which are pending or may be initiated on the basis of facts or circumstances occurring before the effective date of a State blue sky statute. See Hilton v. Mumaw, 522 F.2d 588, 600 (9th Cir. 1975).

Exhibit 3

Legislative Analysis, Uniform Securities Act (2002)

Legislative Analysis

Mitchell Bean, Director
Phone: (517) 373-8080
http://www.house.mi.gov/hfa

UNIFORM SECURITIES ACT (2002)

House Bill 5008 (Substitute H-2)
Sponsor: Rep. Bill Huizenga

House Bill 5009 as introduced
Sponsor: Rep. Andy Coulouris

House Bill 5010 as introduced
Sponsor: Rep. Martin Griffin

House Bill 5011 as introduced
Sponsor: Rep. Mike Simpson

House Bill 5012 as introduced
Sponsor: Rep. Ed Clemente

House Bill 5013 as introduced
Sponsor: Rep. Arlan Meekhof

House Bill 5014 as introduced
Sponsor: Rep. David Palsrok

House Bill 5015 (Substitute H-1)
Sponsor: Rep. Tonya Schuitmaker

House Bill 5016 as introduced
Sponsor: Rep. Brian Calley

House Bill 5017 as introduced
Sponsor: Rep. Dave Hildenbrand

House Bill 5018 as introduced
Sponsor: Rep. Andy Meisner

House Bill 5019 as introduced
Sponsor: Rep. Steve Tobocman

House Bill 5020 (Substitute H-2)
Sponsor: Rep. Bert Johnson

House Bill 5022 as introduced
Sponsor: Rep. Robert Jones

House Bill 5023 as introduced
Sponsor: Rep. Frank Accavitti, Jr.

House Bill 5024 as introduced
Sponsor: Rep. Joel Sheltrown

Committee: Commerce
Complete to 4-30-08

A SUMMARY OF HOUSE BILLS 5008-5020 AND 5022-5024 AS REPORTED FROM COMMMITTEE

House Bill 5008 would create the Uniform Securities Act (2002). It would repeal the existing Uniform Securities Act, Public Act 265 of 1964. The new act would take effect 180 days after enactment. House Bills 5009-5020 and 5022-5024 would each amend a separate act to update references to make them apply to the new Uniform Securities Act. The administrator of the act would be the Office of Financial and Insurance Regulation (OFIR) within the Department of Labor and Economic Growth.

The new act is based on a uniform act developed by the National Conference of Commissioners on Uniform State Laws (NCCUSL). According to the NCCUSL, the model act is designed to coordinate federal and state securities legislation. The purpose of such regulation is to prevent fraudulent sales of securities to investors. By "securities," the act means notes; stocks; treasury stocks; security futures; bonds; debentures;

evidences of indebtedness; certificates of interest or participation in profit sharing agreements; collateral trust agreements; interests in oil, gas, or mineral rights; puts, calls, straddles, and options on securities, certificates of deposits, or groups and indexes of securities; investments in viatical or life settlement agreements; and similar instruments.

The website for the model act, with summaries and explanatory articles, is:
http://www.uniformsecuritiesact.org/usa/DesktopDefault.aspx?tabindex=0&tabid=1

[According to the NCCUSL, 14 states have now enacted the 2002 model act: Missouri, Idaho, Iowa, Kansas, Oklahoma, South Dakota, U.S. Virgin Islands, Maine, Vermont, South Carolina, Minnesota, Hawaii, Indiana, and Wisconsin.]

The model act is divided into seven articles as follows.

Article 1 (General Provisions) deals with definitions and references to federal statutes and federal agencies, and provides the act's short title.

Article 2 (Exemptions from Registration of Securities) provides for exempt securities and exempt transactions and the denial, suspension, revocation, condition, and limitation of exemptions.

Article 3 (Registration of Securities) addresses notice filings; securities registration by coordination; securities registration by qualification; and securities registration filings; as well as the denial, suspension, and revocation of securities registration.

Article 4 (Broker-Dealers, Agents, Investment Advisers, Investment Adviser Representatives, and Federal Covered Investment Advisers) addresses registration requirements and exemptions for each classification of professional; succession and change in registration; filing fees; post-registration requirements; and denials, revocations, suspensions, withdrawals, restrictions, conditions, and limitations related to registration.

Article 5 (Fraud and Liabilities) deals with prohibited conduct in providing investment advice; evidentiary burden; the filing of sales and advertising literature; misleading filings; and misrepresentations concerning registration or exemption, immunities, criminal penalties, civil liability, and rescission offers.

Article 6 (Administration and Judicial Review) addresses matters related to administration; investigation and subpoenas; civil and administrative enforcement; rules, orders, interpretative opinions, and orders; public records and confidentiality; uniformity and cooperation with other agencies; judicial review; jurisdiction; and service of process.

Article 7 (Transition) deals with the repeal of existing legislation and the effective date of the new act, as well as the application of the new act to existing proceedings and existing rights and duties.

According to information from the NCCUSL, the new act "will give states regulatory and enforcement authority that avoids duplication of regulatory effort and blends with federal regulation and enforcement in a more efficient system for investor protection." The

NCCUSL lists the following as key components of the model act: 1) the registration of securities by means of three methods (notice, coordination, and qualification) to clarify and simplify the process for both regulators and industry; 2) the regulation of broker-dealers, investment advisors, and their agents and representatives through registration in the states where they do business; 3) expanded enforcement powers, including civil and criminal actions against perpetrators of fraud, including court and administrative action; 4) investigatory and subpoena powers for state securities administrators; 5) criminal penalties, which are set by the state; 6) investor education; and 7) electronic filing facilitation.

The criminal provisions in House Bill 5008 would make a willful violation of the act or a rule adopted or an order issued under the act a felony punishable by imprisonment for up to 10 years and/or a fine of up to $500,000 for each violation. An individual convicted of violating a rule or order could be fined but not imprisoned if he or she did not have knowledge of the rule or order. The attorney general or the proper prosecuting attorney could institute appropriate criminal proceedings with or without a reference from the state administrator. The act would not limit the power of the state to punish a person for conduct that constituted a crime under other state laws.

All civil fines, costs of investigation, administrative assessments received by OFIR under the act would be deposited in a newly created Securities Investor Education and Training Fund. The Fund would be used in developing and implementing investor education initiatives to inform the public about investing in securities with particular emphasis on the prevention and detection of securities fraud.

If the amount in the Fund at the close of any fiscal year is $1 million or less, the money would remain in the Fund and not lapse to the General Fund. Amounts exceeding $1 million would be credited to the General Fund.

According to information from the NCCUSL,

> The states have an important role in securities regulation. There is fraudulent activity at a level that eludes federal law protection, even when federal law applies. And by no means is every security sold a "federal covered security." Many schemes to defraud investors involve locally generated pyramid schemes, misrepresentation, and scam sales. Without state regulation accompanied by civil and criminal enforcement of the law in state courts, there would be little hope of redress for many victimized investors. State enforcement is also available when there are fraudulent schemes involving federal covered securities. In effect, Congress and the SEC have acknowledged that the federal level is unable to cope with all the enforcement that needs to be done.
>
> The 2002 Uniform Act is an effort to give states regulatory and enforcement authority that minimizes duplication of regulatory resources and that blends with federal regulation and enforcement in a more efficient system for investor protection. Uniformity of law among the states is essential for this to happen, but it needs to be a uniform law that coordinates with federal law.

House Bill 5009 would amend the Michigan Strategic Fund Act (MCL 125.2023), which exempts the fund's bonds and notes from filing requirements in the state securities law.

House Bill 5010 would amend the Michigan Consumer Protection Act (MCL 445.920).

House Bill 5011 would amend Public Act 227 of 1971 (MCL 445.111), which deals with home solicitation sales.

House Bill 5012 would amend the Public Employee Retirement System Investment Act (MCL 38.1133), under which investment fiduciaries have to be registered under state securities law.

House Bill 5013 would amend the Nonprofit Corporation Act (MCL 450.3137) to address cooperative nonvoting investment certificates and bonds.

House Bill 5014 would amend the Michigan Penal Code (MCL 750.159g and 411j) to include certain violations of the securities law in the definition of "racketeering."

House Bill 5015 would amend the Revised Judicature Act of 1961 (600.4701) to amend the definition of "crime" to update the securities act reference.

House Bill 5016 would amend the Savings and Loan Act of 1980 (MCL 491.515) to update the definition of "securities."

House Bill 5017 would amend the Michigan Education Trust Act (MCL 390.1439), which exempts advance tuition payment contracts from the Uniform Securities Act.

House Bill 5018 would amend the Code of Criminal Procedure (MCL 777.14j) to put the new felony created by the Uniform Securities Act (2002) in the sentencing guidelines as a Class E felony violating the public trust and carrying a 10-year maximum imprisonment penalty. Current felonies (also carrying 10-year maximum prison terms) under the existing securities law would be deleted.

House Bill 5019 would amend the Michigan Export Development Act (MCL 447.160).

House Bill 5020 would amend the Mortgage Brokers, Lenders, and Servicers Licensing Act (MCL 445.1651a and 1679).

House Bill 5022 would amend the Credit Services Protection Act (MCL 445.1822).

House Bill 5023 would amend the Professional Service Corporation Act (MCL 450.228).

House Bill 5024 would amend the Natural Resources and Environmental Protection Act (MCL 324.21528 and 50510), which exempts certain bonds and notes from having to be filed under the state securities law.

FISCAL IMPACT:

The fiscal impact on the state is indeterminate. The bill generally maintains the existing fee structure for securities, although there are several deviations, the cumulative effect of which is presently unknown. The bill increases the registration fee for a "federally covered advisor" from $150 (MCL 451.602a) to $200 (HB 5008, Section 410). The bill also adds new responsibilities for the Office of Financial and Insurance Regulation and a filing fee ($65) related to the registration of investment advisor representatives. The bill also eliminates the fee ($50-$100) for certain "exempted securities" currently listed in MCL 451.802(a) and (b), and imposes a $65 fee for a change of an agent registration.

In addition, the Office of Financial and Insurance and Regulation indicates that it would require an additional 7.0 FTE positions to carry out its responsibilities under the bill. The additional staffing would increase expenses by approximately $595,000 on a full-year basis.

The bill creates a new fund, the Securities Investor Education and Training Fund, which would be used to educate and train Michigan residents on securities laws and investment issues. The bill provides that the fund would consist of all civil fines, any costs of an investigation into a possible violation charged by OFIR, as well as other "administrative assessments." The bill further provides that the balance in the fund in excess at the close of the fiscal year shall lapse to the General Fund. [The fund is created in Section 601(5). However, subsection 6 contradicts subsection 5 in that it designates the civil fines be used by OFIR to administer the act.]

Consistent with current law, the bill provides that revenue in excess of the amounts necessary to administer the act shall be credited to the General Fund. In recent years, the amount transferred to the General Fund has ranged from $4.0 million to $6.0 million. To the extent the bill increases the costs to administer the act (through additional FTE positions) and reduces available security fee revenue, the bill could potentially reduce GF/GP revenue. Similarly, to the extent securities fee revenue increases above the additional administrative costs, the bill could potentially increase GF/GP revenue.

POSITIONS:

The Office of Financial and Insurance Regulation (OFIR) supports the bills. (4-29-08)

The Business Law Section of the State Bar of Michigan supports the bills. (4-29-08)

The Michigan Bankers Association supports the bills. (4-29-08)

Legislative Analyst: Chris Couch
Fiscal Analyst: Mark Wolf

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.

Exhibit 4

Corporations and Securities Commission, Chapter 451

CHAPTER 451. CORPORATIONS AND SECURITIES COMMISSION

Act 13, 1935, p. 24; Eff. Sept. 21.

AN ACT to create a commission to be known as the Michigan corporation and securities commission; to define the powers and duties thereof; to provide for the transfer to said commission of certain powers and duties now vested by law in the Michigan securities commission and the secretary of state, and to abolish the Michigan securities commission.

The People of the State of Michigan enact:

451.1 Michigan corporation and securities commission; creation; commissioner, term, disqualification; seal; offices.

Sec. 1. A commission to be known and designated as the Michigan corporation and securities commission is hereby created. Immediately upon the taking effect of this act a corporation and securities commissioner shall be appointed by the governor for the term of 4 years, subject to confirmation by the senate. The said commissioner shall devote his entire time in the performance of the duties of his office. Upon the expiration of the said term a successor shall be appointed in like manner for a term of 4 years and until his successor is appointed and qualified. Vacancies shall be filled in the same manner as is provided for the appointment in the first instance. Said commissioner shall not be directly or indirectly interested in any corporation, firm or association engaged in the business of underwriting, issuing or selling securities of any character. The commission shall adopt and have a suitable seal, of which all courts of the state shall take judicial notice, and all proceedings, orders and decrees shall be authenticated thereby. It shall be the duty of

the board of state auditors to provide suitable offices, supplies, and equipment in Lansing, Michigan, and in such other place or places in the state as may be determined upon by the commissioner and governor; expenses thereof to be audited, allowed and paid in such manner as is or may be provided by law for the payment of necessary state expenses.

451.2 Same; powers; employes, salary; fees.

Sec. 2. Said commissioner shall have the power to appoint not more than 3 deputy commissioners, who shall have the power and authority to conduct hearings in the several matters submitted to the commissioner for his determination, and to make report of such evidence as may be submitted to them, together with their conclusions and recommendations, to the commissioner for his action, and shall likewise have power and authority to perform such other duties as may be delegated to them by the commissioner. The commission shall have power to appoint a secretary and such clerks, assistants, examiners, and other employes as shall be necessary for the proper exercise of the powers hereby granted. The commissioner, each deputy commissioner and the secretary shall receive such annual salary as shall be appropriated by the legislature, payable in the same manner as are the salaries of other state officials. The salaries of clerks, assistants, examiners and other employes, shall be fixed and determined by the commissioner, subject to the approval of the director of finance. The commissioner, deputies and other employes of the commission shall be entitled to reasonable expenses while traveling in the performance of any of the duties hereby imposed. All salaries and expenses authorized hereunder shall be paid out of the state treasury in the same manner as the salaries of other state officers and employes are paid. Any appropriation made for the Michigan securities commission, or for the secretary of state, insofar as the corporation division thereof is concerned, together with any sums receivable by said Michigan securities commission under any act or acts under which said commission has existed and functioned, or receivable by the secretary of state incident to the operation of the corporation laws of the state of Michigan, shall be paid into the general fund of the state of Michigan. For furnishing photostatic or typewritten or other copies of records or proceedings of the commission or of documents and papers required or permitted by law to be filed with the commission, and for certifying same, the commission shall charge in accordance with a schedule of fees which it shall adopt with the approval of the state administrative board, which schedule of fees may be changed or amended by the commission with the approval of the state administrative board: Provided, however, that a minimum charge of $1.00 shall be made for each certificate.

HISTORY: Am. 1939, p. 423, Act 228, Imd. Eff. June 14.

451.3 Same; powers and duties transferred from Michigan securities commission and secretary of state.

Sec. 3. The powers and duties now vested by law in the Michigan securities commission, by virtue of the provisions of Act No. 220, Public Acts of 1923, and the acts amendatory thereof and supplemental thereto, and that conferred under and by virtue of the provisions of Act No. 306, Public Acts of 1919, and the powers and duties now vested by law in the secretary of state, with respect to the formation, organization, regulation and control of corporations, and the fees, taxes and charges to be paid by corporations, under Act No. 327, Public Acts of 1931, as amended, and Act No. 85, Public Acts of 1921, as amended, are hereby transferred to and vested in the Michigan corporation and securities commission hereby created. Immediately on the taking effect of this act the Michigan securities commission, whose powers and duties are hereby transferred, shall cease to exist and the tenure of the office of the members thereof shall be at once terminated, and whenever reference thereto is made in any law of the state; or to the secretary of state with reference to the formation, organization, regulation and control of corporations, and the fees, taxes and charges to be paid by corporations, under Act No. 327, Public Acts of 1931, as amended, and Act No. 85, Public Acts of 1921, as amended, reference shall be deemed to be intended to be made to the Michigan corporation and securities commission. All hearings, matters and proceedings of whatever nature now pending before the Michigan securities commission, or the secretary of state, with ref-

erence to the formation, organization, regulation and control of corporations, and the fees, taxes and charges to be paid by corporations, under Act No. 327, Public Acts of 1931, as amended, and Act No. 85, Public Acts of 1921, as amended, shall not be terminated or abated, but shall be transferred to the Michigan corporation and securities commission created hereby, and shall be carried on in the same manner and subject to the same incidents as though such transfer were not made. All records, files and other papers belonging to the Michigan securities commission, or to the secretary of state respecting the formation, organization, regulation and control of corporations, and the fees, taxes and charges to be paid by corporations, under Act No. 327, Public Acts of 1931, as amended, and Act No. 85, Public Acts of 1921, as amended, the duties of which are hereby transferred to the Michigan corporation and securities commission, shall be turned over to said commission and shall be continued as part of the records and files thereof.

NOTE: Act 220, 1923, is Compilers' § 451.101 et seq.; Act 306, 1919, is Compilers' § 451.201 et seq.; Act 327, 1931, is Compilers' § 450.1 et seq.; Act 85, 1921, is Compilers' § 450.30 et seq.

451.4 Same; review of orders; injunctions.

Sec. 4. Any final order of said commission shall be subject to review in the manner now provided by law for reviewing orders of the Michigan securities commission. In no case, however, shall any injunction or other order issue, suspending or staying any order of the commission, except after due notice to the commission and reasonable opportunity for hearing thereon.

Act 220, 1923, p. 345; Imd. Eff. May 23.

AN ACT to prevent fraud, deception and imposition in the issuance, trade, purchase, exchange, sale or disposition of stocks, bonds and other securities sold, traded, purchased, exchanged or offered for sale, trade, purchase or exchange within the state of Michigan, to prevent the disposal of such securities on unfair terms, and for such purpose to create a commission to regulate and supervise the issuance, sale, trade, purchase, exchange and disposition of such securities; to prescribe the powers and duties of such commission; to license dealers, brokers and salesmen of securities; to regulate the business of such dealers, brokers and salesmen; and to prescribe penalties for violation of this act.

The People of the State of Michigan enact:

SUBDIVISION I.

451.101 Corporation and securities commission; creation; powers and duties; pending proceedings; rules and regulations; prepare blanks.

Sec. 1. The administration and enforcement of the provisions of this act are vested in the Michigan corporation and securities commission, created by Act No. 13 of the Public Acts of 1935. Any subsequent reference in this act to the "commission" or to the "Michigan securities commission" shall be construed as referring to the said Michigan corporation and securities commission. The commission may issue subpoenas to compel the attendance and testimony of witnesses and the production of records, books, and papers relating to any matter over which it has jurisdiction, at any hearing or investigation. The circuit court for the county of Ingham, may upon application of the commissioner on behalf of the commission, compel the attendance of witnesses and the giving of testimony before the commission in the same manner and to the same extent as before the said court. Except in the case of banks and trust companies, the commission shall have authority to cause an examination or inspection to be made of the books and records of a licensed dealer or broker and may require any licensed dealer or broker buying, selling, or dealing in securities on marginal accounts or partial payments, to have a semi-annual audit of the books and records of such licensee made by a certified public accountant at such time and in such form as the commission may require, and a copy thereof filed with the commission.

The said commission shall succeed the Michigan securities commission created by Act No. 46 of the Public Acts of 1915, as amended, and the commission created by Act No. 220 of the Public Acts of 1923, as amended, and as such successor shall receive all of the files, papers and property of the said Michigan securities commissions created by said acts.

All proceedings pending before said Michigan securities commissions so created by virtue of any law of this state, shall be continued by the Michigan corporation and securities commission; all actions, civil and criminal, pending under said acts, shall be continued and completed thereunder; and all securities, approved by the Michigan securities commission under Act No. 46 of the Public Acts of 1915, and the commission created by Act No. 220 of the Public Acts of 1923, as amended, shall be legally salable unless otherwise ordered by the Michigan corporation and securities commission. It shall make such rules and regulations as may be necessary to carry out the provisions of this act and may prepare all necessary blanks to be used in its proceedings and in the conduct of its business, and any order, authority or permission made or granted by said commission under any such regulations shall be of equal force and effect and provide the same protection as if made or granted under a specific provision of this act.

HISTORY: Am. 1929, p. 309, Act 136, Imd. Eff. May 9;—C L 1929, 9769;—Am. 1941, p. 225, Act 165, Imd. Eff. June 9;—Am. 1945, p. 503, Act 295, Imd. Eff. May 25.

Title Am. 1929, p. 309, Act 136, Imd. Eff. May 9;—Am. 1935, p. 51, Act 37, Imd. Eff. July 1;—Am. 1947, p. 420, Act 271, Eff. Oct. 11.

NOTE: Act 220, 1923, above referred to, is this act. Act 46, 1915, above referred to, being C L 1915, 11945-11969, was repealed by Sec. 33 of this act as originally enacted. Sec. 35 hereof is the present repealing section.

FORMER ACT: Act 46 of 1915, being C L 1915, 11945-11969 as amended by Act 404 of 1921.

BLUE SKY LAW: This act as well as Act 46 of 1915, and act which it repeals are commonly known as the "Blue Sky Laws."

COMMISSION: EX-OFFICIO MEMBERS: The attorney general and the banking commissioner have always been appointed as members of the securities commission. But see above section and Compilers' § 14.41 as to deputies.

CONTEMPT: Practice in circuit courts, see Compilers' § 605.1 et seq.

INVESTMENT COMPANIES: See Compilers' § 494.1 et seq.

FRAUDULENT STOCK: Penalty for issuance by officer of railroad corporation, see Compilers' § 467.9; by brine pipe line corporation officers, see Compilers' § 483.226.

451.102 Definitions.

Sec. 2. That when used in this act:

(a) The term "commission" means Michigan corporation and securities commission.

(b) The term "person" shall include a natural person, corporation, partnership, association, company, syndicate, and trust, incorporated or unincorporated. As used herein, the term "trust" shall be deemed to include a common law trust, but shall not include a trust created or appointed under or by virtue of a last will and testament or by a court of law or equity.

(c) The term "security" or "securities" shall include any note, stock, treasury stock, bond, debenture, evidence of indebtedness, preorganization certificate or preorganization subscription, transferable certificate of interest or participation, certificate of interest in a profit-sharing agreement, certificate of interest, units and/or shares in an oil, gas, or mining lease, oil or gas well, collateral trust certificate, any transferable share, investment contract, or beneficial interest in or title to property or profits, or any other instrument commonly known as security, or warrant or right to subscribe to or purchase any of the foregoing.

(d) The term "sale" or "sell" shall include an agreement to transfer an interest in securities, and an exchange. Any security given or delivered with or as a bonus on account of any purchase of securities, or any other thing, shall be deemed to constitute a part of the subject of such purchase and to have been sold for value. "Sale" or "sell" shall also include an attempt to sell, an option of a sale, a solicitation of a sale, a subscription or an offer to sell, directly or by an agent, or by a circular, letter, advertisement or otherwise: Provided, however, That nothing herein shall limit or diminish the full meaning of the terms "sale" or "sell" as used by or accepted in courts of law or equity.

(e) The term "issuer" shall include every person who proposes to issue or who has issued or shall hereafter issue any security.

(f) The term "intangible assets" means patents, copyrights, secret processes and formulae, good will, trade-marks, trade brands, franchises and other like assets. Tangible assets are all assets other than intangible assets.

(g) The terms "dealer" or "broker" shall include every person and every company, firm, trust, partnership or association, incorporated or unincorporated, other than a salesman or issuer, that engages either wholly or in part in the business of selling, offering for sale, negotiating for the sale of or otherwise dealing in any securities issued by another

or by others, or underwriting, purchasing or otherwise acquiring such securities from another for the purpose of reselling them or of offering them for sale, or offering, buying, selling or otherwise dealing or trading in securities, as a broker, agent or principal, or who deals in futures or differences in market quotations of prices or value of any securities or accepts margin on purchases or sales or pretended purchases or sales of such securities.

(h) The term "solicitor," "solicitors," "agent" and "salesman" shall include every natural person, other than dealer, broker or issuer, employed or appointed or authorized by a dealer, broker or issuer, to sell, trade or purchase securities in any manner in this state, or who takes subscriptions for the sale of any securities.

(i) The term "trading" shall mean:

(1) Trading in securities in the ordinary course of the business of trading in securities by or through dealers licensed under this act;

(2) Redistributions of securities by an owner, as or through a dealer licensed under this act, where any 1 of the following conditions is met:

(a) The aggregate offering price of the securities so redistributed in Michigan in any 12 month period does not exceed $30,000.00;

(b) The total of securities so redistributed in Michigan in any 12 month period does not exceed 10 per cent of the total of said securities so accepted for filing, and there is an established over-the-counter market in the said securities, and provided that such securities are not part of a public offering in Michigan and elsewhere of more than 10 per cent of the total of said securities so accepted for filing;

(c) The securities so redistributed are fully listed on a national securities exchange pursuant to the registration provisions of the federal securities exchange act of 1934, as amended, and the total of said securities so redistributed in Michigan in any 12 month period does not exceed 10 per cent of the securities so listed.

HISTORY: Am. 1929, p. 311, Act 136, Imd. Eff. May 9;—C L 1929, 9770;—Am. 1935, p. 51, Act 37, Imd. Eff. July 1;—Am. 1941, p. 226, Act 165, Imd. Eff. June 9;—Am. 1945, p. 504, Act 295, Imd. Eff. May 25.—Am. 1947, p. 420, Act 271, Eff. Oct. 11.

NOTE: Federal securities exchange act, of 1934, above referred to, is 15 U.S.C.A. 78a et seq.

451.103 Unlawful sales; construction of act.

Sec. 3. No person, either acting personally or through an agent, or as the agent of another, shall on and after the date this act goes into effect, sell or trade any security to, and/or with any person in the state of Michigan contrary to the provisions of this act. The provisions of this act shall be liberally construed to the end that the purposes thereof may be accomplished by preventing fraud, deception and imposition on purchasers of securities.

HISTORY: C L 1929, 9771;—Am. 1935, p. 52, Act 37, Imd. Eff. July 1.

PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.104 Inapplicability of act; kinds of securities.

Sec. 4. Except as hereinafter provided, the provisions of this act shall not apply to any security which at the time of the sale thereof is within any of the following classes of securities:

(a) Any security issued or guaranteed by the United States or any territory or insular possession thereof, or by the District of Columbia, or by any state or political subdivision or agency thereof;

(b) Any security issued or guaranteed by any foreign government with which the United States is maintaining diplomatic relations, or political subdivision thereof having the power of taxation or assessment;

(c) Any security issued by any federal land bank or joint stock land bank or national farm loan association under the provisions of the federal farm loan act of July 17, 1916, or by the war finance corporation, or by any corporation created or acting as an instrumentality of the government of the United States pursuant to authority granted by the congress of the United States: Provided, That such corporation is subject to supervision and regulation by the government of the United States;

(d) Any security issued or guaranteed either as to principal, interest or dividend, by a corporation owning or operating a railroad or any other public service utility: Provided, That the offering and issuance of such securities are subject to regulation of the

interstate commerce commission, or such securities have been affirmatively passed upon by the Michigan public utilities commission, or by a public commission, board or officer, with authority equal to that of the Michigan public utilities commission, of the government of the United States, or of any state, territory, or insular possession thereof, or of the District of Columbia, or of the Dominion of Canada, or any province thereof, and who by law are charged with the supervision of such securities; also equipment trust certificates or equipment notes or bonds based on chattel mortgages, leases or agreements for conditional sales of cars, motive power, or other rolling stock mortgages, leased or sold to or furnished for the use of or upon such railroads or other public service utility corporations supervised as above, or equipment notes or bonds where the ownership or title of such equipment is pledged or retained in accordance with the provisions of the laws of the United States, or of any state thereof, or of the Dominion of Canada, to secure the payment of such equipment trust certificates, bonds or notes;

(e) Any security issued by a corporation organized and operated exclusively for religious purposes, and no part of the earnings of which inures to the benefit of any private stockholder or individual;

(f) Any security issued by a bank incorporated under the laws of and subject to the examination, supervision or control of any state or of the United States, or any building and loan association organized and doing business under the laws of this state;

(g) Any bonds or notes secured by a first mortgage on property within the state of Michigan, when the entire mortgage together with all of the bonds or notes secured thereby is sold or offered for sale or resale to a single purchaser or at a single sale;

(h) Negotiable promissory notes or commercial paper: Provided, That such issue of notes or commercial paper matures in not more than 12 months from date of issue and shall be issued within 3 months after the date of sale: And provided further, That such sale of notes or commercial paper be subject to section 27 of this act and that such notes arise out of current transactions or the proceeds of which have been or are to be used for current transactions; and that the issue or sale thereof shall not involve a public offering;

(i) Capital stock of a trust company organized under the laws of Michigan;

(j) Securities fully listed or admitted to the list on notice of issuance on the New York stock exchange;

(k) All reorganization issues coming under the provisions of Act No. 89 of the Public Acts of 1933.

HISTORY: Am. 1929, p. 312, Act 136, Imd. Eff. May 9;—C L 1929, 9772;—Am. 1935, p. 52, Act 37, Imd. Eff. July 1;—Am 1941, p. 227, Act 165, Imd. Eff. June 9;—Am. 1947, p. 421, Act 271, Eff. Oct. 11.

NOTE: The federal farm loan act of July 17, 1916, above referred to, is 12 U. S. C. A. § 641 et seq.
The war finance corporation act, above referred to, is 15 U. S. C. A. § 331 et seq.
Act 89, 1933, above referred to, is Compilers' § 451.302 et seq.
Public service commission, see Compilers' § 460.61; corporation code, see Compilers' § 450.1 et seq.; banks and trust companies, see Compilers' § 487.1 et seq.; building and loan associations, see Compilers' § 489.1 et seq.; negotiable instruments law, see Compilers' § 439.1 et seq.
SUBDIVISION D: Approval of public utilities securities, see Compilers' § 460.301.
SUBDIVISION K: Act 89, 1933, above referred to, is Compilers' § 451.302 et seq.

451.105 Same; kinds of sales; exceptions, acceptance of securities for filing for trading by commission.

Sec. 5. And, except as hereinafter provided, the provisions of this act shall not apply to the sale of any security in any of the transactions enumerated below: Provided, however, That, except to the extent expressly permitted by paragraphs (g), (l) and (m) hereof, the language of this section shall not be construed to permit trading in securities the subject of such transactions, unless such securities have been accepted for filing for trading by the commission as provided in this act.

(a) At any judicial executor's, administrator's, guardian's or conservator's sale, or at any sale by a receiver or trustee in insolvency or bankruptcy or any sale or issuance of securities pursuant to an order of, or reorganization plan, or recapitalization plan, approved by any court of jurisdiction within the state of Michigan or any federal court of the United States;

(b) By or for the account of a pledge holder of mortgages selling or offering for

sale or delivery, in the ordinary course of business, to liquidate a bona fide debt, a security pledged in good faith as security for such debt;

(c) In an isolated transaction in which any security is sold, offered for sale, or delivered by the owner thereof either directly or through a licensed dealer as his agent, such sale or offer for sale or delivery not being made in the course of repeated and successive transactions of a like character by such owner, and such owner not being the issuer or a dealer or the underwriter of such security;

(d) The distribution by a corporation of capital stock, bonds, or other securities to its stockholders or other security holders as stock dividend or other distribution out of earnings or surplus; the distribution by a cooperative corporation of its capital stock, bonds, or other securities to its patrons as patronage refunds or returns distributed on a patronage basis;

(e) Any sale of a security to banks, trust companies, or insurance companies, or to dealers licensed under this act;

(f) Subscriptions to capital stock made by incorporators in a proposed Michigan corporation, not exceeding 25 in number: Provided, That no public offering is made nor subscriptions to such proposed corporation solicited by advertising or commissions received for such subscriptions and that such subscribers actually sign the articles of association in person and not by agent;

(g) The trading by an owner as or through a dealer licensed under this act, in any security fully listed on a national securities exchange pursuant to the registration provisions of the federal securities exchange act of 1934, as amended;

(h) The transfer or exchange by 1 corporation to another corporation or its stockholders of its own securities in connection with a complete sale of corporate assets, consolidation, or merger;

(i) The exchange of securities by an issuer with its existing security holders exclusively, where no commission or remuneration is paid or given directly or indirectly for soliciting such exchange: Provided, That such exchange has been duly authorized and has been approved by not less than a majority of the outstanding stock of each class of stock affected by such exchange, unless the securities are to be issued upon the exercise of conversion rights of outstanding securities;

(j) The sale of certificates or other evidences of participation in a joint adventure; for the purpose of this section, a joint adventure shall be construed as a voluntary association of not more than 25 individuals who shall agree to be joined together for the purpose of carrying out the plan or project for which the association has been organized;

(k) The sale of any security issued by a nonprofit corporation organized under the laws of the state of Michigan where the sale of such securities does not exceed $30,000.00 and no part of its net earnings inures to the benefit of any of its stockholders or any individual, and the total commission, remuneration, expense or discount in connection with the same securities does not exceed $500.00 plus 2 per cent of the total sales price thereof:

(l) The trading by an owner, as or through a dealer licensed under this act, in any security issued by an insurance corporation which has been continuously in operation for not less than 25 years and the business of which is subject to the supervision and regulation of the insurance commissioner of this state;

(m) The trading by an owner, as or through a dealer licensed under this act, in any security of a corporation owning or operating a public service utility if such corporation has been continuously in operation for not less than 10 years and such security has been affirmatively passed upon by the Michigan public service commission, or by a public commission, board or officer of the government of the United States, or of any state, territory or insular possession thereof, or of the District of Columbia, or of the Dominion of Canada, or of any province thereof, and who by law are charged with the supervision of such securities;

(n) The offering and sale by an issuer of its securities pro rata to its stockholders, provided they do not exceed 25 in number, and the subsequent offering and sale within 3

months after such offer of any unsubscribed portion of such securities to 1 or more stockholders upon terms not less favorable to the issuer than the previous offering.

HISTORY: Am. 1929, p. 313, Act 136, Imd. Eff. May 9;—C L 1929, 9773;—Am. 1935, p. 53, Act 37, Imd. Eff. July 1;—Am. 1941, p. 228, Act 165, Imd. Eff. June 9;—Am. 1945, p. 505, Act 295, Imd. Eff. May 25;—Am. 1947, p. 422, Act 271, Eff. Oct. 11.

GENERAL CORPORATION ACT: See Compilerss' § 450.1 et seq.

451.106 Same; unnecessary to negative exemptions in process or pleadings, burden of proof.

Sec. 6. It shall not be necessary to negative any of the aforesaid exemptions in any complaint, information, indictment, or any other writ or proceedings laid or brought under this act; and the burden of proof of any such exemption shall be upon the party claiming the same.

HISTORY: C L 1929, 9774.

451.107 Acceptance of securities for filing by commission; necessity; acceptance of a portion of a class of securities for filing.

Sec. 7. No security shall be sold to or traded by any person within the state of Michigan unless and until the entire class of securities, of which such security is a part, shall have been accepted for filing for sale, issuance, or trading, by the commission, excepting as the security itself or the transaction therein is exempted by either section 4 or 5 of this act as the case may be, or the security itself has been accepted for filing without express or implied restriction as to trading by the commission prior to June 30, 1941: Provided, however, That the language of this section shall not be construed as limiting acceptance for filing by notification under the provisions of section 13 hereof, where the provisions of said section clearly contemplate acceptance of a portion of a class of securities; nor as limiting acceptance for filing of a portion of a class of securities where the commission deems such acceptance not contrary to the interest of present and prospective investors.

HISTORY: C L 1929, 9775;—Am. 1941, p. 229, Act 165, Imd. Eff. June 9;—Am. 1945, p. 506, Act 295, Imd. Eff. May 25;—Am. 1947, p. 424, Act 271, Eff. Oct. 11.

PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.108 Same; application, form and contents; false statements; information, interest bearing securities; time of sale of securities; fee.

Sec. 8. The commission is authorized to receive and act upon applications to have securities accepted for filing and shall prescribe forms upon which such applications are made. Applications shall be sworn to and dated and lodged in the office of the commission and may be made either by the issuer of the securities applied for or by any person licensed as a dealer under this act desiring to sell the same in the state of Michigan, and each application shall show upon its face that the persons signing the same have full power and legal authority so to do and shall contain a statement, by one qualified as to knowledge and availability for service to make such a statement, swearing that he has knowledge of the facts and representations contained in the application and all exhibits filed in connection therewith, and that said facts and representations are true to the best of his knowledge and belief.

The filing with this commission of any false statement of a material fact or omission to state a material fact by any applicant in his application to have securities accepted for filing, shall be deemed a violation of this act and punishable as hereinafter provided.

Before accepting any securities for filing the commission may require the applicant to furnish any information necessary to determine whether such security should be so accepted.

The commission shall not have authority to accept for filing, except for trading, interest bearing securities that exceed 50 per cent of the appraised or estimated value of the mortgaged properties: Provided, That the foregoing provisions shall not apply to the interest bearing securities of any issuer which has shown, in accordance with generally accepted principles of accounting, during a period of not less than 1 year and not more than 3 years next prior to a date not more than 6 months preceding the submittal date of an application for an acceptance for filing of said interest bearing securities, an annual average of the total of: (1) net income, plus (2) interest charges on outstanding interest

bearing securities, plus (3) taxes based on income and undistributed profits, equal to not less than 2 times the resultant of: (a) the annual interest charges on all presently outstanding interest bearing securities, plus (b) the annual interest charges on the interest bearing securities to be offered, minus (c) the annual interest charges on outstanding interest bearing securities to be retired in connection with the offering.

The commission may provide in orders accepting securities for filing a time within which the securities may be sold, but it may extend such time in its discretion. If the number of securities of an issuer accepted for filing by order of the commission is increased by reason of stock dividends or stock split-ups, the commission may provide in such order that such additional securities shall also be accepted for filing without the payment of an additional fee and without any further action on the part of the issuer or the applicant.

HISTORY: C L 1929, 9776;—Am. 1931, p. 440, Act 255, Eff. Sept. 18;—Am. 1935, p. 54, Act 37, Imd Eff. July 1;—Am. 1941, p. 229, Act 165, Imd. Eff. June 9;—Am. 1947, p. 424, Act 271, Eff. Oct. 11.

451.109 Same; filing fee; returns, expense charge.

Sec. 9. The commission shall charge and collect from each applicant for filing of securities a fee of 1/10 of 1 per centum upon the sale or market price of the securities, whichever is higher, for which an acceptance for filing is requested: Provided, That such fee shall not be less than $50.00 nor more than $250.00 excepting where application is made pursuant to section 13, subsection 2, or section 13, subsection 3, in which event the fee shall be $50.00 and $25.00, respectively. The commission may order the return of filing fees paid when securities applications are permitted by it to be withdrawn, but it may impose a charge of not to exceed $25.00 to cover its estimated expense.

HISTORY: Am. 1929, p. 314, Act 136, Imd. Eff. May 9;—C L 1929, 9777;—Am. 1935, p. 55, Act 37, Imd. Eff. July 1;—Am. 1941, p. 230, Act 165, Imd. Eff. June 9;—Am. 1947, p. 425, Act 261, Eff. Oct. 11.

451.110 Same; investigation, appraisal, etc.; costs.

Sec. 10. Before accepting securities for filing the commisison may make and/or demand investigations, appraisals and audits with respect thereto and require the estimated cost of same to be deposited in advance thereof. The commission may also from time to time make and/or demand investigations of the books, records, and affairs of any investment company, investment trust, or investment fund, whose securities have been accepted for filing under this act, and may require the estimated cost thereof to be paid by such company, trust, or fund. In computing such expenses the commission may charge the sum of $20.00 per day for each day, or fraction thereof, that a member of the commission or employe thereof is necessarily absent from the state office building in connection therewith.

HISTORY: C L 1929, 9778;—Am. 1935, p. 55, Act 37, Imd. Eff. July 1;—Am. 1945, p. 507, Act 295, Imd. Eff. May 25.

451.111 Same; record; rights of applicant; order of commission, recording, notice.

Sec. 11. (a) The commission shall keep and maintain a permanent filing record for all securities accepted for filing, the date thereof, and such other data as may be deemed proper. Upon such filing the applicant shall be deemed to have complied with the provisions of this act and the securities involved may be offered for sale within this state under such restrictions thereon as the commission may prescribe. The order of the commission either accepting or rejecting securities for filing shall be recorded and communicated to the applicant.

Order of acceptance, construed, form; violation of act.

(b) No order of the commission accepting securities for filing shall be construed as an approval of the merits, value or worth of said securities, and any person who in any manner represents that the state, the commission or any officer thereof has recommended its purchase or uses the name "Michigan securities commission" in advertising or offering any security, shall be deemed to have violated this act. Every order accepting securities for filing shall contain the following: "In accepting this security for filing neither the state of Michigan nor the Michigan securities commission has undertaken to pass upon

the worth or value of the security mentioned or to recommend its purchase," nor shall the name "Michigan securities commission" appear in the advertising or offer of this security.

HISTORY: Am. 1929, p. 314, Act 136, Imd. Eff. May 9;—C L 1929, 9779.
PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.112 Same; grounds of refusal; escrow; price; sinking fund.

Sec. 12. The right to sell securities in this state shall not be granted in any case where it appears to the commission that the sale of such securities would work a fraud, deception or imposition on purchasers or the public, or that the proposed disposal of the securities is on unfair terms. The commission may impose such conditions as it may determine necessary to safeguard the sale and transfer of securities before the same are accepted for filing, and may require such part thereof as were or are proposed to be issued to be escrowed with the commission under such terms as may be prescribed to the end that the owners of the securities so issued shall not in case of dissolution or insolvency participate in the assets of the owner until the owners of all other securities have been paid in full. The commission shall also have authority to order the cancellation of all or any part of such securities held in escrow if deemed necessary for the protection of stockholders and/or investors.

The commission may also limit the price at which the securities, either of par or no par value, may be sold, and allow a commission not to exceed 20 per cent of the sale price.

The commission shall in no case authorize the sale of any stock at a price in excess of the fair and reasonable book value thereof, unless, if such stock is common stock, the same can show average net income of not less than 5 per cent of the proposed offering price per year for a period of not less than 1 year and not more than 5 years immediately preceding the application.

When the indenture under which any bonds are issued shall contain provisions for a sinking fund applicable to the payment of the principal and/or interest of such bonds or any part thereof and/or to the payment of taxes and/or insurance on the property security therefor, the commission may require, if the indenture does not, the deposit with the trustee or fiscal agent designated in such indenture of such amounts of the income from such property as may be necessary to meet such sinking fund requirements. If the trustee or fiscal agent shall be other than a bank or trust company the commission may also require such trustee (other than a bank or trust company) to file with the commission a bond in such amount as the commission may specify, the condition of which shall be to secure the application of the amounts deposited in such sinking fund in accordance with the terms thereof: Provided, however, That all books and records of all trustees pertaining to trusteeship shall be subject to and open for inspection by the commission or its duly designated employes.

HISTORY: Am. 1929, p. 315, Act 136, Imd. Eff. May 9;—C L 1929, 9780;—Am. 1931, p. 440, Act 255, Eff. Sept. 18;—Am. 1935, p. 55, Act 37, Imd. Eff. July 1;—Am. 1941, p. 230, Act 165, Imd. Eff. June 9.

451.113 Same; filing by notification; classes of securities; conditions; reports.

Sec. 13. The commission, in lieu of other investigation prior to the acceptance of securities for filing, may accept for filing by notification only, the following securities:

(1) Securities of an issuer engaged in a business which has been in continuous operation for not less than 5 years and fulfill such requirements as the commission may by rules prescribe may be issued, sold, or traded upon their acceptance for filing by the commission if part of said interest bearing securities, preferred stock, or common stock, as the case may be, to be offered, is required by the federal securities act of 1933, as amended, to be registered thereunder, and a sufficient filing has been made with the federal securities and exchange commission to accomplish such registration.

Acceptance for filing by notification shall be accomplished by order of the commission upon its determination that a properly prepared and duly executed application, in conjunction with a fee as provided in section 9 of this act, has been delivered to the commission: Provided, That the commission may refuse to issue said order if at the time of said application the financial condition or operations of the issuer or other conditions affecting the securities are such that the sale of said securities, in the opinion of the commission, would

work or tend to work a fraud or imposition on purchasers or the public: And provided further, That the commission may make said order subject to such conditions as it deems necessary for the protection of purchasers or the public.

(2) Outstanding securities of an issuer engaged in a business which has been in continuous operation for not less than 10 years and has shown, in accordance with generally accepted principles of accounting, during a period of not less than 2 years and not more than 10 years next prior to the close of its fiscal year preceding the submittal date of such application, the following earning power:

(a) In the case of interest bearing securities: An annual average of the total of net income plus interest charges on outstanding interest bearing securities, equal to not less than the total of the annual interest charges on all presently outstanding interest bearing securities;

(b) In the case of preferred stock: An annual average of net income equal to not less than the total of the annual dividend requirement on all presently outstanding preferred stock;

(c) In the case of common stock: An annual average of net income after allowing for all prior dividend requirements, equal to not less than 5 per centum on all presently outstanding common stock, computed on the basis of the current market price or book value of such stock, whichever is higher: Provided, however, That if the said market price does not exceed the current book value of the said outstanding common stock after deducting: (1) All write-ups in the valuation of assets and (2) intangibles as defined in section 2, subsection (f), of this act, the requirement herein set forth as to net income may be waived by the said commission; may be traded by an owner as or through a dealer licensed under this act, if such securities are owned by not less than 100 persons and have been issued and are outstanding in full compliance with the laws applicable thereto, upon their acceptance for filing by the commission.

Acceptance for filing by notification shall be accomplished by order of the commission upon its determination that a properly prepared and duly executed application, in conjunction with a fee as provided in section 9 of this act, has been delivered to the commission: Provided, That the commission may refuse to issue said order if at the time of said application the financial condition or operations of the issuer or other conditions affecting the securities are such that the sale of said securities, in the opinion of the commission, would work or tend to work a fraud or imposition on purchasers or the public; And provided further, That the commission may make said order subject to such conditions as it deems necessary for the protection of purchasers or the public.

(3) Securities of an issuer may be issued or sold, to the issuer's own security holders, bona fide permanent employees, and/or not more than 5 other persons, where no commission or other remuneration is paid or given, directly or indirectly, for soliciting such issuance or sale, upon the said securities being accepted for filing by the commission.

Acceptance for filing by notification shall be accomplished by order of the commission upon its determination that a properly prepared and duly executed application, in conjunction with a fee as provided in section 9 of this act, has been delivered to the commission: Provided that the commission may refuse to issue said order if at the time of said application the financial condition or operations of the issuer or other conditions affecting the securities are such that the sale of said securities, in the opinion of the commission, would work or tend to work a fraud or imposition on purchasers or the public: And provided further, That the commission may make said order subject to such conditions as it deems necessary for the protection of purchasers or the public.

Securities accepted for filing under this section shall not be subject to the requirements as to price, commission, book value and net income set forth in section 12 of this act. Securities shall not be accepted for filing by notification pursuant to subsection 1 of this section when the proposed commission exceeds 20 per cent, or the proposed spread or profit exceeds 30 per cent of the sale price. Securities accepted for filing by notification pursuant to subsection 3 of this section shall not be traded unless such right is expressly granted.

In lieu of the filing of annual securities reports as and in the manner required by section 28 of this act, issuers whose securities are accepted for filing pursuant to this section, or the applicant obtaining such acceptance for filing, may be required to file reports of a comparable nature in such manner as the commission may require. Where said report is filed by some person other than the issuer, said person shall be entitled to the benefit of a prima facie presumption that said report is correct if it is identical with the balance sheet and annual profit and loss statement, prepared by independent certified public accountants, issued by the issuer to its security holders.

HISTORY: C L 1929, 9781;—Am. 1935, p. 56, Act 37, Imd. Eff. July 1;—Am. 1941, p. 231, Act 165, Imd. Eff. June 9;—Am. 1947, p. 425, Act 271, Eff. Oct. 11.

451.114 Same; suspension or revocation; grounds; hearing.

Sec. 14. The commission may temporarily suspend or permanently revoke any order accepting securities for filing for sale, issuance or trading made under any of the provisions of this act, when it appears to such commission that the terms of such order or any provision of this act or any published and recorded rule or regulation promulgated thereunder have been or are about to be violated or when it appears to the commission that the sale or trading of such securities is working or would tend to work a fraud, deception or imposition on purchasers or the public, or that fraud or misrepresentation or other means detrimental to purchasers or the public are being or are about to be employed in the sale or proposed sale or trading of such securities, or that the issuer or the applicant for filing of such securities has forfeited its corporate charter, or is insolvent, or is the subject of receivership or bankruptcy or reorganization proceedings, or has made an assignment for benefit of creditors, or is in such poor financial condition that the sale of such securities would tend to work an imposition on purchasers or the public. No such suspension order shall be effective for longer than 10 days unless the commission shall within such time serve notice upon the party charged of the reasons therefor, and shall grant a hearing thereon at a date not more than 15 days from the date of the suspension order. At such hearing the commission may make such further order respecting the sale of such securities as it deems necessary to safeguard the public, or may permanently revoke the original filing order in its discretion, if it finds such charges or any material part thereof to be true. Violation of or failure to comply with an order of the commission shall be deemed a violation of this act.

HISTORY: C L 1929, 9782;—Am. 1935, p. 56, Act 37, Imd. Eff. July 1;—Am. 1941, p. 233, Act 165, Imd. Eff. June 9.

451.115 Evidence of record; certificate of nonacceptance.

Sec. 15. An exemplification of the record under the hand of the chairman and the seal of the commission shall be good and sufficient evidence of any record made or entered in said commission. A certificate under the hand of the chairman and the seal of the commission showing that the securities in question have not been accepted for filing shall constitute prima facie evidence that such securities have not been qualified for sale pursuant to the provisions of this act, and shall be admissible in evidence in any proceedings before the courts of the state.

HISTORY: C L 1929, 9783.

451.116 Lists of securities and licenses; civil liability for false statements or misrepresentation.

Sec. 16. The commission may issue and make available lists of securities accepted for filing, names of licensees and suspensions or revocations of filings or licenses, for the newspapers and other periodical publications in the state receiving and printing advertisements of securities or dealers or salesmen. It shall be a violation of this act to publish advertisements in newspapers or periodical publications published in this state concerning the sale of securities not specifically exempt under this act, or of securities dealers or salesmen, unless such advertisement is published in accordance with such rules and regulations as shall be promulgated by the commission. The commission may from time to time issue warnings to the public concerning securities being sold or offered for sale.

Any person who sells a security, which comes under the provisions of this act, by means of a prospectus or other type of circular or advertising, or by oral communica-

tion, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statement, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, upon the tender of such security, or for damages if he no longer owns the security.

No action shall be maintained to enforce any liability created under this section unless brought within 2 years after the discovery of the untrue statement or omission. or after such discovery should have been made by the exercise of reasonable diligence: Provided, That in no event shall any such action be brought more than 3 years after the sale. In any suit under this section the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorneys' fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit.

HISTORY: Am. 1929, p. 315, Act 136, Imd. Eff. May 9;—C L 1929, 9784;—Am. 1935, p. 57, Act 37, Imd. Eff. July 1;—Am. 1941, p. 233, Act 165, Imd. Eff. June 9.
PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.117 Subscription blanks, approval.

Sec. 17. In all cases where securities, after filing, are sold either by the issuer, underwriter or any dealer, on a subscription or partial payment plan, the subscription blank shall be approved by the commission before being used.

HISTORY: C L 1929, 9785;—Am. 1935, p. 57, Act 37, Imd. Eff. July 1.
PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.118 Hearing on written request.

Sec. 18. Any interested person aggrieved by any order of the commission under any provision of this act, or by any refusal or failure of the commission to make an order under any of said provisions, shall be entitled to a hearing before the commission, if request be made therefor in writing to the commission. At such hearing such person may be represented by counsel and shall be entitled to be advised of the nature, source and substance of any adverse evidence of which the commission has taken official notice, and may submit any evidence relevant thereto.

HISTORY: C L 1929, 9786.

451.119 Non-resident applicant; service of process.

Sec. 19. Every applicant for the filing of securities who is a non-resident of the state of Michigan, shall at the time of filing his application file with the commission his irrevocable consent that suits and actions arising out of or founded upon misrepresentation or fraud in connection with the sale of such securities in this state may be commenced against him in the proper court of any county in the state in which the plaintiff may reside, by the service of any process or pleadings authorized by the laws of this state, on the chairman of the commission, said consent stipulating and agreeing that such service of such process or pleadings on such chairman shall be taken and held in all courts to be as valid and binding as if due service had been made upon the applicant himself, and such consent of service shall be authenticated in the same manner as is provided for the authentication of applications in section 8 of this act. All process or pleadings required in this act to be served upon said chairman shall be served in duplicate copies, 1 of which shall be retained in the office of the commission and the other forwarded by registered mail forthwith to the head office of the person against whom said process or pleadings are directed.

HISTORY: Am. 1929, p. 316, Act 136, Imd. Eff. May 9;- C L 1929, 9787; Am. 1947, p. 427, Act 271, Eff Oct. 11.
NOTE: Sec. 8, above referred to, is Compilers' § 451.108.
SERVICE OF PROCESS: On state officer as agent, see Compilers' § 613.34.

451.120 Unlawful sales; voidability, civil liability of seller.

Sec. 20. Every sale or contract for sale of any security, not accepted for filing or otherwise exempt under this act or made contrary to any order of the commission, or made contrary to any provision of this act, shall be voidable at the election of the purchaser, and the person making such sale or contract for sale, and every agent of or for such seller who shall have participated or aided in any way in making such sale, shall be jointly and severally liable to such purchaser, upon tender to the seller or in court of the securities sold or of the contract made, for the full amount paid by such purchaser, together with all taxable court costs, in any action brought under this section: Provided, That no action shall be brought for the recovery of the purchase price after 2 years from the date of such sale or contract for sale. No purchaser otherwise entitled shall claim or have the benefit of this section, who, having knowledge of the fact that such sale was made in violation of the provisions of this act shall have refused or fail within a reasonable time to accept the voluntary offer of the person making the sale to take back the securities in question and to refund the full amount paid by such purchaser.

HISTORY: Am. 1929, p. 316, Act 136, Imd. Eff. May 9;—C L 1929, 9788;—Am. 1935, p. 58, Act 37, Imd. Eff. July 1.

SUBDIVISION II.

451.121 License of dealer or salesman; issuance, corporate officers; exceptions.

Sec. 21. Hereafter it shall be unlawful for any person to engage in the business of dealing in securities whether exempt from or included in the provisions of subdivision 1 of this act, without first procuring a license and continuing to be licensed therefor, as hereinafter provided, except that the president, vice-president, secretary or treasurer of a corporation, whose securities have been accepted for filing, need not qualify as a salesman, nor shall it be necessary for such corporation to qualify as a dealer in the sale of its own securities: Provided, No such officer who receives a salary from such corporation shall also accept or receive a commission on the sale of such corporation's securities. For the purpose of this act, any person who for any consideration acts as an investment counsellor and advises the purchase and sale of securities, shall be deemed a "dealer"; and any person who solicits or takes orders for sales or purchase of securities either for or in behalf of and in employ of a dealer, shall be deemed a salesman, and any person who is employed by an issuer of securities to sell his or its securities otherwise than as a dealer or broker therein, shall be deemed a "special salesman" and as such shall be limited to the securities of the issuer under whom he is licensed. A salesman's license shall not be deemed a dealer's license, nor shall a dealer's license be deemed a salesman's license. Nothing in this subdivision shall be construed as prohibiting a bona fide owner of securities from selling the same, excepting that when such owner sells or desires to sell such securities in continued and successive transactions to any person other than a licensed dealer in securities, he shall be deemed a "dealer" therein and subject to the provisions hereof: Provided further, That nothing in this subdivision shall be construed to require a bank or trust company, or any officer or employee thereof, to be licensed under this subdivision with respect to the sale of securities held by such bank or trust company in its individual capacity or in the trusts administered by such bank or trust company. No person selling securities as the agent of the government of the United States, or of this state, or by order of any court of this state or of the United States shall be required to be licensed under this subdivision as to such securities. The commission shall have the authority to issue the licenses herein required. Neither a dealer nor a salesman licensed under this act need obtain a license under the provisions of Act No. 57 of the Public Acts of Michigan of 1943, as amended, by reason of selling or offering to sell, buying or offering to buy, or negotiating the purchase or sale or exchange of a business, business opportunity or the good will of an existing business for others.

HISTORY: Am. 1929, p. 316, Act 136, Imd. Eff. May 9;—C L 1929, 9789;—Am. 1935, p. 58, Act 37, Imd. Eff. July 1;—Am. 1937, p. 262, Act 167, Imd. Eff. July 9;—Am. 1947, p. 427, Act 271, Eff. Oct. 11.

NOTE: Act 57, 1943, above referred to, is an amendatory act to this act.

BROKERS: Real estate brokers, real estate salesmen and business chance brokers licensed by securities commission, see Compilers' § 451.201 et seq.

PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

tion, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statement, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, upon the tender of such security, or for damages if he no longer owns the security.

No action shall be maintained to enforce any liability created under this section unless brought within 2 years after the discovery of the untrue statement or omission, or after such discovery should have been made by the exercise of reasonable diligence: Provided, That in no event shall any such action be brought more than 3 years after the sale. In any suit under this section the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorneys' fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit.

HISTORY: Am. 1929, p. 315, Act 136, Imd. Eff. May 9;—C L 1929, 9784;—Am. 1935, p. 57, Act 37, Imd. Eff. July 1;—Am. 1941, p. 233, Act 165, Imd. Eff. June 9.
PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.117 Subscription blanks, approval.

Sec. 17. In all cases where securities, after filing, are sold either by the issuer, underwriter or any dealer, on a subscription or partial payment plan, the subscription blank shall be approved by the commission before being used.

HISTORY: C L 1929, 9785;—Am. 1935, p. 57, Act 37, Imd. Eff. July 1.
PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.118 Hearing on written request.

Sec. 18. Any interested person aggrieved by any order of the commission under any provision of this act, or by any refusal or failure of the commission to make an order under any of said provisions, shall be entitled to a hearing before the commission, if request be made therefor in writing to the commission. At such hearing such person may be represented by counsel and shall be entitled to be advised of the nature, source and substance of any adverse evidence of which the commission has taken official notice, and may submit any evidence relevant thereto.

HISTORY: C L 1929, 9786.

451.119 Non-resident applicant; service of process.

Sec. 19. Every applicant for the filing of securities who is a non-resident of the state of Michigan, shall at the time of filing his application file with the commission his irrevocable consent that suits and actions arising out of or founded upon misrepresentation or fraud in connection with the sale of such securities in this state may be commenced against him in the proper court of any county in the state in which the plaintiff may reside, by the service of any process or pleadings authorized by the laws of this state, on the chairman of the commission, said consent stipulating and agreeing that such service of such process or pleadings on such chairman shall be taken and held in all courts to be as valid and binding as if due service had been made upon the applicant himself, and such consent of service shall be authenticated in the same manner as is provided for the authentication of applications in section 8 of this act. All process or pleadings required in this act to be served upon said chairman shall be served in duplicate copies, 1 of which shall be retained in the office of the commission and the other forwarded by registered mail forthwith to the head office of the person against whom said process or pleadings are directed.

HISTORY: Am. 1929, p. 316, Act 136, Imd. Eff. May 9;—C L 1929, 9787;—Am. 1947, p. 427, Act 271, Eff. Oct. 11.
NOTE: Sec. 8, above referred to, is Compilers' § 451.108.
SERVICE OF PROCESS: On state officer as agent, see Compilers' § 613.34.

451.120 Unlawful sales; voidability, civil liability of seller.

Sec. 20. Every sale or contract for sale of any security, not accepted for filing or otherwise exempt under this act or made contrary to any order of the commission, or made contrary to any provision of this act, shall be voidable at the election of the purchaser, and the person making such sale or contract for sale, and every agent of or for such seller who shall have participated or aided in any way in making such sale, shall be jointly and severally liable to such purchaser, upon tender to the seller or in court of the securities sold or of the contract made, for the full amount paid by such purchaser, together with all taxable court costs, in any action brought under this section: Provided, That no action shall be brought for the recovery of the purchase price after 2 years from the date of such sale or contract for sale. No purchaser otherwise entitled shall claim or have the benefit of this section, who, having knowledge of the fact that such sale was made in violation of the provisions of this act shall have refused or fail within a reasonable time to accept the voluntary offer of the person making the sale to take back the securities in question and to refund the full amount paid by such purchaser.

HISTORY: Am. 1929, p. 316, Act 136, Imd. Eff. May 9;—C L 1929, 9788;—Am. 1935, p. 58, Act 37, Imd. Eff. July 1.

SUBDIVISION II.

451.121 License of dealer or salesman; issuance, corporate officers; exceptions.

Sec. 21. Hereafter it shall be unlawful for any person to engage in the business of dealing in securities whether exempt from or included in the provisions of subdivision 1 of this act, without first procuring a license and continuing to be licensed therefor, as hereinafter provided, except that the president, vice-president, secretary or treasurer of a corporation, whose securities have been accepted for filing, need not qualify as a salesman, nor shall it be necessary for such corporation to qualify as a dealer in the sale of its own securities: Provided, No such officer who receives a salary from such corporation shall also accept or receive a commission on the sale of such corporation's securities. For the purpose of this act, any person who for any consideration acts as an investment counsellor and advises the purchase and sale of securities, shall be deemed a "dealer"; and any person who solicits or takes orders for sales or purchase of securities either for or in behalf of and in employ of a dealer, shall be deemed a salesman, and any person who is employed by an issuer of securities to sell his or its securities otherwise than as a dealer or broker therein, shall be deemed a "special salesman" and as such shall be limited to the securities of the issuer under whom he is licensed. A salesman's license shall not be deemed a dealer's license, nor shall a dealer's license be deemed a salesman's license. Nothing in this subdivision shall be construed as prohibiting a bona fide owner of securities from selling the same, excepting that when such owner sells or desires to sell such securities in continued and successive transactions to any person other than a licensed dealer in securities, he shall be deemed a "dealer" therein and subject to the provisions hereof: Provided further, That nothing in this subdivision shall be construed to require a bank or trust company, or any officer or employee thereof, to be licensed under this subdivision with respect to the sale of securities held by such bank or trust company in its individual capacity or in the trusts administered by such bank or trust company. No person selling securities as the agent of the government of the United States, or of this state, or by order of any court of this state or of the United States shall be required to be licensed under this subdivision as to such securities. The commission shall have the authority to issue the licenses herein required. Neither a dealer nor a salesman licensed under this act need obtain a license under the provisions of Act No. 57 of the Public Acts of Michigan of 1943, as amended, by reason of selling or offering to sell, buying or offering to buy, or negotiating the purchase or sale or exchange of a business, business opportunity or the good will of an existing business for others.

HISTORY: Am. 1929, p. 316, Act 136, Imd. Eff. May 9;—C L 1929, 9789;—Am. 1935, p. 58, Act 37, Imd. Eff. July 1;—Am. 1937, p. 262, Act 167, Imd. Eff. July 9;—Am. 1947, p. 427, Act 271, Eff. Oct. 11.

NOTE: Act 57, 1943, above referred to, is an amendatory act to this act.

BROKERS: Real estate brokers, real estate salesmen and business chance brokers licensed by securities commission, see Compilers' § 451.201 et seq.

PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.121a Investment counsellor registered with securities and exchange commission not required to be licensed.

Sec. 21a. There shall be exempted from the provisions of section 21 of this act, any investment counsellor who is fully registered with the securities and exchange commission at Washington, D. C., pursuant to the registration provisions of the investment advisers' act of 1940, and who at no time takes custody of clients' or customers' securities or funds.

HISTORY: Add. 1941, p. 234, Act 165, Imd. Eff. June 9.

451.122 Dealers or salesmen, license; application; fee; consent to service of process; bond filed by dealer; display of license.

Sec. 22. Any person desiring a license either as a dealer or salesman shall apply therefor upon application forms to be furnished by the commission, showing the name, age, residence, business address, principal occupation and antecedent business experience of the applicant, and such other personal facts as the commission shall require, including references or recommendations as to the personal integrity, competence and financial standing of the applicant, but the commission may waive the submittal of any information already filed in previous applications of the applicant. Application forms may be varied in the case of the applicant being a corporate entity, in which case the commission may also require facts as to the principal officers of such corporation, corresponding to those required of natural persons. Every such application shall be duly sworn to as may be required by the comission. An annual license fee of $100.00 shall be charged for each dealer, provided a fee of $50.00 may be accepted by the commission on and after March 1 of each year; where a dealer maintains more than 1 office for the purpose of conducting a general brokerage or security business within this state, an additional annual fee of $50.00 shall be charged for each additional office so maintained: Provided, That a fee of $25.00 may be accepted by the commission on and after March 1 of each year; and an annual license fee of $5.00 shall be charged for each salesman, which fee shall accompany the application. The commission may require such further information as it shall deem necessary to satisfy it of the personal integrity and financial standing of the applicant, and of his knowledge of this act and of the regulations promulgated thereunder. Such knowledge will be conclusively presumed when the applicant had been licensed under this act immediately prior to the date of relicensing. Every applicant desiring a license either as a dealer or salesman, being a non-resident of the state of Michigan, shall have on file with the commission, his irrevocable consent that suits and actions may be commenced against him in the proper court of any county in the state in which a plaintiff may reside, by the service of any process or pleadings authorized by the laws of this state, on the commissioner, said consent to be authenticated as provided in section 8 of this act and to contain the same stipulations and agreements as to service as provided in section 19 of this act, and said process and pleadings to be served in the manner described in section 19 of this act. Every applicant who is a resident of Michigan shall have on file with the commission his irrevocable consent that in case he shall remove from the state or become a non-resident of Michigan that suits and actions may be commenced against him in the proper court of any county in the state in which a plaintiff may reside by the service of any process or pleadings authorized by the laws of this state, on the commissioner, said consent to be authenticated as provided in section 8 of this act and to contain the same stipulations and agreements as to service as provided in section 19 of this act, and said process and pleadings to be served in the manner, described in section 19 of this act. Said applicant who is a resident of the state of Michigan at the time of his application shall have on file with the commission his irrevocable consent that in case he shall remove from the state or become a non-resident, he may be served with process and pleadings as herein provided. Every applicant for a dealer's license except banks and trust companies shall file with his application a bond in the sum of $10,000.00, running to the people of the state of Michigan, executed by a surety company authorized to transact business in Michigan, in such form as the commission may designate, such bond to be conditioned upon the faithful compliance with the provisions of this act by said dealer and all salesmen registered by him. Each applicant for

a dealer's license shall have a place of business other than his residence and shall satisfy the commission that his business has been or will be honestly conducted, that he is financially solvent, and of such reputation for honesty and integrity as will reasonably insure honest treatment of the public with whom such dealer transacts business. Licenses both of dealers and salesmen shall run from July 1 to June 30 of the succeeding year and shall be upon such forms as may be prescribed by the commission: Provided, however, That every non-resident dealer and salesman shall within 30 days from the taking effect of this act file his consent to service as hereinabove provided, in default of which his license shall be revoked by the commission. A dealer's license shall be constantly displayed in his place or places of business and a failure so to display shall be a violation of this act. The salesman's license shall be issued to the dealer with whom he is registered, and retained by said dealer. Nothing in this section shall prevent the commission from considering an application by a dealer for a license as such and for licenses for salesmen continuing in his employ on July 1 of any year; in such case both the dealer and the salesmen shall be regarded as applicants within the meaning of this section.

HISTORY: Am. 1929, p. 317, Act 136, Imd. Eff. May 9;—C L 1929, 9790;—Am. 1931, p. 400, Act 229, Imd. Eff. May 29;—Am. 1935, p. 58, Act 37, Imd. Eff. July 1;—Am. 1941, p. 234, Act 165, Imd. Eff. June 9;—Am. 1945, p. 507, Act 295, Imd. Eff. May 25.

PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.123 Same; refusal to issue, hearing.

Sec. 23. If the applicant, either for a dealer's or salesman's license, shall fail to convince the commission that he is entitled to a license, it may be refused: Provided, That no order of refusal shall be entered until the applicant has been given a hearing, if requested within 30 days, bearing on the reasons for such refusal.

HISTORY: C L 1929, 9791;—Am. 1935, p. 60, Act 37, Imd. Eff. July 1.

451.124 Same; suspension or revocation, reasons.

Sec. 24. The commission shall have the power to suspend or revoke licenses once issued for any of the following reasons:

Dealer's license.

(a) In the case of a dealer's license: Misrepresentations, either as to the financial worth, merits, value or price of security, either in advertising or through salesmen; charging on listed securities more than the commission customarily charged in similar transactions by other members of the stock exchange of which such dealer is a member; charging as a commission of his own on listed securities more than an amount equal to the commission customarily charged for such transactions by members of the exchange on which the security is listed, provided he is not a member of such exchange; taking a profit while acting as a principal and/or charging a commission and/or service charge on any transaction in unlisted securities, which is in excess of the commonly accepted profit, commission and/or service charge for the same sort of a transaction among other dealers; bucketing, or while acting as a broker under orders to purchase or sell securities for customers, selling or purchasing for his own account of the same securities with intent to trade against the customer's order; or in any way filling an order for a client other than in the usual method of making a purchase or sale upon the open market; for being in a condition of insolvency; for failing to keep or maintain sufficient records to permit of an audit satisfactorily disclosing to the commission the true situation or condition of such business; for dealing in securities on marginal account or partial payments or issuing interim certificates or receipts unless such dealer has at all times net assets in excess of $100,000.00, or has on file with the commission a bond in the penal sum of $100,000.00, to the people of the state of Michigan for the use and benefit of any resident thereof, conditioned upon the payment of any judgment that may be obtained against such dealer or any suit or action arising out of or founded upon any act or omission of such dealer in the purchase or sale of securities; disobeying in any way orders made by the Michigan securities commission as a condition precedent to the acceptance for filing of a security; dealing in securities not accepted for filing or otherwise exempt; having in his employ any unlicensed salesman or salesmen whose license has been revoked, provided the dealer has knowledge of said revocation; practices of any sort tending toward defrauding the public;

Salesman's license.

(b) In the case of a salesman's license: Making any misrepresentation of an existing fact regarding any security; promise of dividends unless said dividends have already been declared; promising a resale at a price above that at which the security is sold to a purchaser; taking any subscription or contract for the purchase of any security on the partial payment plan upon any bank [blank] other than that approved by the Michigan securities commission; using any advertsing matter in connection with the sale of any security, which advertising has not been approved by the Michigan securities commission; dividing commissions for the sale of securities with, or giving rebates to any person or persons not licensed with the Michigan securities commission, either as dealers or salesmen; any practices which, in the judgment of the commission, not explicitly outlined in this act, tend to defraud the public; conviction in any court in the state of a violation of this act. Any act or omission by a licensed broker or salesman which is herein made a ground for suspension or revocation of license, shall be deemed a violation of this act and punishable accordingly.

HISTORY: Am. 1929, p. 318, Act 136, Imd. Eff. May 9;—C L 1929, 9792;—Am. 1935, p. 60, Act 37, Imd. Eff. July 1;—Am. 1947, p. 428, Act 271, Eff. Oct. 11.

451.125 Same; suspension or revocation; hearing; notices; return of license.

Sec. 25. The commission may temporarily suspend or permanently revoke any license after a hearing before the commission, of which the licensee shall have due notice and be given an opportunity to present a defense: Provided, That where the commission shall determine that in the interests of the public an immediate suspension is necessary, such may issue, but in such case a hearing shall be held within 5 days, unless a longer time is requested by the licensee. When the commission has sufficient evidence to warrant a revocation of any license, notice shall be sent to the licensee by registered mail to his last address, citing him to appear and show cause why such license should not be revoked. Such citation shall contain the essence of the matter upon which the proposed revocation is based, and in case the licensee so cited is a salesman, a copy of such citation shall be sent under registered mail to the dealer or issuer under whom such salesman is registered. Notices of revocation shall be sent by registered mail in a like manner. Upon notice of revocation, it shall be the duty of the holder of such license so revoked to forward the same at once to the commission together with any salesmen's licenses and pocket cards issued thereunder, and failure to so return shall be construed a violation of this act.

HISTORY: C L 1929, 9793.
PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.126 Statement to customer; violation of act.

Sec. 26. Every dealer when acting as a broker or agent in securities shall deliver to each customer, on whose behalf securities are bought or sold, a statement or memorandum of such purchase or sale, a description of the securities so purchased or sold, the name of the person, firm or corporation from which such securities were purchased, or to which the same were sold, and the date and the hours between which such transaction took place. Any dealer who refuses such statement or memorandum to a customer within 24 hours after a written demand therefor, or who delivers a statement or memorandum which is false in any material respect, shall be deemed to have violated this act.

HISTORY: C L 1929, 9794.
PENALTY: For violation of this section, see Sec. 33, being Compilers' § 451.133.

451.127 Stopping of sale of securities for violation of act; recourse to courts; powers of investigation.

Sec. 27. Whenever it shall appear to the commission that any person, either in the actual or proposed sale of, trading in, or dealing in any security or securities, is engaged or is about to engage in any act or practice which constitute or will constitute a violation of the provisions of this act, or of any published and recorded rule or regulation promulgated thereunder, or is employing means detrimental to the public, in that such means may be construed as fraudulent, fictitious, or as promises and representations amounting to false pretenses, the commission may, by order, stop the sale, trading in, or dealing in, or proposed sale of, trading in, or dealing in such securities. The commission may apply to the

circuit court of Ingham county for process compelling obedience to such order, and the court is hereby given jurisdiction over such proceeding.

Whenever it shall appear to the commission that the provisions of this act, or of any published and recorded rule or regulation promulgated thereunder, have been or are about to be violated, the commission may make such investigation as it deems necessary, and may issue subpoenas, and compel the attendance of witnesses, and shall have such other powers as are necessary to carry out the provisions of this act and make any investigation complete.

HISTORY: C L 1929, 9795;—Am. 1935, p. 61, Act 37, Imd. Eff. July 1;—Am. 1941, p. 235, Act 165, Imd. Eff. June 9.

SUBDIVISION III.

451.128 Reports by issuers and dealers; receiver for dealer.

Sec. 28. Every issuer of securities filed under this act shall, until such time as is otherwise ordered by the commission, or before March first of each year, file with the commission, on blanks to be provided by it, a detailed statement showing the condition of said issuer on the thirty-first day of December preceding, and shall at the same time pay a filing fee therefor of $3.00; or the commission may instead permit an issuer to file such a statement as at the close of the fiscal year of the issuer if filed within 60 days thereof. The commission may order when it deems necessary that such statement be certified to by a certified public accountant.

The commission may compel every licensed dealer to make a report not later than the tenth of each month of all securities purchased and sold by such dealer and its salesmen during the preceding calendar month, and the books of licensed dealers shall at all times be open to the inspection of the commision or any of its employees or any person delegated to examine them. If, upon examination, it is found that the dealer is insolvent or if the records are in such condition that the examiner is unable to determine the financial condition of the dealer, the commission may ask the appointment of a receiver to safeguard the interests of the public. The circuit court in Ingham county or the county in which such dealer has his principal place of business shall have authority to appoint such receiver. The commission shall be empowered to take into custody all books and records and all the other property in the place of business of the said dealer and/or issuer: Provided, That the commission shall within 5 days after the taking of said property in custody file its petition for the appointment of a receiver in the said court.

HISTORY: Am. 1929, p. 319, Act 136, Imd. Eff. May 9;—C L 1929, 9796;—Am. 1935, p. 61, Act 37, Eff. July 1;—Am. 1945, p. 508, Act 295, Imd. Eff. May 25.

451.129 Review of orders of commission by circuit court; stay.

Sec. 29. The circuit court for the county of Ingham, upon petition of any person aggrieved, may review any final order of determination of the commission, either as to securities or licenses. The findings of fact involved in any such order shall be conclusive, but said circuit court shall have power to review any questions of law involved in said order. The review shall not, however, unless specifically ordered by the court, operate as a stay of proceedings.

HISTORY: Am. 1929, p. 319, Act 136, Imd. Eff. May 9;—C L 1929, 9797;—Am. 1941, p. 236, Act 165, Imd. Eff. June 9.
This section, as amended in 1929, is a re-enactment of Sec. 30, as enacted in 1923.
The provisions of Sec. 29, as enacted in 1923, now appear in amended form in Sec. 30.

451.130 False statement; felony.

Sec. 30. Any person who shall knowingly or wilfully subscribe to or make or cause to be made any false statement or false entry in any book of any applicant for filing, or for dealer's or salesman's license under this act, or who shall exhibit any false paper with the intention or for the purpose of deceiving any person authorized to examine into the affairs of said applicant, or shall make or publish any false statement of the financial condition of said applicant, or false statement relating to the securities issued and offered for filing or relating to applications for licenses, shall be deemed guilty of a felony and shall be punished as hereinafter provided.

HISTORY: Am. 1929, p. 320, Act 136, Imd. Eff. May 9;—C L 1929, 9798.
The provisions of Sec. 30, as enacted in 1923, have been re-enacted in the 1929 amendment to Sec. 29.

451.131 Insolvent dealer or broker, unlawful receipts from customers.

Sec. 31. It shall be unlawful for any person engaged in business as a dealer and/or broker within the meaning of this act and who is insolvent, to accept or receive from a customer, ignorant of such broker's insolvency, any money or securities belonging to such customer otherwise than in liquidation of or as security for an existing indebtedness and to thereby cause the customer to lose in whole or in part any money or securities. A person shall be deemed insolvent within the meaning of this act whenever the aggregate of his property shall not at a fair value be sufficient in amount to pay his debts.

HISTORY: Am. 1929, p. 320, Act 136, Imd. Eff. May 9;—C L 1929, 9799;—Am. 1935, p. 61, Act 37, Imd. Eff. July 1.

The provisions of Sec. 31, as enacted in 1923, appear in amended form in Sec. 33.

PENALTY: For violation of this section, see Sec. 33.

451.132 Unlawful pledging of securities.

Sec. 32. It shall be unlawful for any person engaged in business as a dealer and/or broker, within the meaning of this act, who has in his possession for safekeeping or otherwise any securities belonging to a customer without having any lien thereon, to pledge or dispose of the same or any part thereof without such customer's consent; or for 1 who has in his possession any securities belonging to a customer on which he has a lien for indebtedness due him by the customer, to pledge the same or any part thereof for more than the amount due to him thereon, or otherwise dispose of the same or any part thereof for his own benefit without the customer's consent without having other securities of the kind and amount to which the customer is then entitled, for delivery to him upon demand therefor and tender of the amount due thereon, and to thereby cause the customer to lose such securities or any part thereof.

HISTORY: Am. 1929, p. 320, Act 136, Imd. Eff. May 9;—C L 1929, 9800;—Am. 1935, p. 61, Act 37, Imd. Eff. July 1.

The provisions of Sec. 32, as enacted in 1923, have been re-enacted in Sec. 34 added in 1929.

PENALTY: For violation of this section, see Sec. 33.

451.133 Penalty.

Sec. 33. Any person violating any of the provisions of this act shall be deemed guilty of a felony and upon conviction thereof, shall be punished by a fine of not less than 100 dollars or more than 5,000 dollars, together with costs of prosecution, or by imprisonment in a county jail, state prison or other penal institution for not less than 30 days or more than 2 years, or by both such fine and imprisonment in the discretion of the court. The term "person" as is used in this section shall include an officer or employee of a corporation or a member or employee of a partnership who, as such officer, employee or member is under a duty to perform the act in respect to which the violation occurred.

HISTORY: Am. 1929, p. 320, Act 136, Imd. Eff. May 9;—C L 1929, 9801;—Am. 1935, p. 62, Act 37, Imd. Eff. July 1.

This section, as amended in 1929, contains, in amended form, the provisions of Sec. 31 as enacted in 1923.

The provisions of Sec. 33, as enacted in 1923, appear, with additions, in Sec. 35 added in 1929.

NOTE: The sections above referred to and their respective Compilers' section numbers are as follows: 3, Sec. 451.103; 7, Sec. 451.107; 11, Sec. 451.111; 16, Sec. 451.116; 17, Sec. 451.117; 21, Sec. 451.121; 22, Sec. 451,122; 25, Sec. 451.125; 26, Sec. 451.126; 30, Sec. 451.130; 31, Sec. 451.131; 32, Sec. 451.132.

Sec. 34. (This was a severing clause section.)

HISTORY: Add. 1929, p. 321, Act 136, Imd. Eff. May 25;—C L 1929, 9802;—Rep. 1945, p. 413, Act 267, Imd. Eff. May 25.

Sec. 35. (This was a repeal section.)

HISTORY: Add. 1929, p. 321, Act 136, Imd. Eff. May 9;—C L 1929, 9803;—Rep. 1945, p. 406, Act 267, Imd. Eff. May 25.

ACTS REPEALED: Act 46, 1915; Act 204, 1925.

Act 306, 1919, p. 535; Eff. Aug. 14.

AN ACT to define, regulate and license real estate brokers and real estate salesmen, including within the term real state broker, also those who act as real estate appraisers, real estate mortgage brokers, building job brokers, business chance brokers and those who, as owners or otherwise, engage in the sale of real estate as a principal vocation, and persons employed by any of them as salesmen, and to provide a penalty for a violation of the provisions hereof.

The People of the State of Michigan enact:

451.201 Real estate broker or salesman; license.

Sec. 1. It shall be unlawful for any person, firm, partnership association, copartnership or corporation, whether operating under an assumed name or otherwise, from and after January first, 1920, to engage in the business or capacity, either directly or indirectly, of a real estate broker or real estate salesman within this state without first obtaining a license under the provisions of this act.

HISTORY: C L 1929, 9806;—Am. 1943, p. 60, Act 57, Eff. July 30.
Title Am. 1939, p. 495, Act 268, Eff. Sept. 29;—Am. 1943, p. 60, Act 57, Eff. July 30.
NOTE: Act 306 of 1919 was specifically excepted from the provisions of Act 307 of 1925 relating to finance companies, by Sec. 1 thereof, being Compilers' § 492.1
AGREEMENT FOR COMMISSION: For sale of any interest in real estate must be in writing, see Compilers' § 566.132 subd. 5.

451.202 Same; definitions; scope of act; applicability.

Sec. 2. A real estate broker within the meaning of this act is any person, firm, partnership association, copartnership or corporation, who with intent to collect or receive a fee, compensation or valuable consideration, sells or offers for sale, buys or offers to buy, appraisers or offers to appraise, lists or offers or attempts to list, or negotiates the purchase or sale or exchange or mortgage of real estate, or negotiates for the construction of buildings thereon, or who leases or offers to lease or rents or offers for rent any real estate or the improvements thereon for others, as a whole or partial vocation, or who sells or offers for sale, buys or offers to buy, leases or offers to lease, or negotiates the purchase or sale or exchange of a business, business opportunity, or the good will of an existing business for others, or who, as owner or otherwise, engages in the sale of real estate as a principal vocation. A real estate salesman within the meaning of this act is any person who for compensation or valuable consideration is employed either directly or indirectly by a licensed real estate broker to sell or offer to sell, or buy or offer to buy, to appraise or offer to appraise, to list, or offer or attempt to list, or to negotiate the purchase or sale or exchange or mortgage of real estate, or to negotiate for the construction of buildings thereon, or to lease or offer to lease, rent or offer for rent any real estate, or who sells or offers for sale, buys or offers to buy, leases or offers to lease, or negotiates the purchase or sale or exchange of a business, business opportunity, or the good will of an existing business for others, as a whole or partial vocation. The provisions of this act shall not apply to any person, firm, partnership association, copartnership or corporation, who as owner or lessor or as attorney-in-fact acting under a duly executed and recorded power of attorney from such owner or lessor, or who has been appointed by court, shall perform any of the acts aforesaid with reference to property owned by them, unless performed as a principal vocation not through brokers duly licensed hereunder, nor shall this act be construed to include in any way the services rendered by an attorney at law in the performance of his duties as such attorney at law, nor shall it be held to include a receiver, trustee in bankruptcy, administrator or executor, or any person selling or appraising real estate under order of any court, nor to a trustee selling under a deed of trust: Provided, That this exemption of trustee shall not apply to repeated and/or successive sales of real estate by such trustee, unless such sales are made through brokers duly licensed hereunder.

HISTORY: Am. 1921, p. 708, Act 387, Eff. Aug. 18;—C L 1929, 9807;—Am. 1937, p. 294, Act 188, Imd. Eff. July 14;—Am. 1939, p. 495, Act 268, Eff. Sept. 29;—Am. 1943, p. 60, Act 57, Eff. July 30.

451.203 Same; persons constituting.

Sec. 3. One acting for a compensation or valuable consideration of buying or selling real estate of or for another, or offering for another to buy or sell or exchange or mortgage or appraise real estate, or to negotiate for the construction of buildings thereon, or leasing or renting or offering to rent real estate, or selling or offering for sale, or buying or offering to buy, or leasing or offering to lease, or negotiating the purchase or sale or exchange of a business, business opportunity, or the good will of an existing business for others, or one who, as owner or otherwise, engages in the sale of real estate as a principal vocation, except as herein specifically excepted, shall constitute the person, firm, partnership association, copartnership or corporation performing, offering or attempting to perform any of

the acts enumerated herein, a real estate broker or a real estate salesman within the meaning of this act. The commission of a single act prohibited hereunder shall constitute a violation.

HISTORY: C L 1929, 9808;—Am. 1937, p. 294, Act 188, Imd. Eff. July 14;—Am. 1939, p. 496, Act 268, Eff. Sept. 29;—Am. 1943, p. 61, Act 57, Eff. July 30.

451.204 Commission; duty to enforce act.

Sec. 4. It shall be the duty of the Michigan corporation and securities commission created by Act No. 13 of the Public Acts of 1935, and hereinafter referred to in this act as "the commission" to administer and provide for the enforcement of all of the provisions of this act.

HISTORY: C L 1929, 9809;—Am. 1943, p. 61, Act 57, Eff. July 30.
NOTE: Act 13, 1935, above referred to, is Compilers' § 451.1 et seq.

451.205 Same; clerks and offices.

Sec. 5. The commission shall employ such clerks and assistants as shall be deemed necessary to discharge the duties imposed by the provisions of this act. Such clerks and assistants shall perform such duties as the commission shall prescribe and shall receive such compensation as shall be fixed by the commission, subject to the general laws of the state. The commission shall obtain such office space, furniture, stationery, fuel, light and other proper conveniences as shall be reasonably neccessary for carrying out the provisions of this act.

HISTORY: C L 1929, 9810.
ADMINISTRATIVE BOARD: Supervisory powers, see Compilers' § 17.3.

451.206 Same; seal; records as evidence; inspection of records.

Sec. 6. The commission shall adopt a seal with such design as the commission may prescribe engraved thereon, by which it shall authenticate its proceedings. Copies of all records and papers in the office of the commission, duly certified and authenticated by the seal of said commission shall be received in evidence in all courts equally and with like effect as the original. All records kept in the office of the commission under authority of this act shall be open to public inspection under such rules and regulations as shall be prescribed by the commission.

HISTORY: C L 1929, 9811.

451.207 Same; disposition of fees; expenses.

Sec. 7. All fees and charges collected by the commission under the provisions of this act shall be paid into the general fund in the state treasury. All expenses incurred by the commission under the provisions of this act, including compensation to clerks and assistants, and such costs as fees and mileage, shall be paid out of the general fund in the state treasury upon warrants of the auditor general from time to time when vouchers therefor are exhibited and approved by the commission: Provided, That the total expense for every purpose incurred shall not exceed the total fees and charges collected and paid into the state treasury.

HISTORY: Am. 1921, p. 709, Act 387, Eff. Aug. 18;—C L 1929, 9812.

451.208 License; application; procedure; eligibility; duplicate; rules; examinations; fees.

Sec. 8. All applications for licenses shall be made in writing to the commission. Such applications shall also be accompanied by the recommendation of at least 2 citizens, real estate owners, who have owned real estate for a period of 1 year or more, in the county in which said applicant resides or had his place of business, which recommendation shall certify that the applicant bears a good reputation for honesty and fair dealing, and recommending that a license be granted to the applicant. Every applicant for a license shall furnish a sworn statement setting forth his present address, both of business and residence, the complete address of all former places where he may have resided or been engaged in business, or acted as a real estate salesman, for a period of 60 days or more, during the last 5 years, and the length of such residence, together with the name of at least 1 real estate owner in each of the said counties where he may have resided, engaged in business, or acted as a salesman. Every applicant for a broker's license shall also state

the name of the person, firm, partnership association, copartnership or corporation, and the location of the place, or places, for which said license is desired, and set forth the period of time, if any, which said applicant has been engaged in the business, and shall be executed by such person, or by an officer or member thereof. A broker's license shall not be issued to any new applicant who is not a citizen of the United States nor to any person who has been convicted of embezzlement or misappropriation of funds. Every real estate broker shall maintain a place of business in this state. In case a real estate broker maintains more than 1 place of business within the state a duplicate license must be secured by such broker for each branch office so maintained: Provided, That a broker shall be permitted to maintain, in the city which constitutes the situs of his main office, not more than 1 branch office for each 60,000 residents, according to the last federal decennial census or any subsequent federal decennial census: Provided further, That any branch office maintained in excess of 25 miles from the city limits in which such broker maintains his main office must be under the personal, direct supervision of an associate broker. Every applicant for a salesman's license shall, in addition to the requirements of the first paragraph of this section, also set forth the period of time, if any, during which he has been engaged in the business, stating the name of his last employer and the name and the place of business of the person, firm, partnership association, copartnership or corporation then employing him or in whose employ he is to enter. The application shall be accompanied by a written statement by the broker in whose employ he is to enter stating that in his opinion the applicant is honest, truthful and of good reputation, and recommending that the license be granted to the applicant. Every applicant for a salesman's license shall be a citizen of the United States.

The commission shall have the right to prescribe the form of application for all licenses. The commission is hereby authorized to require and procure any and all satisfactory proof as shall be deemed desirable in reference to the honesty, truthfulness, business experience, competence and reputation of any applicant for a real estate broker's or salesman's license or of any of the officers or members of any such applicant, prior to the issuance of any such license. The commission is expressly vested with the power and authority to make, prescribe and enforce, after having been approved by the attorney general and recorded by the secretary of state, as required under Act No. 88 of the Public Acts of 1943, any and all such rules and regulations connected with the application, for any license, and the issuing of the same as shall be deemed necessary to administer and enforce the provisions of this act, and the issuance or refusal of a license shall be discretionary with the commission. The commission shall also require each applicant for broker's or salesman's license to pass an examination establishing, in a manner satisfactory to the commission, that the applicant has a fair knowledge of the English language, including reading, writing, spelling and elementary arithmetic, a satisfactory understanding of the fundamentals of real estate practice and of the laws and principles of real estate conveyancing, deeds, mortgages, land contracts, leases, the obligations of a broker to the public and his principal, and the provisions of the Michigan statutes defining, regulating and licensing real estate brokers and salesmen: Provided, however, That the commission shall have the authority to require at its discretion written examination or written re-examination of brokers and/or salesmen, and in these cases that passing grades, satisfactory to the commission shall be required as a condition precedent to reissuance of licenses to such brokers and/or salesmen. The commission shall also require proof that each applicant for a broker's license has been engaged in the real estate business for a period of not less than 3 years, at least 2 of which shall have been as a salesman licensed hereunder, or its equivalent in relevant, related experience in the discretion of the commission: Provided, That brokers heretofore licensed hereunder shall not be required to meet said 3 year requirement. An examination fee of $3.00 shall be collected from each applicant to defray the expenses of holding such examination.

HISTORY: Am. 1921, p. 708, Act 387, Eff. Aug. 18;—Am. 1929, p. 257, Act 111, Eff. Aug. 28;—C.L. 1929, 9813;—Am. 1931, p. 231, Act 148, Eff. Sept. 18;—Am. 1937, p. 294, Act 188, Imd. Eff. July 14;—Am. 1939, p. 496, Act 268, Eff. Sept. 29;—Am. 1943, p. 61, Act 57, Eff. July 30;—Am. 1947, p. 660, Act 352, Eff. Oct. 11.

NOTE: Act 88, 1943, above referred to, is Compilers' § 24.71 et seq.

NON-RESIDENT: See Sec. 16, being Compilers' § 451.216, in connection with this section.

451.209 Same; form; custody and display; notice of change in business address; pocket card.

Sec. 9. The commission shall issue to each licensee a license in such form and size as shall be prescribed by the commission. This license shall show the name and address of the licensee and in case a real estate salesman's license, shall show the name of the real estate broker by whom he is employed. Each license shall have imprinted thereon the seal of the commission, and in addition to the foregoing shall contain such matter as shall be prescribed by the commission. The license of each real estate salesman shall be delivered or mailed to the real estate broker by whom such real estate salesman is employed and shall be kept in the custody and control of such broker. It shall be the duty of each real estate broker to conspicuously display his license in his place of business. Notice in writing shall be given to the commission by each licensee of any change of either principal or branch business location, whereupon the commission shall issue a new license for the unexpired period without charge. The commission shall prepare and deliver to each licensee a pocket card not larger than 2¼ inches in width and 3¼ inches in length, which card among other things shall contain the name and address of the licensee, and in case of a salesman the name and address of the employer, and shall contain the imprint of the seal of the commission and shall certify that the person whose name appears thereon is a licensed real estate salesman or real estate broker, as the case may be. The matter to be printed on such pocket card, except as above set forth, shall be prescribed by the commission.

HISTORY: Am. 1921, p. 710, Act 387, Eff. Aug. 18;—C L 1929, 9814;—Am. 1947, p. 661, Act 352, Eff. Oct. 11.

451.210 Same; surrender or transfer upon termination of employment; relicensing, fee.

Sec. 10. When any real estate salesman shall be discharged or shall terminate his employment with the real estate broker by whom he is employed, by giving employer a written notice of such termination, it shall be the duty of such real estate broker to deliver or mail by registered mail to the commission, within 5 days, such real estate salesman's license. When no written notice of termination of employment is served upon the said broker by the said salesman, any application to the commission for a transfer of license by said salesman shall be communicated in writing by the commission to said broker and from the date of said communication said notice shall operate as if a written notice had been served by the said salesman upon said broker. The real estate broker shall at the time of mailing such real estate salesman's license to the commission, address a communication to the last known residence address of such real estate salesman, which communication shall advise such real estate salesman that his license has been delivered or mailed to the commission. A copy of such communication to the real estate salesman shall accompany the license when mailed or delivered to the commission. It shall be unlawful for any real estate salesman to perform any of the acts contemplated by this act either directly or indirectly under authority of said license from and after the date of receipt of the said license from said broker by the commission: Provided, That another license shall not be issued to such real estate salesman until he shall return his former pocket card to the commission or shall satisfactorily account to it for same: Provided further, That not more than 1 license shall be issued to any real estate salesman for the same period of time. The commission shall, at its discretion, issue a new license to said salesman upon the filing of an application for a transfer and the payment of a transfer fee of 1 dollar.

HISTORY: Am. 1921, p. 711, Act 387, Eff. Aug. 18;—C L 1929, 9815.

451.211 Same; fee; branch office fees; associate broker; suspension, expiration renewal, revocation.

Sec. 11. The fee for each original real estate broker's license shall be $20.00 and a renewal shall be $15.00. The fee for each branch office license shall be $10.00 and a renewal shall be $10.00. The fee for each original real estate salesman's license shall be $4.00 and a renewal shall be $3.00. Each real estate broker's license which may be granted to an individual shall entitle such individual to perform all of the acts contemplated by this act with respect to a real estate broker. Each real estate broker's license granted to

any firm, partnership association, copartnership or corporation consisting of more than 1 person shall entitle such real estate broker to designate which of its officers or members are active, who upon compliance with the terms of this act shall, upon the payment of a fee of $3.00 each, upon issuance of said broker's license, be entitled to perform all of the acts of a real estate broker contemplated by this act: Provided, That a broker's license granted to any firm, partnership association, copartnership or corporation shall not be transferable. The officers and members so designated, however, must make application for an associate broker's license, which application shall accompany the application of the real estate broker, and be filed with the commission at the same time as the application of the real estate broker for a license. Every active officer or member of a firm, partnership association, copartnership or corporation shall obtain an associate broker's license, as hereinbefore provided: Provided, That the license of any such officer or member who ceases to be connected with such firm, partnership association, copartnership or corporation shall be automatically suspended and shall also be automatically suspended upon the revocation of the broker's license of such firm, partnership association, copartnership or corporation: Provided further, That in case any such officer or member shall become connected with any firm, partnership association, copartnership or corporation, after the issuance of a broker's license thereto, he shall as a prerequisite to becoming an active officer or member secure an associate broker's license as hereinbefore provided. Every application for a license under the provisions of this act shall be accompanied by the license fee herein prescribed and every license shall expire on the 31st day of December 1943, and on the 31st day of December of every third year thereafter. In the absence of any reason or condition which might warrant the refusal of the granting of a license, the commission shall issue a new license for each ensuing 3 year term upon receipt of application and fee therefor. The revocation of a broker's license shall automatically suspend every real estate salesman's license granted to any person by virtue of his employment by the broker whose license has been revoked, pending a change of employer and the issuance of a new license. Such new license shall be issued without charge, if granted during the same 3 year term in which original license was granted.

HISTORY: C L 1929, 9816;—Am. 1937, p. 295, Act 188, Imd. Eff. July 14;—Am. 1939, p. 497, Act 268, Eff. Sept. 29;—Am. 1943, p. 63, Act 57, Eff. July 30;—Am. 1947, p. 662, Act 352, Eff. Oct. 11.

451.212 Unlawful commission.

Sec. 12. It shall be unlawful for any real estate salesman to accept a commission or valuable consideration for the performance of any of the acts herein specified from any person, except his employer who must be a licensed real estate broker.

HISTORY: Am. 1921, p. 711, Act 387, Eff. Aug. 18;—C L 1929, 9817;—Am. 1947, p. 662, Act 352, Eff. Oct. 11.

451.212a Lotteries, etc., unlawful; promotional sales; rules governing.

Sec. 12a. No plan or scheme involving lotteries, contests, games, prizes or drawings shall be used by any broker or salesman for the sale or promotion of sales of real estate.

Brokers who propose to engage in sales of a promotional nature in Michigan of property located outside of Michigan, must submit to the commission full particulars regarding such property and the proposed terms of sale, and they and their salesmen must comply with such rules, restrictions and conditions pertaining thereto as the commission may impose. All expenses incurred by the commission in investigating such property and the proposed sale thereof in Michigan, shall be borne by the broker. No broker or salesman shall in any manner refer to the Michigan corporation and securities commission, or to any officer or employee thereof, in selling, offering for sale, or advertising, or otherwise promoting the sale, mortgage or lease of any such property, nor make any representation whatsoever that such property has been inspected or approved or otherwise passed upon by said commission, or by any state official, department or employe.

HISTORY: Add. 1939, p. 498, Act 268, Eff. Sept. 29;—Am. 1943, p. 63, Act 57, Eff. July 30.

451.213 Suspension or revocation of license; investigation, grounds; civil or criminal liability.

Sec. 13. The commission may upon its own motion and shall upon the verified complaint in writing of any person, investigate the actions of any real estate broker or

real estate salesman or any person who shall assume to act in either such capacity within this state and shall have the power to suspend or revoke any license issued under the provisions of this act at any time where the licensee in performing or attempting to perform any of the acts mentioned herein, is deemed to be guilty of:

(a) Making any substantial misrepresentation, or

(b) Making any false promises of a character likely to influence, persuade or induce, or

(c) Pursuing a continued and flagrant course of misrepresentation or the making of false promises through agents or salesmen or advertising or otherwise, or

(d) Acting for more than 1 party in a transaction without the knowledge of all parties thereto, or

(e) Representing or attempting to represent a real estate broker other than the employer, without the express knowledge and consent of the employer, or

(f) Failure to account for or to remit for any moneys coming into his possession which belong to others, or

(g) Changing his business location without notification to the commission.

(h) Failure of a broker to return salesman's license within 5 days as provided in section 10.

(i) Paying a commission or valuable consideration to any person not licensed under the provisions of this act.

(j) Any other conduct whether of the same or a different character than hereinbefore specified, which constitutes dishonest or unfair dealing.

This act shall not be construed to relieve any person from civil liability or criminal prosecution under the general laws of this state.

HISTORY: Am. 1921, p. 711, Act 387, Eff. Aug. 18;—C L 1929, 9818;—Am. 1943, p. 64, Act 57, Eff. July 30;—Am. 1947, p. 663, Act 352, Eff. Oct. 11.

451.214 Same; hearing, notice; review of questions of law.

Sec. 14. The commission shall, before suspending or revoking any license and at least 10 days prior to the date set for the hearing, notify in writing the holder of such license of any charges made and shall afford said licensee an opportunity to be heard in person or by counsel in reference thereto. Such written notice may be served by delivery of the same personally to the licensee or by mailing same by registered mail to the last known business address of such licensee. If said licensee be a salesman, the commission shall also notify the broker employing him of the charges, by mailing notice by registered mail to the broker's last known business address. The hearing on such charges shall be at such time and place as the commission shall prescribe. The commission shall have the power to subpoena and bring before it any person in this state or to take the testimony of any such person by deposition in the same manner as prescribed by law in judicial procedure in courts of this state in civil cases, with the same fees and mileage as provided by law for criminal cases. If the commission shall determine that any licensee is guilty of a violation of any of the provisions of this act, said license shall be suspended or revoked. The findings of fact made by the commission, acting within its powers, shall in the absence of fraud be conclusive, but the supreme court shall have the power to review questions of law involved in any final decision or determination of the commission: Provided, That application is made by the aggrieved party within 30 days after such determination, by certiorari, mandamus or by any other method permissible under the rules and practice of said court or the laws of this state, and to make such further orders in respect thereto as justice may require.

HISTORY: Am. 1921, p. 712, Act 387, Eff. Aug. 18;—C L 1929, 9819.

451.215 Same; unlawful act of salesman or employe, effect on broker.

Sec. 15. Any unlawful act or violation of any of the provisions of this act upon the part of any real estate salesman, or employe, or of any officer or member of a licensed real estate broker, shall not be cause for the suspension or revocation of a license of any real estate broker, unless it shall appear to the satisfaction of the commission that the real estate broker had guilty knowledge thereof.

HISTORY: Am. 1921, p. 713, Act 387, Eff. Aug. 18;—C L 1929, 9820.

451.216 License of non-resident; consent to jurisdiction and service of process; manner of service.

Sec. 16. A non-resident of this state may become a real estate broker or a real estate salesman by conforming to all of the conditions of this paragraph and this act. Every non-resident applicant shall file an irrevocable consent that suits and actions may be commenced against such applicant in the proper court of any county of this state in which a cause of action may arise in which the plaintiff may reside, by the service of any process or pleading authorized by the laws of this state on the commissioner of the Michigan corporation and securities commission, said consent stipulating and agreeing that such service of such process or pleadings on said commissioner shall be taken and held in all courts to be as valid and binding as if due service had been made upon said applicant in the state of Michigan. Said instrument containing such consent shall be authenticated by the seal thereof, if a corporation, or by the acknowledged signature of a member or officer thereof, if otherwise. All such applications, except from individuals, shall be accompanied by the duly certified copy of the resolution of the proper officers or managing board authorizing the proper officer to execute same. In case any process or pleadings mentioned in this act are served upon the commissioner of the Michigan corporation and securities commission, it shall be by duplicate copies, 1 of which shall be filed in the office of the commission and the other immediately forwarded by registered mail to the main office of the applicant against which said process or pleadings are directed.

HISTORY: C L 1929, 9821;—Am. 1939, p. 498, Act 268, Eff. Sept. 29.

NON-RESIDENT: See Sec. 8, being Compilers' § 451.208, in connection with this section. Also see Sec. 9 et seq., being Compilers' § 451.209 et seq.

451.217 Same; lists of licenses; fee.

Sec. 17. The commission shall every third year, and may oftener in its discretion, furnish the prosecuting attorney and clerk of each county, and such other public officials as may be deemed proper, a list of all licenses in their respective counties under this act, together with any suspensions or revocations which have been ordered. These lists can be obtained by persons other than public officials upon the payment of $1.00.

HISTORY: Am. 1921, p. 713, Act 387, Eff. Aug. 18;—C L 1929, 9822;—Am. 1939, p. 499, Act 268, Eff. Sept. 29;—Am. 1943, p. 64, Act 57, Eff. July 30;—Am. 1947, p. 663, Act 352, Eff. Oct. 11.

Sec. 18. (This was a severing clause section.)

HISTORY: C L 1929, 9823;—Rep. 1945, p. 413, Act 267, Imd. Eff. May 25.

451.219 Penalty.

Sec. 19. Any person, firm, partnership, association, copartnership or corporation violating the provisions of this act shall upon conviction thereof, if a natural person, be for the first offense punished by a fine of not more than 100 dollars or imprisonment in the county jail not to exceed 90 days and for a second offense be punished by a fine of not to exceed 500 dollars, or imprisonment for a term not to exceed 2 years, or by both such fine and imprisonment in the discretion of the court. In all cases where the violator is other than a natural person the fine for the first offense shall be not more than 100 dollars, and for the second not more than 1,000 dollars.

HISTORY: Am. 1921, p. 713, Act 387, Eff. Aug. 18;—C L 1929, 9824.

Act 275, 1937, p. 496; Imd. Eff. July 22.

AN ACT to provide for the keeping of records of real estate bonds and other real estate securities, to require reports and other information relative to real estate bonds and other real estate securities in default, and the filing of such information with the public trust commission, and to provide for the giving of information relative to such defaulted obligations, by all persons, firms, associations or corporations acting as trustees, depositaries or fiscal agents or in any other capacity in which funds may be received for the retirement of real estate bonds, notes, debentures, certificates of participation, or other like real estate securities, or for the payment of interest thereon.

The People of the State of Michigan enact:

451.251 Records of real estate bonds and securities; duties of fiduciaries; report to public trust commission, contents; authority of commission.

Sec. 1. All persons, firms, associations or corporations acting as trustees or depositaries or fiscal agents or in any other capacity in which funds may be received for the

retirement of real esate bonds or other real estate securities, or for the payment of interest thereon, shall keep an accurate record of all transactions in connection therewith, which record shall be open to examination when bonds are in default by the public trust commission or its duly authorized representative or representatives, and, in case of a default in principal or interest payments upon any such obligation, shall make a report thereof to the said public trust commission, setting forth such information as it may have of the number and face value of the bonds or securities originally issued, the number and face value of the bonds or securities outstanding, the cash on hand for application thereon, the extent of default or deficiency in funds for retirement of principal and interest, the period of time for which such real estate bonds or securities were issued, a description of the lands which constitute the security for the payment of said obligations sufficient to identify the same, and, upon demand of the public trust commission, any other information pertinent to the default upon such obligations or the possibility of payment thereon, and shall also, upon demand of the public trust commission, furnish like and further information as and when the same may be required by the said public trust commission. The public trust commission is hereby given express authority to demand that any and all additional information necessary for the performance of its duties be included or given to supplement, at any time, any report required hereby. Upon receiving such demand the trustee, depositary or fiscal agent shall, within the time specified therein, furnish to the said public trust commission such of said requested information as may then be available to said trustee, depositary or fiscal agent. Every such report and such additional information shall be in writing and sworn to by the persons or by the owner or 1 of the owners, if a partnership or unincorporated association, or by any officer having knowledge of the facts if a corporation acting as trustee, depositary, fiscal agent or in any other capacity as above set forth.

151.252 Same; failure to file reports or give information, authority of attorney general, procedure, requirements for bringing action; taxable costs.

Sec. 2. Upon the failure or refusal of any person, firm, association or corporation to file reports or give information required by this act, the attorney general upon the relation of said public trust commission, may file a verified petition in the proper circuit court in chancery praying for the production of any and all records or other information relative to any such obligation in default and for permission to examine any person or persons in relation thereto, and the court may thereupon enter an order directing the production of any and all records, papers, documents or other information and the appearance of any person or persons to be examined on a day to be fixed by the court: Provided, however, That no action as herein provided shall be taken by the attorney general except upon request of said public trust commission and unless and until there shall have been deposited with said public trust commission an amount of money by the holder or holders of such obligations sufficient to meet all expenses in connection with such proceeding, the initiation of the proceeding and the amount of said deposit required to rest solely within the discretion of the attorney general and said public trust commission. The circuit court upon the conclusion of the hearing on such petition may tax the costs of said proceeding. Any and all proceedings by virtue of such petition, not otherwise prescribed herein, shall be in accordance with the usual chancery practice.

Act 89, 1933, p. 106; Imd. Eff. May 25.

AN ACT to prevent fraud, deception and imposition in the solicitation within the state of Michigan of the deposit of bonds, notes, debentures and other evidences of indebtedness under, and/or the consent of the holders or owners of such securities, to a protective committee agreement, and to prevent fraud, deception and imposition in the operations and activities of protective committees organized within the state of Michigan to act for and in behalf of the holders or owners of such securities, and for such purposes to create a commission to regulate and supervise the establishment and the operations of protective committees, depositaries under protective committee agreements, and solicitors for protective committee agreements; to authorize said commission to have supervision over defaulted bonds, notes, debentures, certificates of participation and similar evidences of indebtedness; to prescribe the powers and duties of such commission; to license mem-

bers or protective committees, depositaries under protective committee agreements and solicitors for protective committee agreements; to regulate and supervise and control the solicitation by anyone of bonds, notes, debentures and all other similar evidences of indebtedness, issued by the maker of any security for the purpose of procuring the modification and/or amendment and/or foreclosure of any instrument in writing securing any issue of bonds, notes, debentures and all other similar evidences of indebtedness; to authorize such commission to act as custodian or receiver and appoint custodians, agents and managers of defaulted mortgage property under orders of court or otherwise; to prescribe penalties for violation of this act; and to repeal Act No. 37 of the Public Acts of the first extra session of 1932.

The People of the State of Michigan enact:

Sec. 1.

HISTORY: Rep. 1943, p. 190, Act 149, Imd. Eff. April 14.
Title Am. 1935, p. 360, Act 218, Imd. Eff. June 8.
Section 1 provided for a public trust commission. Act 149, 1943, contained a section 3 as follows:
"Section 3. The powers and duties vested by law in the public trust commission by virtue of the provisions of this act and of Act No. 89 of the Public Acts of 1933 and the acts amendatory thereof and supplemental thereto and that conferred under and by virtue of the provisions of Act No. 205 of the Public Acts of 1933 and Act No. 218 of the Public Acts of 1935 and Act 212 of the Public Acts of 1937, are hereby transferred to and vested in and shall be exercised by, the Michigan corporation and securities commission. Immediately on the taking effect of this act the public trust commission, whose powers and duties are hereby transferred, shall cease to exist and shall be abolished and the tenure of the office of the members thereof shall be at once terminated, and whenever reference thereto is made in any law of the state, such reference shall be deemed to be intended to be made to the Michigan corporation and securities commission. All hearings, matters and proceedings of whatever nature now pending before the public trust commission shall not be terminated or abated but shall be transferred to the Michigan corporation and securities commission and shall be carried on in the same manner and subject to the same incidents as though such transfer were not made. All records, files and other papers belonging to the public trust commission under Act No. 89 of the Public Acts of 1933, as amended by Act No. 205 of the Public Acts of 1933, Act No. 218 of the Public Acts of 1935 and Act No. 212 of the Public Acts of 1937, the powers and duties of which are hereby transferred to the Michigan corporation and securities commission shall be turned over to said commission and shall be continued as part of the records and files thereof."

451.302 Definitions.

Sec. 2. Definitions as used in this act are as follows:

(a) The term "commission" means the public trust commission as hereinbefore created.

(b) The term "person" or "persons" shall include natural persons, corporations, partnerships, associations, companies, and syndicates.

(c) The term "security" or "securities" shall include bonds, notes, debentures, and any other instrument of like character used to evidence indebtedness.

(d) The term "protective committee" shall include all persons who propose or purport to act, or who are now acting, for and in behalf of others and/or themselves with respect to a security and/or for the purpose of protecting and preserving the common interests of the holders or owners of the particular security.

(e) The term "depositary" shall include all persons who propose to act, or who are now acting, in connection with a protective committee for the purpose of accepting securities for deposit under and/or consents to a protective committee agreement.

(f) The term "solicitor" shall include all persons who procure or solicit directly or indirectly, or who are now procuring or soliciting directly or indirectly the deposit of securities with a depositary under a protective committee agreement or similar instrument and/or who procure or solicit directly or indirectly, or who are now procuring or soliciting directly or indirectly, the consent of holders or owners of securities to a protective committee agreement or similar instrument.

451.303 Licenses of protective committees, depositaries and solicitors; applications, fees, hearing, bonds; inactive committee or depositary; inspection of names.

Sec. 3. It shall be unlawful for any person to act as a member of a protective committee, as a depositary or as a solicitor in this state for the purpose of procuring the modification and/or amendment and/or foreclosure of any instrument in writing securing any issue of bonds, notes, debentures and all other similar evidences of indebtedness without first procuring a license and continuing to be licensed therefor. Any person desiring a license either as a member of a protective committee, as a depositary, or as a solicitor shall apply therefor to the commission upon application forms to be furnished by

the commission. Such application shall, in the event that the applicant is a natural person, set forth the name, age, residence, business address, principal occupation and antecedent business experience of the applicant, the name of the security with respect to which the applicant desires to act, and such other facts as the commission shall require. In the event that the applicant is a non-natural person the application shall set forth such pertinent information as the commission may require including information and facts concerning the applicant's principal officers or members similar to those required of natural persons. The commission may require such further information as it shall deem necessary to satisfy it of the integrity and the financial responsibility of the applicant. Every application shall be under oath. An annual license fee of 5 cents for each 1,000 dollars par value of outstanding bonds or notes shall be charged each protective committee and each depositary, and an annual license fee of 25 dollars shall be charged each solicitor, for each issue, and these respective license fees shall accompany the application: Provided, however, That the commission, in its discretion, may provide that such respective license fees need not accompany the application, but the payment thereof may be deferred to such time as the commission shall designate. In case the payment of such respective license fees is deferred as above provided, such fees shall be a lien on the securities deposited. If the commission should conclude that a license should not issue, the application may be denied: Provided, That no order of denial shall be entered until the applicant has been given a hearing on the reasons for such denial. Any duly licensed member of a protective committee may act as a solicitor without procuring a license as such.

The commission may in its discretion require a sufficient bond to be filed by each of the members of the bondholder's committee. Such bonds shall be subject to the approval of the commission.

In case any protective committee or depositary which is in existence at the time this act shall take effect, shall fail to function, the commission, in its discretion, may grant to the protective committee or depositary whose application covering the same issue of securities has been granted under the provisions of this act, power to function as and in lieu of such inactive protective committee or depositary or the commission may designate a person or persons to act as a protective committee and/or the commission may designate a person or persons to act as a depositary under the provisions of this act, and/or the commission may designate a person or persons to act as conservator of the deposit agreement of the inactive protective committee and/or the deposited securities pledged or remaining or deposited under the emergency clause of this act. In all cases of inactive or delinquent protective committees or inactive or delinquent depositaries the commission shall have power to summon and compel such committees and/or depositaries to appear at a hearing before said commission, by giving 3 days notice to such inactive or delinquent committee and/or depositary. At such hearing, the commission shall take proofs and hear evidence as to the delinquency and/or inactivity complained of. In the event the commission shall decide that it is necessary for the safeguarding of the interests of the holders or owners of the particular security under control of delinquent and inactive committee and/or depositary it shall enter such order in the premises in accordance with its findings, and shall have power to compel the inactive or delinquent committee and/or depositary to surrender, deliver and yield up forthwith to the commission, or to any depositary nominated by said commission, all securities of every kind theretofore deposited with said inactive or delinquent committee or depositary whose license was revoked by this commission and make such other order and/or orders in the matter, as may be necessary or advisable in the judgment of the commission to safeguard and protect the interest of said security holders, and preserve any liens, attaching to such securities. The names and addresses of bondholders filed with the commission shall be open to the mortgagor, or successor to title of record upon proper application to the commission, but shall not be made public or subject to inspection by anyone not connected with the commission, except by order of the commission.

HISTORY: Am. 1933, p. 320, Act 205, Imd. Eff. June 28;—Am. 1935, p. 360, Act 218, Imd. Eff. June 8.

Act 205 of 1933 contained a section 2 reading as follows:

"Section 2. This act, being enacted to meet an emergency under the police power of the state, is hereby declared to be immediately necessary for the preservation of the public welfare, peace, health and safety."

451.304 Same; filing by non-resident applicants of consent to service of process.

Sec. 4. Every applicant for a license who is a non-resident of this state shall file with the application an irrevocable consent that suits and actions arising out of or founded upon any activity of such applicant in this state as a member of a protective committee, as depositary, or as solicitor, as the case may be, may be commenced against the applicant in the proper court of any county in the state in which the plaintiff may reside, or if the plaintiff is a non-resident, in Ingham county, by the service of any process authorized by the laws of this state on the chairman of the commission; said consent stipulating and agreeing that such service of any process on such chairman shall be taken and held in all courts to be as valid and binding as if due service had been made on the applicant personally. All process which shall be served upon said chairman in reliance upon the consent of an applicant shall be served in duplicate, 1 of which shall be retained in the office of the commission and the other forwarded by the commission forthwith by registered mail to the address of the person against whom said process is directed.

451.305 Same; suspension or revocation.

Sec. 5. The commission shall have the power to suspend or revoke licenses once issued for any practices on the part of the person licensed partaking of, or actually resulting in, fraud, deception or imposition upon the holders or owners of securities whether or not such holders or owners have deposited their securities and/or consented to a protective committee agreement, and also for activity in violation of the commission's orders or rulings or the provisions of this act, or in case of members of protective committees for failure to act expeditiously in the matter with respect to which they organized: Provided, That no order of suspension or revocation of license shall be entered until the person licensed has been given a hearing on the reasons for such suspension or revocation. Upon notice of revocation, it shall be the duty of the person licensed to return the license to the commission for cancellation.

451.306 Protective committees; statements, application to solicit security holders.

Sec. 6. Before any protective committee now in existence or hereafter formed, shall employ solicitors, or itself solicit, the deposit of securities with a depositary under a protective agreement and/or the consent of holders or owners of securities to a protective agreement, it shall file with the commission a statement under oath containing the following information:

(a) The amount of the particular security originally issued:

(b) The amount of the particular security outstanding at the date of the execution of the statement;

(c) The names and addresses of all persons known to or believed by the protective committee to be the holder or owner of the particular security and the amount of the particular security which such persons severally hold or own;

(d) A copy of the agreement or indenture, if any, under which the security was issued;

(e) The purpose and reasons for the organization and formation of the protective committee;

(f) A copy of the depository or protective agreement which the protective committee proposes to employ, and in the case of existing protective committees, a copy of the depository or protective agreement which the committee is now employing, in the procurement of the deposit of securities and/or the consent to a protective committee agreement of the holders or owners of securities;

(g) A complete list of the names and addresses of the members of the protective committee and an identification of its chairman and its secretary;

(h) The name and address of the person or persons who executed the security.

The foregoing statement shall, in the case of protective committees organized after the date this act goes into effect, be accompanied by an application for permission to solicit the holders or owners to make deposit of the particular security under, and/or to procure the consent of holders or owners to the proposed protective committee agreement, and no such solicitation shall be made unless and until the application is granted by the commission.

451.307 Solicitation of security holders; fraud, conditions, limitation of charges.

Sec. 7. The right to solicit the deposit of securities by, and/or the consent to a protective committee agreement of, the holders or owners of securities in this state by protective committees organized after this act goes into effect shall not be granted by the commission in any case where it appears to the commission that such solicitation of deposit and/or consent would work a fraud, deception, or damage on the holders or owners of said securities. The commission may impose such conditions as it may determine to be necessary to safeguard the holders or owners of the particular security and said commission may also supervise the terms and provisions of the depository or protective committee agreement and may limit the compensation of, and the charges to be made against a depositing and/or consenting holder or owner, by the protective committee, which compensation shall include all expenses of said protective committee, its agents, and attorneys.

451.308 Same; notice to issuer of security, objections, hearing.

Sec. 8. Before said commission shall authorize a protective committee which is organized after this act goes into effect to solicit, either through its members or its employes, the deposit of securities and/or the consent of holders or owners of securities, it shall cause notice to be served by registered mail upon the person or persons who executed said security, advising said person or persons that an application for permission to solicit the deposit of the particular security and/or the consent of the holders or owners to a protective committee agreement has been filed with said commission and that if there are any objections to the granting of such application written objections thereto shall be filed with the commission within 15 days from the date of the receipt of said notice. The commission is hereby authorized and empowered for good cause shown to extend the time within which such written objections may be filed.

In the event that no written objections are filed with said commission by the person or persons who executed said security within 15 days from the date of the receipt of the aforesaid notice or within such further time as the commission may allow, said commission shall proceed promptly to dispose of said application.

In the event, however, that written objections are filed within proper time as aforesaid, the commission shall promptly serve notice upon the chairman and secretary of the protective committee and upon the person or persons who filed the written objections that a hearing of the matter will be had before the commission at a time and place designated by the commission. At such hearing there may be presented to the commission such testimony and evidence as bears upon the question whether the solicitation of the deposit of securities and/or the consent of holders or owners to the protective committee agreement would work a fraud, deception, or damage on the holders or owners of said security. After said hearing, the commission shall proceed promptly to dispose of said application.

451.309 Same; records and reports.

Sec. 9. Every protective committee now in existence or hereafter to be formed shall keep a written record of its meetings, doings and activities and it shall file with the commission at least as often as once each month a written report under oath of its meetings, doings and activities for the period preceding the date of the report. The report shall set forth the minutes of its meetings, all data as to negotiations with or in behalf of the holders or owners of the security with respect to which the protective committee was organized; the names and addresses of persons who have deposited their security and/or consented to the protective committee agreement, the total amount of the security which has been deposited and/or with respect to which consent to the protective agreement has been obtained, and such other or further facts pertinent to its activity. Said commission may request any protective committee to supplement its reports from time to time with such information as the said commission may deem necessary or expedient.

451.310 Same; authority to take action.

Sec. 10. No protective committee, either now in existence or hereafter to be organized, shall take or authorize the taking of any action by suit or otherwise, against the property and/or business with respect to which a security was issued and/or against any person or persons liable or obligated in connection with said property or security, or consent to or

approve of any plan, agreement, sale or exchange with respect to such security and/or property, unless the authority so to do has been conferred upon the protective committee by the commission.

Any committee desiring to obtain such authority shall file with the commission an application therefor; which application shall set forth the proposed action, plan, agreement, sale or exchange. Thereupon the commission shall enter an order appointing a time and place for a hearing before the commission upon said application and upon the fairness of the terms and conditions of the proposed action, plan, agreement, sale or exchange, and providing for the giving of notice of said hearing, either by mail or by publication, or both, as the commission shall determine, to all holders or owners of said securities, and to all persons to whom it is proposed to issue securities in exchange for 1 or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash. Any interested party, including all persons to whom it is proposed to issue securities in such exchange, shall have the right to appear at said hearing and to be heard.

The commission shall have the authority to approve said application, if satisfied that said action, plan, agreement, sale or exchange will not work a fraud, deception or damage upon the holders or owners of the securities affected thereby. If it is proposed to issue any security in exchange for 1 or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, authority to make, consent to or approve of such exchange shall not be granted unless, after such hearing, the fairness of the terms and conditions of such exchange are approved by the commission.

HISTORY: Am. 1935, p. 362, Act 218, Imd. Eff. June 8;—Am. 1943, p. 189, Act 149, Imd. Eff. April 14.
See note concerning section 3 of Act 149 of 1943 preceding Compilers' § 451.302.

451.311 Public trust commission; investigations, audits and appraisals.

Sec. 11. The said commission is authorized and empowered to make investigations, audits, or appraisals relative to or in connection with the property and/or business located in this state with respect to which the security for the protection of which a protective committee has been organized. The said commission is authorized to act for and in behalf of the holders or owners of defaulted mortgage securities by acting as custodian, and is hereby authorized to appoint custodians of defaulted mortgage property and to have supervision of defaulted bonds, notes, debentures, and any other instruments of like character used to evidence indebtedness secured by mortgage. All books, records and documents of the commission whether filed with it or prepared by it shall be open to the public.

HISTORY: Am. 1935, p. 362, Act 218, Imd. Eff. June 8.

451.312 Same; subpoenas, oaths, records.

Sec. 12. The said commission is authorized and empowered to issue subpoenas to compel the attendance of witnesses and to compel the production of books, records and documents in connection with any investigation, hearing, or other matter pending before the board, to issue process to compel such attendance and production. Each member shall be authorized to swear witnesses and administer oaths in any matter coming before him or the commission. The commission shall keep records of its hearings, meetings and other activities. Any witness who refuses to obey a subpoena or who refuses to be sworn or testify, or who fails to produce any papers, books or documents touching any matter under investigation, or any witness, party or attorney who is guilty of any contempt while in attendance at any hearing held under this act may be punished as for contempt of court; and for this purpose an application may be made to any circuit court within whose territorial jurisdiction the offense is committed, and for which purpose the court is hereby given jurisdiction.

451.313 Same; expense of investigations, audits and appraisals.

Sec. 13. Any person interested in any security in connection with which a protective committee is organized may request said commission to make an investigation, audit or appraisal and report with respect to the property and/or business to which such security pertains: Provided, however, That before any investigation, audit or appraisal and report shall be made by said commission upon such a request, such person so requesting shall when required by the commission, deposit with said commission such sum of money as

said commission shall believe necessary to meet the cost thereof. In the event that the money so deposited shall prove to be insufficient to defray the cost of said investigation, audit or appraisal and report, said commission may request further deposits as a condition of the continuance by it of its investigation, audit or appraisal and report. All money so deposited shall be deposited by said commission in the state treasury in a special fund and disbursements from said fund shall be upon the vouchers drawn by said commission and the warrant of the auditor general drawn on the state treasurer and such disbursements shall be for the purposes for which the money is paid. Any excess over and above the cost of such requested investigation, audit or appraisal and report shall be returned to the person who made the deposit.

Sec. 14.

HISTORY: Rep. 1943, p. 190, Act 149, Imd. Eff. April 14.
This section provided for a quorum of the commission.
See note concerning section 3 of Act 149 of 1943 preceding Compilers' § 451.302.

451.315 Same; suspension of orders.

Sec. 15. The commission may temporarily suspend any of its orders when it appears to such commission that the terms of an order have been or are about to be violated but no such suspension order shall be effective for longer than 10 days unless the commission shall within such time serve notice upon the persons affected of the reason therefor, and shall grant a hearing thereon at a date not more than 15 days from the date of the suspension order. After such hearing the commission may either withdraw its suspension order or make the order of suspension a permanent order of revocation in accordance with the evidence.

451.316 Action in circuit court by aggrieved parties.

Sec. 16. Any person aggrieved by any order or action of the commission may apply to the circuit court of which such person is a resident or to the circuit court for Ingham county for any relief to which said person shall deem himself entitled, and in said suit the members of said commission shall be named as defendant and process may be served on the commission by serving any member thereof: Provided, That no injunction or other order shall issue suspending or staying any order or decree of said commission except after due notice to the commission and a reasonable opportunity for hearing thereon.

451.317 Fiduciary relation to security holders; reports of purchases.

Sec. 17. All mortgagors and all persons who are depositaries, solicitors, and members of protective committees shall be deemed to be in a fiduciary relationship to the holders or owners of the securities with respect to which they are mortgagors, depositaries, solicitors, and members of protective committees, respectively, whether or not such holders or owners have deposited their securities and/or consented to the protective committee agreement; and every purchase by a mortgagor, depositary, solicitor or member of a protective committee of securities with respect to which such purchaser is the mortgagor, depositary, solicitor or member of a protective committee, respectively, shall be forthwith disclosed in writing to the commission by such purchaser.

HISTORY: Am. 1937, p. 339, Act 212, Imd. Eff. July 21.

451.318 Construction of act; severing clause.

Sec. 18. The provisions of this act shall be liberally construed to the end that the purposes thereof may be accomplished by preventing fraud, deception and damage on holders or owners of securities. Should any section or clause of this act be declared invalid by any court of last resort having jurisdiction in the premises, then such decision shall affect only the section or clause so declared to be invalid and shall not affect any other section or clause of this act.

451.318a Bonds excepted from act; securities exempted from blue sky law and mortgage tax act.

Sec. 18a. The provisions of this act shall not be construed to apply to the bonds and other obligations issued by the United States government, by any state of the United States, or by any political subdivision thereof, or by any assessment district.

The exchange of securities for other securities, when such exchange has been approved

by the commission, shall be exempt from the provisions of Act No. 220 of the Public Acts of 1923, as amended, and Act No. 91 of the Public Acts of 1911.

HISTORY: Add. 1933, p. 321, Act 205, Imd. Eff. June 28.
Act 205 of 1933 contained a section 2 reading as follows:
"Section 2. This act, being enacted to meet an emergency under the police power of the state, is hereby declared to be immediately necessary for the preservation of the public welfare, peace, health and safety."

451.319 Penalty.

Sec. 19. Any person violating any of the provisions of sections 3, 5, 6, 9, 10 and 17 shall be punished by a fine of not less than 500 dollars nor more than 5,000 dollars, together with costs of prosecution, or by imprisonment in the Michigan reformatory at Ionia, state prison or other penal institutions for not less than 6 months nor more than 2 years, or both such fine and imprisonment in the discretion of the court. The term "person" as is used in this section shall include an officer or employe of a corporation or a member or employe of a partnership who as such officer, employe or member is under duty to perform the act in respect to which the violation occurred.

Sec. 20. (This was a repeal section.)

HISTORY: Rep. 1945, p. 408, Act 267, Imd. Eff. May 25.
ACT REPEALED: Act 37, 1st Ex. Ses., 1932.

The following trust mortgage bond act is inserted for information only, having expired March 1, 1935.

Act 114, 1933, p. 156, Imd. Eff. June 10, 1933.

AN ACT to declare an emergency and set forth the conditions constituting such emergency, and to provide ways and means to conserve the value of certain bonds; to provide for the extension of time for the payment of the principal and interest thereof, and for the ratification of change of the manner, time, or amount of sinking fund payments or other payments upon bonds secured by deed of trust, trust indenture or trust mortgage upon real estate, or real estate and other property situated in this state.

The People of the State of Michigan enact:

Section 1. That by reason of the acute financial and economic condition which has arisen and now exists in the State of Michigan, the welfare, peace, health and safety of the public, the soundness and financial integrity of banks, trust companies, and financial institutions doing business in this state, insofar as the collateral value of trust mortgage bonds is concerned, and the credit structure of the state of Michigan, and communities therein, and the carrying on of business is endangered, whereby in the judgment of the legislature a public emergency has arisen and now exists. In order to protect the public welfare, peace, health and safety, said credit structures, banks, trust companies, financial institutions, and the business carried on by them, insofar as the collateral value of trust mortgage bonds is concerned and to conserve, safeguard, and protect depositors therein, and assets in the possession or control of said banks, trust companies and financial institutions, it is hereby declared necessary to provide ways and means to conserve the value of such bonds. For such purposes the police power of the state is hereby invoked.

Sec. 2. As used in this act:

The term "trust mortgage" means any trust mortgage, trust indenture or deed of trust given to secure bonds or other obligations issued and authenticated as herein set forth. The term "trust indenture" means an agreement to be filed with a trustee.

The term "trustee" means the trustee or trustees of any such "trust mortgage."

The term "bonds" means bonds or other obligations outstanding and secured by any such "trust mortgage."

Sec. 3. Whenever 51 per cent. of all holders and the holders of more than 4/5 in amount of all bonds secured by a trust indenture, deed of trust or trust mortgage upon real estate, or leaseholds, or upon real estate and other property, situated in this state, shall hereafter agree with the grantor or mortgagor named in such deed of trust or trust mortgage, by instrument, or instruments, in writing, to extend the time for the payment of the principal of such bonds, or the interest thereon, or both principal and interest, or to modify or change the manner, time or amount of sinking fund payments, or other payments, provided for in such deed of trust or trust mortgage or bonds, the provisions of such agreement shall become binding upon the holders of all the outstanding bonds secured by such deed of trust or trust mortgage upon approval thereof, as provided in this act, by the trustee named in such deed of trust or trust mortgage: Provided, That at least 10 days before such agreement is presented to such trustee for approval, a copy thereof, together with a notice of the time when and place where such agreement will be presented to such trustee for approval, shall be sent by registered mail, with postage fully prepaid, by such grantor or mortgagor, to each of the holders of such bonds as shall not have assented to such agreement, and as shall be known to said grantor or mortgagor, at the last known post office address of such holder, if such grantor or mortgagor has knowledge of such last known address, and that a copy of such agreement and notice shall also be published at least once in a newspaper printed and circulating in the county in which the real estate covered by such deed of trust or trust mortgage is situated at least 10 days before such agreement is presented to such trustee for approval. If there is no such newspaper in such county such publication may be made in any newspaper in the state circulating in such county. Proof of such mailing and publication shall be made by affidavit which shall be annexed to the amendment to such trust deed or trust mortgage provided for in this act. It shall not be necessary to publish in such copy of said agreement the signatures thereto or the names of the persons, firms or corporations who have signed the same. Such trustee may approve such agreement at any time within 15 days after the time specified in such notice for the presentment thereof for approval: Provided, That at any time during such 15 day period the holder or holders of such bonds as shall not have assented to such agreement may apply to a court of chancery in the county in which the real estate covered by such deed of trust or trust mortgage is situated and have a determination made of his or their claims therein, and the court in its discretion may make such order or decree in the premises as shall be fair and equitable under all the circumstances of the case: And provided further, That the provisions of such agreement shall thereafter apply to all bonds alike, without preference of one over another. Any bondholder who fails to make application as herein provided shall be presumed to assent to the provisions of said agreement.

Sec. 4. An amendment to such trust deed or trust mortgage embracing the terms of such agreement shall hereafter be executed by the grantor or mortgagor and the trustee named in the original trust deed, or trust mortgage, or his, its or their successors, which amendment, shall be recorded in the office of the register of deeds of the county where such real estate is situated, in the same manner as mortgages upon real estate may be recorded, and when so recorded the same shall thereafter constitute notice to all persons of the contents of such amendment.

Sec. 5. This act shall be applicable to all bonds, secured as provided in section 3 of this act, heretofore issued as well as those which may be issued hereafter.

Sec. 6. From and after the first day of March, 1935, this act shall cease to be in force: Provided, That any action taken under the provisions of this act, shall be in force and effect until maturity of various issues.

Sec. 7. (This was a severing clause section.)

said commission shall believe necessary to meet the cost thereof. In the event that the money so deposited shall prove to be insufficient to defray the cost of said investigation, audit or appraisal and report, said commission may request further deposits as a condition of the continuance by it of its investigation, audit or appraisal and report. All money so deposited shall be deposited by said commission in the state treasury in a special fund and disbursements from said fund shall be upon the vouchers drawn by said commission and the warrant of the auditor general drawn on the state treasurer and such disbursements shall be for the purposes for which the money is paid. Any excess over and above the cost of such requested investigation, audit or appraisal and report shall be returned to the person who made the deposit.

Sec. 14.

HISTORY: Rep. 1943, p. 190, Act 149, Imd. Eff. April 14.
This section provided for a quorum of the commission.
See note concerning section 3 of Act 149 of 1943 preceding Compilers' § 451.302.

451.315 Same; suspension of orders.

Sec. 15. The commission may temporarily suspend any of its orders when it appears to such commission that the terms of an order have been or are about to be violated but no such suspension order shall be effective for longer than 10 days unless the commission shall within such time serve notice upon the persons affected of the reason therefor, and shall grant a hearing thereon at a date not more than 15 days from the date of the suspension order. After such hearing the commission may either withdraw its suspension order or make the order of suspension a permanent order of revocation in accordance with the evidence.

451.316 Action in circuit court by aggrieved parties.

Sec. 16. Any person aggrieved by any order or action of the commission may apply to the circuit court of which such person is a resident or to the circuit court for Ingham county for any relief to which said person shall deem himself entitled, and in said suit the members of said commission shall be named as defendant and process may be served on the commission by serving any member thereof: Provided, That no injunction or other order shall issue suspending or staying any order or decree of said commission except after due notice to the commission and a reasonable opportunity for hearing thereon.

451.317 Fiduciary relation to security holders; reports of purchases.

Sec. 17. All mortgagors and all persons who are depositaries, solicitors, and members of protective committees shall be deemed to be in a fiduciary relationship to the holders or owners of the securities with respect to which they are mortgagors, depositaries, solicitors, and members of protective committees, respectively, whether or not such holders or owners have deposited their securities and/or consented to the protective committee agreement; and every purchase by a mortgagor, depositary, solicitor or member of a protective committee of securities with respect to which such purchaser is the mortgagor, depositary, solicitor or member of a protective committee, respectively, shall be forthwith disclosed in writing to the commission by such purchaser.

HISTORY: Am. 1937, p. 339, Act 212, Imd. Eff. July 21.

451.318 Construction of act; severing clause.

Sec. 18. The provisions of this act shall be liberally construed to the end that the purposes thereof may be accomplished by preventing fraud, deception and damage on holders or owners of securities. Should any section or clause of this act be declared invalid by any court of last resort having jurisdiction in the premises, then such decision shall affect only the section or clause so declared to be invalid and shall not affect any other section or clause of this act.

451.318a Bonds excepted from act; securities exempted from blue sky law and mortgage tax act.

Sec. 18a. The provisions of this act shall not be construed to apply to the bonds and other obligations issued by the United States government, by any state of the United States, or by any political subdivision thereof, or by any assessment district.

The exchange of securities for other securities, when such exchange has been approved

by the commission, shall be exempt from the provisions of Act No. 220 of the Public Acts of 1923, as amended, and Act No. 91 of the Public Acts of 1911.

HISTORY: Add. 1933, p. 321, Act 205, Imd. Eff. June 28.
Act 205 of 1933 contained a section 2 reading as follows:
"Section 2. This act, being enacted to meet an emergency under the police power of the state, is hereby declared to be immediately necessary for the preservation of the public welfare, peace, health and safety."

451.319 Penalty.

Sec. 19. Any person violating any of the provisions of sections 3, 5, 6, 9, 10 and 17 shall be punished by a fine of not less than 500 dollars nor more than 5,000 dollars, together with costs of prosecution, or by imprisonment in the Michigan reformatory at Ionia, state prison or other penal institutions for not less than 6 months nor more than 2 years, or both such fine and imprisonment in the discretion of the court. The term "person" as is used in this section shall include an officer or employe of a corporation or a member or employe of a partnership who as such officer, employe or member is under duty to perform the act in respect to which the violation occurred.

Sec. 20. (This was a repeal section.)

HISTORY: Rep. 1945, p. 408, Act 267, Imd. Eff. May 25.
ACT REPEALED: Act 37, 1st Ex. Ses., 1932.

The following trust mortgage bond act is inserted for information only, having expired March 1, 1935.

Act 114, 1933, p. 156, Imd. Eff. June 10, 1933.

AN ACT to declare an emergency and set forth the conditions constituting such emergency, and to provide ways and means to conserve the value of certain bonds; to provide for the extension of time for the payment of the principal and interest thereof, and for the modification of change of the manner, time, or amount of sinking fund payments or other payments upon bonds secured by deed of trust, trust indenture or trust mortgage upon real estate, or real estate and other property situated in this state.

The People of the State of Michigan enact:

Section 1. That by reason of the acute financial and economic condition which has arisen and now exists in the State of Michigan, the welfare, peace, health and safety of the public, the soundness and financial integrity of banks, trust companies, and financial institutions doing business in this state, insofar as the collateral value of trust mortgage bonds is concerned, and the credit structure of the state of Michigan, and communities therein, and the carrying on of business is endangered, whereby in the judgment of the legislature a public emergency has arisen and now exists. In order to protect the public welfare, peace, health and safety, said credit structures, banks, trust companies, financial institutions, and the business carried on by them, insofar as the collateral value of trust mortgage bonds is concerned and to conserve, safeguard, and protect depositors therein, and assets in the possession or control of said banks, trust companies and financial institutions, it is hereby declared necessary to provide ways and means to conserve the value of such bonds. For such purposes the police power of the state is hereby invoked.

Sec. 2. As used in this act:

The term "trust mortgage" means any trust mortgage, trust indenture or deed of trust given to secure bonds or other obligations issued and authenticated as herein set forth. The term "trust indenture" means an agreement to be filed with a trustee.

The term "trustee" means the trustee or trustees of any such "trust mortgage."

The term "bonds" means bonds or other obligations outstanding and secured by any such "trust mortgage."

Sec. 3. Whenever 51 per cent. of all holders and the holders of more than 4/5 in amount of all bonds secured by a trust indenture, deed of trust or trust mortgage upon real estate, or leaseholds, or upon real estate and other property, situated in this state, shall hereafter agree with the grantor or mortgagor named in such deed of trust or trust mortgage, by instrument, or instruments, in writing, to extend the time for the payment of the principal of such bonds, or the interest thereon, or both principal and interest, or to modify or change the manner, time or amount of sinking fund payments, or other payments, provided for in such deed of trust or trust mortgage or bonds, the provisions of such agreement shall become binding upon the holders of all the outstanding bonds secured by such deed of trust or trust mortgage upon approval thereof, as provided in this act, by the trustee named in such deed of trust or trust mortgage: Provided, That at least 10 days before such agreement is presented to such trustee for approval, a copy thereof, together with a notice of the time when and place where such agreement will be presented to such trustee for approval, shall be sent by registered mail, with postage fully prepaid, by such grantor or mortgagor, to each of the holders of such bonds as shall not have assented to such agreement, and as shall be known to said grantor or mortgagor, at the last known post office address of such holder, if such grantor or mortgagor has knowledge of such last known address, and that a copy of such agreement and notice shall also be published at least once in a newspaper printed and circulating in the county in which the real estate covered by such deed of trust or trust mortgage is situated at least 10 days before such agreement is presented to such trustee for approval. If there is no such newspaper in such county such publication may be made in any newspaper in the state circulating in such county. Proof of such mailing and publication shall be made by affidavit which shall be annexed to the amendment to such trust deed or trust mortgage provided for in this act. It shall not be necessary to publish in such copy of said agreement the signatures thereto or the names of the persons, firms or corporations who have signed the same. Such trustee may approve such agreement at any time within 15 days after the time specified in such notice for the presentment thereof for approval: Provided, That at any time during such 15 day period the holder or holders of such bonds as shall not have assented to such agreement may apply to a court of chancery in the county in which the real estate covered by such deed of trust or trust mortgage is situated and have a determination made of his or their claims therein, and the court in its discretion may make such order or decree in the premises as shall be fair and equitable under all the circumstances of the case: And provided further, That the provisions of such agreement shall thereafter apply to all bonds alike, without preference of one over another. Any bondholder who fails to make application as herein provided shall be presumed to assent to the provisions of said agreement.

Sec. 4. An amendment to such trust deed or trust mortgage embracing the terms of such agreement shall hereafter be executed by the grantor or mortgagor and the trustee named in the original trust deed, or trust mortgage, or his, its or their successors, which amendment, shall be recorded in the office of the register of deeds of the county where such real estate is situated, in the same manner as mortgages upon real estate may be recorded, and when so recorded the same shall thereafter constitute notice to all persons of the contents of such amendment.

Sec. 5. This act shall be applicable to all bonds, secured as provided in section 3 of this act, heretofore issued as well as those which may be issued hereafter.

Sec. 6. From and after the first day of March, 1935, this act shall cease to be in force: Provided, That any action taken under the provisions of this act, shall be in force and effect until maturity of various issues.

Sec. 7. (This was a severing clause section.)

Act 208, 1933, p. 324; Imd. Eff. June 29.

AN ACT declaring that a public emergency exists in regard to the owners and holders of trust mortgages and bonds; to create the state bondholders committee and to provide for the powers and duties thereof; to require state banks and trust companies to turn over real estate trust mortgage bonds to this committee; to determine the amount of such bonds to be charged off by state banks and trust companies each year; to provide for the payment of salaries and expenses of members, officers and assistants; to provide for the operation and management of properties covered by trust mortgage bonds; to provide for appeals from the rulings of the committee; to provide penalties for violation of this act and to repeal all acts and parts of acts inconsistent herewith.

The People of the State of Michigan enact:

451.351 Declaration of public emergency as to property subject to trust mortgages.

Sec. 1. Whereas, the state of Michigan is now going through an acute financial crisis, making it necessary for this state to use its police power to protect the interests of its citizens and that 1 of the problems involving millions of dollars is the need to protect the interests of mortgagees and trust mortgage bondholders and to protect the interests of the state in mortgaged property with regard to taxes. It is hereby declared that a public emergency exists and this legislature, acting under its police power and for the purpose of protecting the properties involved, the tax revenue of the state and the investments of its citizens, declares that it is necessary to establish and maintain governmental control over said properties.

451.352 State bondholders committee; membership, powers.

Sec. 2. The state bondholders committee shall consist of the 3 members of the public trust commission and the state banking commissioner, at no additional salary, to take immediate action for the protection and preservation of the interests of the state and the interests of mortgagees and trust mortgage bondholders on such mortgaged or bonded property as now or hereafter may be in default in the payment of taxes, interest or principal or otherwise and in which there is involved a trust mortgage or a deed of trust or any mortgage in which there was appointed at the date of execution a trustee or in which the mortgagee or other person or corporation has since become a trustee by virtue of the terms of such instrument or by operation of law.

451.353 Same; secretary, assistants, office.

Sec. 3. State bondholders committee shall appoint a secretary and such other assistants as they may deem necessary, said secretary and assistants to receive not more than 3,000 dollars per year. State administrative board shall provide the state bondholders committee with office space and with suitable furniture.

451.354 Same; appointment of assistant attorney general.

Sec. 4. The attorney general shall appoint 1 or more assistant attorney generals specially experienced in real estate problems, to act under and for the state bondholders committee. These attorneys to spend their full time on this work and to receive not more than the regular salaries paid to assistant attorney generals.

451.355 Same; jurisdiction after default.

Sec. 5. The state bondholders committee shall have jurisdiction after any default has occurred in the payment of principal, interest or taxes and when it shall deem it necessary for the protection of the owners of an equitable interest in any mortgaged property located in the state of Michigan involved in a trust mortgage or a deed of trust or in which mortgage there was appointed at the date of execution of the mortgage a trustee or in which the mortgagee or other person or corporation has since become a trustee by virtue of the terms of such instrument or by operation of law to take over the management and complete control of such properties for the purpose of either managing the property,

collecting the income and rents therefrom, and performing the duties of the trustee or foreclosing or preserving and protecting the interests of the state and the interests of the bondholders or mortgagees.

451.356 Same; powers, rules and regulations, control of properties.

Sec. 6. The committee shall have full authority to take such action as it may deem necessary for the protection of all interests concerned to the end that it may act by and for the depositing bondholders or mortgagees and by and for the dissenting and non-depositing bondholders or mortgagees when necessary. It shall have full authority to negotiate with the owners for additional security, manage the property, collect all rents, profits, and income, and pay interest, principal, taxes and other necessary charges incurred in operating any property. Adequate notice and opportunity to be heard shall be given to all parties in all cases under such rules as shall be formulated by the committee. The committee shall have full authority to pass such further rules and regulations as it may deem necessary for the accomplishment of its purpose. It may turn properties over to any agency, corporate or otherwise, to manage and control, if necessary, for the protection of the mortgagees or bondholders.

451.357 Same; appeal to circuit court, time.

Sec. 7. An appeal may be taken from all final decisions of this committee on questions of law by proper remedy to the circuit court for the county in which the property involved lies: Provided, however, That the appeal shall be taken within 20 days from the date of the filing by the committee of the decision complained of or the right to appeal shall be deemed to have been waived. The appeal shall in other ways conform to the Michigan court rules.

451.358 Same; control by public trust commission.

Sec. 8. This committee shall be directly under the control and responsible to the public trust commission.

451.359 Defaulted trust mortgage bonds held by banks and trust companies; surrender to committee.

Sec. 9. All banks and trust companies operating under the supervision of the state banking department and having on hand, at the time of enacting this act, any trust mortgage bonds which have been in default in the payment of either principal, interest or taxes, for a period of 90 days shall surrender these mortgaged bonds to the state bondholders committee within 10 days from receipt of notice to surrender from the committee, which may require said banks and trust companies so refusing to charge off said bonds.

451.360 Same; certificates, annual charge off.

Sec. 10. The state bondholders committee shall issue to the banks and trust companies turning in any bonds as aforesaid, their certificates in the face amount of the bonds deposited. The banks shall be entitled to carry these certificates on their books in lieu of the bonds charging off 25 per cent of face value at once and then charging off 15 per cent of the face value at the end of each year until refunded, paid or charged off.

451.361 Certificates to private bondholders or mortgagees.

Sec. 11. Private bondholders or mortgagees may turn in their bonds or evidence of indebtedness to the state bondholders committee and receive its certificate in lieu thereof.

451.362 Assessment for expenses, repayment.

Sec. 12. State bondholders committee shall charge a percentage on all collections sufficient to cover expenses. The committee may call for an assessment against each party depositing bonds with said committee in proportion to the amount of bonds deposited. If, at a later date, the committee has on hand available funds from collections, these assessments shall be repaid.

451.363 Declaration of necessity.

Sec. 13. It is further declared that this act is necessary for the protection of the public health, peace and safety.

Sec. 14. (This was a severing clause section.)

HISTORY: Rep. 1945, p. 414, Act 267, Imd. Eff. May 25.

451.365 Repeal, exception.

Sec. 15. All acts and parts of acts inconsistent with the provisions of this act are hereby expressly repealed except Act 89 of the Public Acts of 1933.

Act 210, 1933, p. 330; Imd. Eff. July 3.

AN ACT to provide for the acquisition, management and disposition, by the trustee or trustees as a trust under the jurisdiction of equity, of property mortgaged to such trustee or trustees to secure bonds or other obligations, where such acquisition is requested or assented to by the holders of a majority in amount of such bonds or obligations and no bid for the mortgaged property at public sale under decree of foreclosure was or is made or appears to be obtainable for a sum representing the fair and reasonable value of the interest in said property of all holders of such bonds or obligations; to provide for the concurrence or non-concurrence of such holders in said request and for the method, time and manner of payment to non-concurring holders of their pro rata share of the amount so bid by said trustee or trustees.

The People of the State of Michigan enact:

451.401 Definitions.

Sec. 1. As used in this act:

The term "trust mortgage" means any trust mortgage, trust indenture or deed of trust given to secure bonds or other obligations issued and authenticated as therein set forth.

The term "trustee" means the trustee or trustees of any such "trust mortgage."

The term "bonds" means bonds or other obligations outstanding and secured by any such "trust mortgage."

The term "request" as used in sections 2 and 3 of this act means the written request filed by the trustee or holders of bonds for authorization of the trustee to bid for and acquire the mortgaged property as provided in section 2 of this act.

The term "non-concurring holder or holders" means such holder or holders as shall have filed written refusal to concur in said "request."

451.402 Trust mortgage foreclosure; insufficient bid, request for trustee to bid.

Sec. 2. Upon filing in any circuit court in chancery a report of the proceedings had in relation to the sale under a decree of said court for the foreclosure of any trust mortgage given to a trustee to secure bonds issued and authenticated as therein set forth, if it shall appear from said report that no bid was made for the mortgaged property or if a bid therefor was made and it shall, in the manner hereinafter set forth, be made to appear to the court that the sum so bid does not represent the then fair and reasonable value of the interest of the holders of such bonds secured thereby, and, in either event, that no bid for a sum representing such fair and reasonable value of said interest appears to be obtainable, the court may authorize the trustee to bid for and acquire said mortgaged property as hereinafter set forth. Such authorization to bid for and acquire such property shall be made only upon written request therefor to said court by said trustee, or the holders of not less than a majority of the amount of such bonds then secured by said trust mortgage. The request by such holders may be executed by said holders in person, or by agent or attorney. Upon the filing of such request the court shall make an order requiring all interested persons to appear at a time to be designated in said order and show cause, if any, why the court should not authorize the trustee to bid for and acquire the mortgaged property as above provided. The trustee shall cause said order to be published in some newspaper designated by the court and printed in the county where such foreclosure proceedings are pending, and/or in such other newspaper as the court may direct, once in each week for 15 successive weeks prior to the return day of said order to show cause and shall mail or cause to be mailed a copy thereof to the mortgagor, to all other parties in said foreclosure proceedings and to each holder of said bonds secured by said mortgage insofar as the names of such holders are known to the trustee, at least 12 weeks prior to

the date specified in said order, such notice to be mailed in each instance to the last known postoffice address. Proof of such publication and of such mailing shall be filed in said proceedings on or before the return day of said order, and proof of mailing shall be sufficient if made by affidavit of the trustee, or by an agent, employee or representative of the trustee having knowledge of the facts, merely avering [averring] that a copy of said order was so mailed. Neither the validity nor the regularity of proceedings under this act shall be affected by the fact that any mortgagor, party, holder of said bonds or interested person may not have had actual notice of said order to show cause or by the fact that a copy of said order may not have been mailed to, or, for any other reason, may not have been received by such mortgagor, party, holder of said bonds or interested person. Any interested party shall have a right to be heard and may offer testimony upon the hearing on said order to show cause. On or before the return day of said order to show cause any holder of bonds secured by said trust mortgage may file in writing a refusal to concur in such request. An order authorizing but not requiring the trustee to bid for and acquire the mortgaged property for such sum as shall, in the judgment of the court, represent the fair and reasonable value of the interests therein of the holders of the bonds may be entered if, upon said hearing, the court shall find either that no bid was made for the property offered for sale under said decree or that the sums so bid therefor did not represent the fair and reasonable value of the interests of such holders in said property and that no bid for a sum representing such fair and reasonable value of such interest appears to be obtainable: Provided, however, That no such order shall be entered where the request has been made by the trustee unless the holders of not less than a majority of the amount of such bonds then outstanding shall, prior to the entry of said order, have joined in said request, by a writing filed in said proceedings executed by said holders in person or by agent or attorney. The trustee may make said bid in open court or may file said bid in writing in said proceedings within 30 days after the entry of said order. Such bid for and acquisition of said property by said trustee shall be for and on behalf of all holders of bonds secured by said trust mortgage who shall not, in the manner herein set forth, have filed in said proceedings their written refusal to concur in the request whereon said order to show cause was entered, according to respective pro rata interests, and every holder of said bonds shall be conclusively presumed to have assented to such acquisition of said property and to the use of such bonds of such holders therefor unless such holder shall have filed such refusal to concur. Any such acquisition by the trustee shall be subject to all rights of redemption of the mortgagor and other parties. The subsequent transfer of any bond in respect of which any request, assent or action under any provision of this act shall have been made, presumed or taken shall not affect such request, assent or action. To the extent of the net amount which would have been distributable on the bonds secured by said trust mortgage if such bid were fully paid in cash, the bid shall be satisfied by a pro rata credit deemed to have been made on each such bond. The court shall make provision in said order for payment to non-concurring holders of their pro rata share of the net amount to which each of said holders shall be entitled by reason of said bid and acquisition.

451.403 Same; payment to non-concurring holders.

Sec. 3. The court may in its discretion provide in said order that such payment to non-concurring holders may be made in installments, or otherwise deferred for a period of time if the amount so deferred shall not exceed 25 per cent of the net amount of the bid: Provided, however, That the full pro rata to be paid said non-concurring holders hereunder shall, in any event, be made within 18 months from the entry of said order. The sum so deferred shall bear interest at the rate borne by said bonds. No personal obligation for such deferred payment shall be imposed upon the trustee but such deferred payment shall be secured upon the right, title and interest acquired by the trustee as a result of such acquisition and shall be enforced as herein provided. If payment to said non-concurring holders shall not be made as provided in said order, the court may, upon application of any non-concurring holder to whom such payment shall not have been made, order the trustee to sell the property so purchased by the trustee, or such part thereof as may be

necessary, either at public or private sale after notice thereof shall have been given to all interested parties in such manner as the court shall direct, and out of the proceeds of said sale pay the sums due said non-concurring holders, the balance, if any, to belong to the beneficiaries of the trust hereafter provided for and to be held and dealt with by the trustee as the court shall direct.

451.404 Trustee, maintenance and operation of property; sale, accounting.

Sec. 4. Any property acquired by the trustee as aforesaid shall be managed and administered by the trustee under and in accordance with the rules and principles of law and equity pertaining to express trusts generally subject to the jurisdiction of said court to be exercised in said cause by proceedings subsequent to the decree therein. The trustee shall be allowed all proper expenses and disbursements and reasonable compensation to be approved by the court. The trustee shall have power and authority to repair, maintain, protect, preserve and operate or lease the property until such time as a sale or other disposal thereof shall be approved or directed. The trustee may borrow money for any of said purposes, to discharge prior liens, taxes, assessments or other incumbrances against said property or for any other purpose of the trust and may secure such money so borrowed by mortgage of said property or by pledge of the income thereof. Any such mortgage or pledge shall be superior to and binding on the interests of the beneficiaries of said trust. It shall be the duty of the trustee to negotiate and effect a sale or other disposal of the property and make distribution of the proceeds of such sale or disposal to the beneficiaries of the trust at the earliest time at which the same can be done without sacrifice of the fair and reasonable value of such property. Any sale, unless for cash, shall be upon such terms as the court may approve after notice shall have been given to all beneficiaries of the trust in such manner as the court shall direct. No operating contract which is for more than 2 years or borrowing of money, mortgage, sale or other disposal shall be made except by and with the approval and authorization of the court upon notice in such manner as the court shall direct to the beneficiaries of said trust. The court may provide such other terms and conditions of the trust and powers, duties and authority of the trustee, not inconsistent with the foregoing, as to the court shall be deemed to be to the interests of the beneficiaries of the trust as a whole. Upon the complete consummation of a sale or other disposition of all of the trust property the trustee shall render in writing a full and complete report and account of the administration of said trust and of the distribution of the assets, income and proceeds thereof upon which a hearing shall be had after such notice to the beneficiaries of the trust as the court shall direct. If any such trust shall continue for more than 1 year an account and report of the administration of such trust shall be rendered at such times as may be required by the court but at least annually and when any such report shall have been made the final account and report aforesaid shall be required to cover only from the date of the then last account and report.

451.405 Construction and application of act; severing clause.

Sec. 5. This act is intended to be remedial and to be liberally construed and to be supplemented by rule of court if necessary or expedient to the accomplishment or furtherance of the intents and purposes thereof. This act shall be applicable to and in all foreclosure proceedings of the nature aforesaid pending at the time of the coming into effect hereof in which the sale shall not then have been confirmed as well as to and in all such proceedings begun after the coming into effect hereof. If any provision hereof shall be found invalid or unenforceable the remaining provisions hereof shall not be affected thereby.

Exhibit 5

PUBLIC ACTS 1964 NO. 265

elected at the general election in November, 1964, for a term of 6 years and shall assume the duties of the office January 1, 1965.

This act is ordered to take immediate effect.
Approved June 3, 1964.

[No. 265.]

AN ACT to enact the uniform securities act relating to the issuance, offer, sale or purchase of securities; to prohibit fraudulent practices in relation thereto; to require the registration of broker-dealers, agents, investment advisers, and securities; to make uniform the law with reference thereto; and to repeal certain acts and parts of acts.

The People of the State of Michigan enact:

Part I

FRAUDULENT AND OTHER PROHIBITED PRACTICES

451.501 Uniform securities act; fraudulent and other prohibited practices. [M.S.A. 19.776(101)]

Sec. 101. It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:

(1) To employ any device, scheme or artifice to defraud.

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

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

451.502 Investment adviser, unlawful acts. [M.S.A. 19.776(102)]

Sec. 102. (a) It is unlawful for any person who receives any consideration from another person primarily for advising the other person as to the value of securities or their purchase or sale, whether through the issuance of analyses or reports or otherwise:

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

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

Same; contracts, contents, compensation, assignment.

(b) It is unlawful for any investment adviser to enter into, extend or renew any investment advisory contract unless it provides in writing:

(1) That the investment adviser shall not be compensated on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client;

(2) That no assignment of the contract may be made by the investment adviser without the consent of the other party to the contract; and

(3) That the investment adviser, if a partnership, shall notify the other party to the contract of any change in the membership of the partnership within a reasonable time after the change.

Clause (1) does not prohibit an investment advisory contract which provides for compensation based upon the total value of a fund averaged over a definite period, or as of definite dates or taken as of a definite date. "Assignment", as used in clause (2), includes any direct or indirect transfer or hypothecation of an investment advisory contract by the assignor or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; but, if the investment adviser is a partnership, no assignment of an investment advisory contract is considered to result from the death or withdrawal of a minority of the members of the investment adviser having only a

minority interest in the business of the investment adviser, or from the admission to the investment adviser of 1 or more members who, after admission, will be only a minority of the members and will have only a minority interest in the business.

Same; custody of securities or funds.

(c) It is unlawful for any investment adviser to take or have custody of any securities or funds of any client if:

(1) The administrator by rule prohibits custody; or

(2) In the absence of rule, the investment adviser fails to notify the administrator that he has or may have custody.

Part II

REGISTRATION OF BROKER-DEALERS, AGENTS AND INVESTMENT ADVISORS

451.601 Registration; broker-dealer, agent. [M.S.A. 19.776(201)]

Sec. 201. (a) It is unlawful for any person to transact business in this state as a broker-dealer or agent unless he is registered under this act.

Agent's registration, effectiveness, notice to administrator.

(b) It is unlawful for any broker-dealer or issuer to employ an agent unless the agent is registered. The registration of an agent is not effective during any period when he is not associated with a particular broker-dealer registered under this act or a particular issuer. When an agent begins or terminates a connection with a broker-dealer or issuer, or begins or terminates those activities which make him an agent, the agent as well as the broker-dealer or issuer shall promptly notify the administrator in writing on a form prescribed by it.

Investment adviser; registration; exemption, filing.

(c) It is unlawful for any person to transact business in this state as an investment adviser unless:

(1) He is so registered under this act;

(2) He is registered as a broker-dealer without the imposition of a condition under section 204 (b) (5);

(3) His only clients in this state are investment companies as defined in the investment company act of 1940 or insurance companies, banks or trust companies; or

(4) He is an investment adviser who is fully registered with the securities and exchange commission pursuant to the investment advisers act of 1940 and who at no time takes or has custody of any securities or funds of any client, provided that such federally registered investment adviser files with the administrator annually an exemption statement limited to identifying data consisting of name, address and evidence of currently effective full registration as an investment adviser under the investment advisers act of 1940.

Expiration of registration; renewal.

(d) Every registration expires 1 year from its effective date unless renewed. The administrator by rule or order may prepare an initial schedule for registration renewals so that subsequent renewals of registrations effective on the effective date of this act may be staggered by calendar months. For this purpose the administrator by rule or order may reduce the registration fee proportionately.

451.602 Same; application, contents, effectiveness. [M.S.A. 19.776(202)]

Sec. 202. (a) A broker-dealer, agent or investment adviser may obtain an initial or renewal registration by filing with the administrator an application together with a consent to service of process pursuant to section 414 (g). The application shall contain whatever information the administrator by rule requires concerning such matters as:

(1) The applicant's form and place of organization;

(2) The applicant's proposed method of doing business;

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

(4) Any injunction or administrative order or conviction of a misdemeanor or of a felony; and

(5) The applicant's financial condition and history.

The administrator may by rule or order require an applicant for initial registration to publish an announcement of the application in 1 or more specified newspapers published in this state. If no denial order is in effect and no proceeding is pending under section 204, registration becomes effective at noon of the thirtieth day after an application is filed. The administrator may by rule or order specify an earlier effective date, and it may by order defer the effective date until noon of the thirtieth day after the filing of any amendment.

Filing fees, additional office, successor.

(b) Every applicant for initial or renewal registration shall pay a filing fee of $100.00 in the case of a broker-dealer, $10.00 in the case of an agent, and $25.00 in the case of an investment adviser. A broker-dealer maintaining more than 1 office for the purpose of conducting his business within this state shall pay an additional filing fee of $50.00 for each additional office. Every applicant filing an application for registration of a successor pursuant to section 202 (c) shall pay a filing fee of $25.00 for the unexpired portion of the year.

Successor, application for registration.

(c) A registered broker-dealer or investment adviser may file an application for registration of a successor, whether or not the successor is then in existence, for the unexpired portion of the year. The administrator may grant or deny the application.

Minimum capital and capital-debt ratio.

(d) The administrator may by rule require a minimum capital for registered broker-dealers and investment advisers and prescribe a ratio between net capital and aggregate indebtedness.

Surety bonds or deposit; limitation of actions.

(e) The administrator may by rule require registered broker-dealers, agents and investment advisers to post surety bonds in amounts up to $100,000.00, and may determine their conditions. Any appropriate deposit of cash or securities shall be accepted in lieu of any bond so required. No bond may be required of any registrant whose net capital, which may be defined by rule, exceeds $100,000.00. Every bond shall provide for suit thereon by any person who has a cause of action under section 410 and, if the administrator by rule or order requires, by any person who has a cause of action not arising under this act. Every bond shall provide that no suit may be maintained to enforce any liability on the bond unless brought within 2 years after the sale or other act upon which it is based.

451.603 Accounts and records of broker-dealer and investment adviser. [M.S.A. 19.776(203)]

Sec. 203. (a) Every registered broker-dealer and investment adviser shall make and keep such accounts, correspondence, memoranda, papers, books and other records as the administrator by rule prescribes. All records so required shall be preserved for 3 years unless the administrator by rule prescribes otherwise for particular types of records.

Financial reports.

(b) Every registered broker-dealer and investment adviser shall file such financial reports as the administrator by rule prescribes.

Filed document, correction.

(c) If the information contained in any document filed with the administrator is or becomes inaccurate or incomplete in any material respect, the registrant shall promptly file a correcting amendment unless notification of the correction has been given under section 201 (b).

Examination of records, reciprocity with other administrators.

(d) All the records referred to in subsection (a) are subject at any time or from time to time to such reasonable periodic, special or other examinations by representatives of the administrator, within or without this state, as the administrator deems necessary or appropriate in the public interest or for the protection of investors. For the purpose of avoiding unnecessary duplication of examinations, the administrator, insofar as it deems it practicable in administering this subsection, may cooperate with the securities administrators of other states, the securities and exchange commission, and any national securities exchange or national securities association registered under the securities exchange act of 1934.

451.604 Registration; denial, suspension, revocation, grounds. [M.S.A. 19.776(204)]

Sec. 204. (a) The administrator may by order deny, suspend or revoke any registration if it finds:

(1) That the order is in the public interest, and

(2) That the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:

(A) Has filed an application for registration which as of its effective date, or as of any date after filing in the case of an order denying effectiveness, was incomplete in any material respect or contained any statement which was, in light of the circumstances under which it was made, false or misleading with respect to any material fact;

(B) Has violated or failed to comply with any provision of this act or a predecessor act or any rule or order under this act or a predecessor act;

(C) Has been convicted of any misdemeanor involving moral turpitude or any felony;

(D) Is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in or continuing any conduct or practice involving any aspect of the securities business;

(E) Is the subject of an order of the administrator denying, suspending or revoking registration as a broker-dealer, agent or investment adviser;

(F) Is the subject of an order entered by the securities administrator of any other state or by the securities and exchange commission denying or revoking registration as a broker-dealer, agent or investment adviser, or the substantial equivalent of those terms as defined in this act, or is the subject of an order of the securities and exchange commission suspending or expelling him from a national securities exchange or national securities association registered under the securities exchange act of 1934, or is the subject of a United States post office fraud order;

(G) Has engaged in dishonest or unethical business practices;

(H) Is insolvent, either in the sense that his liabilities exceed his assets or in the sense that he cannot meet his obligations as they mature; but the administrator may not enter an order against a broker-dealer or investment adviser under this clause without a finding of insolvency as to the broker-dealer or investment adviser; or

(I) Is not qualified on the basis of such factors as training, experience and knowledge of the securities business, except as otherwise provided in subsection (b).

The administrator may by order deny, suspend or revoke any registration if it finds (1) that the order is in the public interest and (2) that the applicant or registrant:

(J) Has failed reasonably to supervise his agents if he is a broker-dealer or his employees if he is an investment adviser; or

(K) Has failed to pay the proper filing fee; but the administrator may enter only a denial order under this clause, and it shall vacate any such order when the deficiency has been corrected.

Qualifications, governing rules; examination of applicants.

(b) The following provisions govern the application of section 204 (a) (2) (I):

(1) The administrator may not enter an order against a broker-dealer on the basis of the lack of qualification of any person other than (A) the broker-dealer himself if he is an individual or (B) an agent of the broker-dealer.

(2) The administrator may not enter an order against an investment adviser on the basis of the lack of qualification of any person other than (A) the investment adviser himself if he is an individual or (B) any other person who represents the investment adviser in doing any of the acts which make him an investment adviser.

(3) The administrator may not enter an order solely on the basis of lack of experience if the applicant or registrant is qualified by training or knowledge or both.

(4) The administrator shall consider that an agent who will work under the supervision of a registered 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 on the basis of experience as a broker-dealer or agent. When it finds that an applicant for initial or renewal registration as a broker-dealer is not qualified as an investment adviser, it may by order condition the applicant's registration as a broker-dealer upon his not transacting business in this state as an investment adviser.

(6) The administrator may by rule provide for an examination, which may be written or oral or both, to be taken by any class of or all applicants, as well as persons who represent or will represent an investment adviser in doing any of the acts which make him an investment adviser.

Summary postponement or suspension of registration, hearing, notice.

(c) The administrator may by order summarily postpone or suspend registration pending final determination of any proceeding under this section. Upon the entry of the order, the administrator shall promptly notify the applicant or registrant, as well as the employer or prospective employer if the applicant or registrant is an agent, that it has been entered and of the reasons therefor and that within 15 days after the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the administrator, the order will remain 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, may modify or vacate the order or extend it until final determination.

Cancellation of registration or application, grounds.

(d) If the administrator finds that any registrant or applicant for registration is no longer in existence or has ceased to do business as a broker-dealer, agent or investment adviser, or is subject to an adjudication of mental incompetence or to the control of a committee, conservator or guardian, or cannot be located after reasonable search, the administrator may by order cancel the registration or application.

Withdrawal of registration, effectiveness.

(e) Withdrawal from registration as a broker-dealer, agent or investment adviser becomes effective 30 days after receipt of an application to withdraw or within such shorter period of time as the administrator may determine, unless a revocation or suspension proceeding is pending when the application is filed or a proceeding to revoke or suspend or to impose conditions upon the withdrawal is instituted within 30 days after the application is

filed. If a proceeding is pending or instituted, withdrawal becomes effective at such time and upon such conditions as the administrator by order determines. If no proceeding is pending or instituted and withdrawal automatically becomes effective, the administrator may nevertheless institute a revocation or suspension proceeding under section 204 (a) (2) (B) within 1 year after withdrawal became effective and enter a revocation or suspension order as of the last date on which registration was effective.

Entry of orders; notice, hearing, written findings of fact and conclusions of law.

(f) No order may be entered under any part of this section except the first sentence of subsection (c) without:

(1) Appropriate prior notice to the applicant or registrant, as well as to the employer or prospective employer if the applicant or registrant is an agent;

(2) Opportunity for hearing; and

(3) Written findings of fact and conclusions of law.

Part III

REGISTRATION OF SECURITIES

451.701 Registration of securities; exemption. [M.S.A. 19.776(301)]

Sec. 301. It is unlawful for any person to offer or sell any security in this state unless (1) it is registered under this act or (2) the security or transaction is exempted under section 402.

451.702 Registration by notification. [M.S.A. 19.776(302)]

Sec. 302. (a) The following securities may be registered by notification, whether or not they are also eligible for registration by coordination under section 303:

(1) Any security whose issuer and any predecessors have been in continuous operation for at least 5 years if (A) there has been no default during the current fiscal year or within the 3 preceding fiscal years in the payment of principal, interest or dividends on any security of the issuer, or any predecessor, with a fixed maturity or a fixed interest or dividend provision, and (B) the issuer and any predecessors during the past 3 fiscal years have had average net earnings, determined in accordance with generally accepted accounting practices, (i) which are applicable to all securities without a fixed maturity or a fixed interest or dividend provision outstanding at the date the registration statement is filed and equal at least 5% of the amount of such outstanding securities, as measured by the maximum offering price or the market price on a day, selected by the registrant, within 30 days before the date of filing the registration statement, whichever is higher, or book value on a day, selected by the registrant, within 90 days of the date of filing the registration statement to the extent that there is neither a readily determinable market price nor a cash offering price, or (ii) which, if the issuer and any predecessors have not had any security of the type specified in clause (i) outstanding for 3 full fiscal years, equal at least 5% of the amount, as measured in clause (i), of all securities which will be outstanding if all the securities being offered or proposed to be offered, whether or not they are proposed to be registered or offered in this state, are issued.

(2) Any security, other than a certificate of interest or participation in an oil, gas or mining title or lease or in payments out of production under such a title or lease, registered for nonissuer distribution if (A) any security of the same class has ever been registered under this act or a predecessor act, or (B) the security being registered was originally issued pursuant to an exemption under this act or a predecessor act.

Registration statement; accompanying documents; consent to service of process.

(b) A registration statement under this section shall 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 414 (g):

(1) A statement demonstrating eligibility for registration by notification;

(2) With respect to the issuer and any significant subsidiary: its name, address and form of organization; the state, or foreign jurisdiction, and the date of its organization; and the general character and location of its business;

(3) With respect to any person on whose behalf any part of the offering is to be made in a nonissuer distribution: his name and address; the amount of securities of the issuer held by him as of the date of the filing of the registration statement; and a statement of his reasons for making the offering;

(4) A description of the security being registered;

(5) The information and documents specified in clauses (8), (10), (11) and (12) of section 304 (b); and

(6) In the case of any registration under section 302 (a) (2) which does not also satisfy the conditions of section 302 (a) (1), a balance sheet of the issuer as of a date within 4 months prior to the filing of the registration statement, and a summary of earnings for each of the 2 fiscal years preceding the date of the balance sheet and for any period between the close of the last fiscal year and the date of the balance sheet, or for the period of the issuer's and any predecessors' existence if less than 2 years.

Same; automatic effectiveness.

(c) If no stop order is in effect and no proceeding is pending under section 306, a registration statement under this section automatically becomes effective at 3 p.m., eastern standard time, on the twentieth full day after the filing of the registration statement or the last amendment, or at such earlier time as the administrator determines.

Same; copy to offeree.

(d) The administrator may by rule or order require as a condition of registration under this section that a copy of the registration statement filed under subsection (b) be given or sent to each person to whom an offer is made before or concurrently with such offer.

451.703 Registration by coordination. [M.S.A. 19.776(303)]

Sec. 303. (a) Any security for which a registration statement has been filed under the securities act of 1933 in connection with the same offering may be registered by coordination.

Registration statement; accompanying documents; consent to service of process.

(b) A registration statement under this section shall 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 414 (g):

(1) Three copies of the latest form of prospectus filed under the securities act of 1933;

(2) If the administrator by rule or otherwise requires, a copy of the articles of incorporation and bylaws, or their substantial equivalents, currently in effect, a copy of any agreements with or among underwriters, a copy of any indenture or other instrument governing the issuance of the security to be registered, and a specimen or copy of the security;

(3) If the administrator requests, any other information, or copies of any other documents, filed under the securities act of 1933; and

(4) An undertaking to forward all future amendments to the federal prospectus, other than an amendment which merely delays the effective date of the registration statement, promptly, and in any event not later than the first business day after the day they are forwarded to or filed with the securities and exchange commission, whichever first occurs.

Same; automatic effectiveness, conditions.

(c) A registration statement under this section automatically becomes effective at the moment the federal registration statement becomes effective if all 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 10 days.

(3) A statement of the maximum and minimum proposed offering prices and the maximum underwriting discounts and commissions has been on file for 2 full business days or such shorter period as the administrator permits by rule or otherwise and the offering is made within those limitations.

Federal registration statement, notice of effectiveness; stop order; waiver of conditions.

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. "Price amendment" means the final federal amendment 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. Upon failure to receive the required notification and post-effective amendment with respect to the price amendment, the administrator may enter a stop order, without notice or hearing, retroactively denying effectiveness to the registration statement or suspending its effectiveness until compliance with this subsection, if it promptly notifies the registrant by telephone or telegram, and promptly confirms by letter or telegram when it notifies by telephone, of the issuance of the order. If the registrant proves compliance with the requirements of this subsection as to notice and post-effective amendment, the stop order is void as of the time of its entry. The administrator may by rule or otherwise waive either or both of the conditions specified in clauses (2) and (3). If the federal registration statement becomes effective before all the conditions in this subsection are satisfied and they are not waived, the registration statement automatically becomes effective as soon as 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 it then contemplates the institution of a proceeding under section 306; but this advice by the administrator does not preclude the institution of such a proceeding at any time.

451.704 Registration by qualification. [M.S.A. 19.776(304)]

Sec. 304. (a) Any security may be registered by qualification.

Registration statement; accompanying documents; consent to service of process.

(b) A registration statement under this section shall 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 414 (g):

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

(2) With respect to every director and officer of the issuer, or person occupying a similar status or performing similar functions: his name, address and principal occupation for the past 5 years; the amount of securities of the issuer held by him as of a specified date within 30 days of the filing of the registration statement; the amount of the securities covered by the registration statement to which he has indicated his intention to subscribe; and a description of any material interest in any material transaction with the issuer or any significant subsidiary effected within the past 3 years or proposed to be effected.

(3) With respect to persons covered by clause (2): the remuneration paid during

the past 12 months and estimated to be paid during the next 12 months, directly or indirectly, by the issuer, together with all predecessors, parents, subsidiaries and affiliates, to all those persons in the aggregate.

(4) With respect to any person owning of record, or beneficially if known, 10% or more of the outstanding shares of any class of equity security of the issuer: the information specified in clause (2) other than his occupation.

(5) With respect to every promoter if the issuer was organized within the past 3 years: the information specified in clause (2), any amount paid to him within that period or intended to be paid to him, and the consideration for any such payment.

(6) With respect to any person on whose behalf any part of the offering is to be made in a nonissuer distribution: his name and address; the amount of securities of the issuer held by him as of the date of the filing of the registration statement; a description of any material interest in any material transaction with the issuer or any significant subsidiary effected within the past 3 years or proposed to be effected; and a statement of his 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, good will or anything else, for which the issuer or any subsidiary has issued any of its securities within the past 2 years or is obligated to issue any of 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 any proportion of the offering is to be made to any person or class of persons other than the underwriters, with a specification of any such person or class; the basis upon which the offering is to be made if otherwise than for cash; the estimated aggregate underwriting and selling discounts or commissions and finders' fees, including separately cash, securities, contracts, or anything else of value to accrue to the underwriters or finders in connection with the offering, or, if the selling discounts or commissioners 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 any such agreement whose terms have not yet been determined; and a description of the plan of distribution of any securities which are to be offered otherwise than through an underwriter.

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

(10) A description of any stock options or other security options outstanding, or to be created in connection with the offering, together with the amount of any such options held or to be held by every person required to be named in clause (2), (4), (5), (6) or (8) and by any person who holds or will hold 10% or more in the aggregate of any such options.

(11) The dates of, parties to, and general effect concisely stated of, every management or other material contract made or to be made otherwise 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 past 2 years, together with a copy of every such contract; and a description of any pending litigation or proceeding to which the issuer is

a party and which materially affects its business or assets, including any such litigation or proceeding known to be contemplated by governmental authorities.

(12) 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.

(13) A specimen or copy of the security being registered; a copy of the issuer's articles of incorporation and bylaws, or their substantial equivalents, as currently in effect; and a copy of any indenture or other instrument covering the security to be registered.

(14) 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 shall state whether the security when sold will be legally issued, fully paid and nonassessable, and, if a debt security, a binding obligation of the issuer.

(15) The written consent of any accountant, engineer, appraiser, or other person whose profession gives authority to a statement made by him, if any such 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.

(16) A balance sheet of the issuer as of a date within 4 months prior to the filing of the registration statement; a profit and loss statement and analysis of surplus for each of the 3 fiscal years preceding the date of the balance sheet and for any period between the close of the last fiscal year and the date of the balance sheet, or for the period of the issuer's and any predecessors' existence if less than 3 years; and, if any part of the proceeds of the offering is to be applied to the purchase of any business, the same financial statements which would be required if that business were the registrant.

(17) Such additional information as the administrator requires by rule or order.

Same; effectiveness.

(c) A registration statement under this section becomes effective when the administrator so orders.

Prospectus to offeree; supplementation.

(d) The administrator may by rule or order require as a condition of registration under this section that a prospectus be sent or given to each person to whom an offer is made. The administrator may by rule or order fix the requirements as to the use, content, revision and supplementation of the prospectus.

Report by accountant, engineer, appraiser, or other professional person; investigation by employee of administrator, deposit.

(e) The administrator may by rule or order require as a condition of registration under this section that a report by an accountant, engineer, appraiser or other professional person be filed and may require that the estimated cost of such report be deposited in advance by the applicant in an escrow account. The administrator may also designate an employee to make an investigation of the books, records and affairs of any applicant for registration by qualification and may require the estimated cost thereof to be deposited in advance by the applicant in an escrow account.

451.705 Registration statement, who may file. [M.S.A. 19.776(305)]

Sec. 305. (a) A registration statement may be filed by the issuer, any other person on whose behalf the offering is to be made, or a registered broker-dealer.

Same; filing fee; withdrawal.

(b) Every person filing a registration statement shall pay a filing fee of 1/10 of 1% of the maximum aggregate offering price at which the registered securities are to be offered in this state, but the fee shall in no case be less than $50.00 or more than $250.00. When a registration statement is withdrawn before the effective date or a pre-effective stop order is entered under section 306, the administrator shall retain $25.00 of the fee.

Same; matters specified.

(c) Every registration statement shall specify:

(1) The amount of securities to be offered in this state.

(2) The states in which a registration statement or similar document in connection with the offering has been or is to be filed.

(3) Any withdrawal or any adverse order, judgment or decree entered in connection with the offering by the regulatory authorities in each state or by any court or the securities and exchange commission.

Same; incorporation of documents by reference.

(d) Any document filed under this act or a predecessor act within 5 years preceding the filing of a registration statement may be incorporated by reference in the registration statement to the extent that the document is currently accurate.

Same; omissions permissible.

(e) The administrator may by rule or otherwise permit the omission of any item of information or document from any registration statement.

Escrow of securities or proceeds.

(f) The administrator may by rule or order require as a condition of registration by qualification or coordination:

(1) That any security issued or to be issued to a promoter for a consideration substantially different from the public offering price, or to any person for a consideration other than cash, be deposited in escrow; and

(2) That the proceeds from the sale of the registered security in this state be impounded until the issuer receives a specified amount from the sale of the security either in this state or elsewhere. The administrator may by rule or order determine the conditions of any escrow or impounding required hereunder, and, after prior notice and opportunity for hearing, may order the cancellation in whole or in part of any such security deposited in escrow where necessary for the protection of security holders. The administrator may not reject a depository solely because of location in another state.

Conditions of sale of security registered by qualification.

(g) The administrator may by rule or order impose conditions under which a security registered by qualification may be sold, if it finds that such conditions are reasonable and in the public interest.

Registration statement; duration of effectiveness; withdrawal.

(h) Every registration statement is effective for 1 year from its effective date, or any longer period during which the security is being offered or distributed in a nonexempted transaction by or for the account of the issuer or other person on whose behalf the offering is being made or by any underwriter or broker-dealer who is still offering part of an unsold allotment or subscription taken by him as a participant in the distribution, except during the time a stop order 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 (1) so long as the registration statement is effective and (2) between the thirtieth day after the entry of any stop order suspending or revoking the effectiveness of the registration statement under section 306, if the registration statement did not relate in whole or in part to a nonissuer distribution, and 1 year from the effective date of the registration statement. A registration statement may not be withdrawn for 1 year from its effective date if any securities of the same class are outstanding. A registration statement may be withdrawn otherwise only in the discretion of the administrator.

Same; reports during effectiveness.

(i) So long as a registration statement is effective, the administrator may by rule or order 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.

Same; face-amount certificates or certain redeemable securities; amendment to increase offering, effectiveness.

(j) A registration statement relating to a security issued by a face-amount certificate company or a redeemable security issued by an open-end management company or unit investment trust, as those terms are defined in the investment company act of 1940, may be amended after its effective date so as to increase the securities specified as proposed to be offered. Such an amendment becomes effective when the administrator so orders. Every person filing such an amendment shall pay a filing fee, calculated in the manner specified in subsection (b), with respect to the additional securities proposed to be offered.

451.706 Same; administrator's stop order denying, suspending, or revoking effectiveness; findings. [M.S.A. 19.776(306)]

Sec. 306. (a) The administrator may issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, any registration statement if it finds (1) that the order is in the public interest and (2) that:

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

(B) Any provision of this act or any rule, order or condition lawfully imposed under this act has been violated, in connection with the offering, by (i) the person filing the registration statement, (ii) the issuer, any partner, officer or director of the issuer, any person occupying a similar status or performing similar functions, or any 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 (iii) any underwriter;

(C) The security registered or sought to be registered is the subject of an administrative stop order or similar order or a permanent or temporary injunction of any court of competent jurisdiction entered under any other federal or state act applicable to the offering; but (i) the administrator may not institute a proceeding against an effective registration statement under clause (C) more than 1 year from the date of the order or injunction relied on, and (ii) it may not enter an order under clause (C) on the basis of an order or injunction entered under any other state act unless that order or injunction was based on facts which would currently constitute a ground for a stop order under this section;

(D) The issuer's enterprise or method of business includes or would include activities which are illegal where performed;

(E) The offering has worked or tended to work a fraud, deception or imposition or would so operate, or such offering is on unfair terms;

(F) 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; with respect to the sale of periodic payment plan certificates for the purchase of securities of investment companies registered under the investment company act of 1940 commissions up to 9% of the total payments to be made during the entire term of the plan, and deductions for such commissions from any of the first 12 monthly payments, or their equivalent, up to one-half thereof, shall be allowed.

(G) When a security is sought to be registered by notification, it is not eligible for such registration;

(H) When a security is sought to be registered by coordination, there has been a failure to comply with the undertaking required by section 303 (b) (4); or

(I) The applicant or registrant has failed to pay the proper filing fee; but the administrator may enter only a denial order under this clause and it shall vacate any such order when the deficiency has been corrected.

Same; summary postponement or suspension of effectiveness, notice, hearing.

(b) The administrator may by order summarily postpone or suspend the effectiveness of the registration statement pending final determination of any proceeding under this section. Upon the entry of the order, the administrator shall promptly notify each person specified in subsection (c) that it has been entered and of the reasons therefor and that within 15 days after the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the administrator, the order will remain 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 (c), may modify or vacate the order or extend it until final determination.

Same; stop order, notice, hearing, written findings of fact and conclusions of law.

(c) No stop order may be entered under any part of this section except the first sentence of subsection (b) without (1) appropriate prior notice to the applicant or registrant, the issuer, and the person on whose behalf the securities are to be or have been offered, (2) opportunity for hearing, and (3) written findings of fact and conclusions of law.

Same; vacation or modification of stop order.

(d) The administrator may vacate or modify a stop order if it finds that the conditions which prompted its entry have changed or that it is otherwise in the public interest to do so.

Part IV

GENERAL PROVISIONS, DEFINITIONS AND EXEMPTIONS

451.801 Definitions. [M.S.A. 19.776(401)]

Sec. 401. When used in this act, unless the context otherwise requires:

Administrator.

(a) "Administrator" means the Michigan corporation and securities commission, or any other agency authorized by law to enforce the provisions of this act.

Agent; nonincluded persons; exclusion by administrator.

(b) "Agent" means any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities. "Agent" does not include an individual who represents an issuer in (1) effecting transactions in a security exempted by clause (1), (2), (3), (9) or (10) of section 402 (a), (2) effecting transactions exempted by section 402 (b), or (3) effecting transactions with existing employees, partners or directors of the issuer or any of its subsidiaries if no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state. "Agent" does not include an officer of an issuer whose securities are registered under the provisions of this act, who represents the issuer in effecting transactions in such registered securities, if no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state. A partner, officer or director of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is an agent only if he otherwise comes within this definition. The administrator may by rule or order exclude other persons from the definition of the word "agent".

Broker-dealer; nonincluded persons.

(c) "Broker-dealer" means any person engaged in the business of effecting transactions in securities for the account of others or for his own account. "Broker-dealer" does not include (1) an agent, (2) an issuer, (3) a bank, savings institution or trust company, (4) a person who has no place of business in this state if (A) he effects transactions in this state exclusively with or through (i) the issuers of the securities involved in the transactions, (ii) other broker-dealers, or (iii) banks, savings institutions, trust companies, insurance

companies, investment companies as defined in the investment company act of 1940, pension or profit-sharing trusts, or other financial institutions or institutional buyers, whether acting for themselves or as trustees, or (B) during any period of 12 consecutive months he does not direct more than 15 offers to sell or buy into this state in any manner to persons other than those specified in clause (A), whether or not the offeror or any of the offerees is then present in this state, or (5) a person who effects transactions in certificates of interest or participation in oil, gas or mining titles or leases or in payments out of production under such titles or leases, to the extent that such transactions are exempted under section 402 (b) (9).

Fraud, deceit, defraud.

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

Guaranteed.

(e) "Guaranteed" means guaranteed as to payment of principal, interest or dividends.

Investment adviser; nonincluded persons; exclusion by administrator.

(f) "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities. "Investment adviser" does not include (1) a bank, savings institution or trust company; (2) a lawyer, accountant, engineer or teacher whose performance of these services is solely incidental to the practice of his profession; (3) a broker-dealer whose performance of these services is solely incidental to the conduct of his business as a broker-dealer and who receives no special compensation for them; (4) a publisher of any bona fide newspaper, news magazine, or business or financial publication of general, regular and paid circulation; (5) a person whose advice, analyses or reports relate only to securities exempted by section 402 (a) (1); (6) a person who has no place of business in this state if (A) his only clients in this state are other investment advisers, broker-dealers, banks, savings institutions, trust companies, insurance companies, investment companies as defined in the investment company act of 1940, pension or profit-sharing trusts, or other financial institutions or institutional buyers, whether acting for themselves or as trustees, or (B) during any period of 12 consecutive months he does not direct business communications into this state in any manner to more than 5 clients other than those specified in clause (A), whether or not he or any of the persons to whom the communications are directed is then present in this state; or (7) such other persons not within the intent of this paragraph as the administrator may by rule or order designate.

Issuer.

(g) "Issuer" means any person who issues or proposes to issue any security, except that:

(1) With respect to certificates of deposit, voting-trust certificates or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors, or persons performing similar functions or of the fixed, restricted management or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which the security is issued.

(2) With respect to certificates of interest or participation in oil, gas or mining titles or leases or in payments out of production under such titles or leases, there is not considered to be any "issuer".

Nonissuer.

(h) "Nonissuer" means not directly or indirectly for the benefit of the issuer.

Person.

(i) "Person" means an individual, a corporation, a partnership, an association, a joint-

stock company, a trust where the interests of the beneficiaries are evidenced by a security, an unincorporated organization, a government or a political subdivision of a government.

Sale, sell, offer, offer to sell.

(j) (1) "Sale" or "sell" includes every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value.

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

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

(4) A purported gift of assessable stock is considered to involve an offer and sale.

(5) Every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, as well as every sale or offer of a security which gives the holder a present or future right or privilege to convert into another security of the same or another issuer, is considered to include an offer of the other security.

(6) The terms defined in this subsection do not include:

(A) Any bona fide pledge or loan.

(B) Any 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 when each stockholder may elect to take the dividend in cash or property or in stock.

(C) Any act incident to a class vote by stockholders, pursuant to the certificate of incorporation or the applicable corporation statute, on a merger, consolidation, reclassification of securities, or sale of corporate assets in consideration of the issuance of securities of another corporation.

(D) Any act incident to a judicially approved reorganization in which a security is issued in exchange for 1 or more outstanding securities, claims or property interests, or partly in such exchange and partly for cash.

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, small business investment act of 1958.

(k) "Securities act of 1933", "securities exchange act of 1934", "public utility holding company act of 1935", "investment company act of 1940", "investment advisers act of 1940" and "small business investment act of 1958", mean the federal statutes of those names as amended before or after the effective date of this act.

Security; exclusions.

(l) "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas or mining title or lease or in payments out of production under such a title or lease; or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period.

State.

(m) "State" means any state, territory or possession of the United States, the District of Columbia and Puerto Rico.

451.802 Exempt securities. [M.S.A. 19.776(402)]

Sec. 402. (a) The following securities are exempted from sections 301 and 403:

(1) Any security, including a revenue obligation, issued or guaranteed by the United States, any state, any political subdivision of a state, or any agency or corporate or other instrumentality of 1 or more of the foregoing; or any certificate of deposit for any of the foregoing.

(2) Any security issued or guaranteed by Canada, any Canadian province, any political subdivision of any such province, any agency or corporate or other instrumentality of 1 or more of the foregoing, or any other foreign government with which the United States currently maintains diplomatic relations, if the security is recognized as a valid obligation by the issuer or guarantor.

(3) Any security issued by and representing an interest in or a debt of, or guaranteed by, any bank organized under the laws of the United States, or any bank, savings institution or trust company organized and supervised under the laws of any state.

(4) Any security issued by and representing an interest in or a debt of, or guaranteed by, any federal savings and loan association, or any building and loan or similar association organized under the laws of any state and authorized to do business in this state.

(5) Any security issued or guaranteed by any federal credit union or any credit union, industrial loan association, or similar association organized and supervised under the laws of this state.

(6) Any security issued or guaranteed by any railroad, other common carrier, public utility or holding company which is:

(A) A registered holding company under the public utility holding company act of 1935 or a subsidiary of such a company within the meaning of that act; or

(B) Regulated in respect of the issuance or guarantee of the security by a governmental authority of the United States, any state, Canada or any Canadian province; also, any equipment trust certificate or equipment note or bond based on chattel mortgages, leases or agreements for conditional sales of cars, motive power, or other rolling stock mortgages, leased or sold to or furnished for the use of or upon such railroads, other common carriers, public utilities or holding companies supervised as above, or equipment, notes or bonds where the ownership or title of such equipment is pledged or retained in accordance with the provisions of the laws of the United States, any state, Canada or any Canadian province, to secure the payment of such equipment trust certificates, bonds or notes.

(7) Any security listed or approved for listing upon notice of issuance on the New York stock exchange; any other security of the same issuer which is of senior or substantially equal rank; any security called for by subscription rights or warrants so listed or approved; or any warrant or right to purchase or subscribe to any of the foregoing.

(8) Any security issued by any person organized and operated not for private profit but exclusively for religious, educational, benevolent, charitable, fraternal, social, athletic or reformatory purposes, or as a chamber of commerce or trade or professional association.

(9) Any negotiable promissory note or commercial paper which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which evidences an obligation to pay cash within 12 months of the date of issuance, exclusive of days of grace, or any renewal of such note or paper which is likewise limited, or any guarantee of such note or paper or of any such renewal.

(10) Any investment contract or option issued in connection with an employees' stock purchase, option, savings, pension, profit-sharing or similar benefit plan, if the administrator is notified in writing before the issuance thereof.

Exempt transactions.

(b) The following transactions are exempted from sections 301 and 403:

(1) Any isolated nonissuer transaction, whether effected through a broker-dealer or not.

(2) Any nonissuer distribution of an outstanding security whose issuer and any predecessors have been in continuous operation for at least 5 years if:

(A) A recognized securities manual contains the names of the issuer's officers and directors, a balance sheet of the issuer as of a date within 18 months, and a profit and loss statement for either the fiscal year preceding that date or the most recent year of operations, or

(B) The security 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 3 preceding fiscal years, or during the existence of the issuer and any predecessors if less than 3 years, in the payment of principal, interest or dividends on the security.

(3) Any nonissuer transaction effected by or through a registered broker-dealer pursuant to an unsolicited order or offer to buy; but the administrator may by rule require that the customer acknowledge upon a specified form that the sale was unsolicited, and that a signed copy of each such form be preserved by the broker-dealer for a specified period.

(4) Any transaction between the issuer or other person on whose behalf the offering is made and an underwriter, or among underwriters.

(5) Any transaction in a bond or other evidence of indebtedness secured by a real or chattel mortgage or deed of trust, or by an agreement for the sale of real estate or chattels, if 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.

(6) Any transaction by an executor, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian or conservator.

(7) Any transaction executed by a bona fide pledgee without any purpose of evading this act.

(8) Any offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the investment company act of 1940, pension or profit-sharing trust, or other financial institution or institutional buyer, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity.

(9) Any transaction pursuant to an offer directed by the offeror to not more than 15 persons, other than those designated in paragraph (8), in this state during any period of 12 consecutive months, whether or not the offeror or any of the offerees is then present in this state, if:

(A) The seller reasonably believes that all the buyers in this state, other than those designated in paragraph (8), are purchasing for investment; and

(B) No commission or other remuneration is paid or given directly or indirectly for soliciting any prospective buyer in this state, other than those designated in paragraph (8); but the administrator may by rule or order, as to any security or transaction or any type of security or transaction, withdraw or further condition this exemption, or increase or decrease the number of offerees permitted, or waive the conditions in clauses (A) and (B) with or without the substitution of a limitation on remuneration.

(10) Any offer or sale of a preorganization certificate or subscription, and the issuance of securities pursuant thereto, if:

(A) No commission or other remuneration is paid or given directly or indirectly for soliciting any prospective subscriber;

(B) The number of subscribers does not exceed 10; and

(C) Each of the subscribers signs the articles of incorporation in person and not by agent and is purchasing for investment.

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

(A) No commission or other remuneration, other than a standby commission, is paid or given directly or indirectly for soliciting any security holder in this state; or

(B) The issuer first files a notice specifying the terms of the offer and the administrator does not by order disallow the exemption within the next 5 full business days.

(12) Any offer, but not a sale, of a security for which registration statements have been filed under both this act and the securities act of 1933 if no stop order or refusal order is in effect and no public proceeding or examination looking toward such an order is pending under either act.

(13) Any offer, sale or issuance of securities pursuant to an investment contract or option which is exempt under the provisions of section 402 (a) (10).

(14) Any offer or sale of a security as contemplated under the small business investment act of 1958 (1) to the federal small business administration, or (2) by a small business concern to a small business investment company or to a development company for equity capital provided or loans made, or (3) by a small business investment company to a small business concern as a condition to providing the latter with equity capital or loans.

(15) Any offer or sale of any security by a nonprofit development corporation, formed and existing under the laws of this state, if the primary purpose of the corporation is to promote and assist the growth and development of business enterprises in the area covered by its operations.

(16) The distribution by a co-operative corporation of its securities to its patrons as patronage refunds or returns distributed on a patronage basis.

Denial or revocation of exemption; notice, hearing, written findings of fact and conclusions of law; summary order, notice, hearing.

(c) The administrator may by order deny or revoke any exemption specified in clause (8) or (10) of subsection (a) or in subsection (b) with respect to a specific security or transaction. No such order may be entered without appropriate prior notice to all interested parties, opportunity for hearing, and written findings of fact and conclusions of law, except that the administrator may by order summarily deny or revoke any of the specified exemptions pending final determination of any proceeding under this subsection. Upon the entry of a summary order, the administrator shall promptly notify all interested parties that it has been entered and of the reasons therefor and that within 15 days of the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the administrator, the order will remain 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 all interested persons, may modify or vacate the order or extend it until final determination. No order under this subsection may operate retroactively. No person may be considered to have violated section 301 or 403 by reason of any offer or sale effected after the entry of an order under this subsection if he sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the order.

Exemption or exception from a definition, burden of proof.

(d) In any proceeding under this act, the burden of proving an exemption or an exception from a definition is upon the person claiming it.

451.803 Filing and approval of prospectus and other materials relating to nonexempt securities and transactions. [M.S.A. 19.776(403)]

Sec. 403. The administrator may by rule or order require the filing and approval prior to use of any prospectus, pamphlet, circular, form letter, advertisement or other sales literature or advertising communication addressed or intended for distribution to prospective investors, including clients or prospective clients of an investment adviser, unless the security or transaction is exempted by section 402.

451.804 False or misleading statements. [M.S.A. 19.776(404)]

Sec. 404. It is unlawful for any person to make or cause to be made, in any document filed with the administrator or in any proceeding under this act, any statement which is, at the time and in the light of the circumstances under which it is made, false or misleading in any material respect.

451.805 Application for registration, registration statement, effect of filing; unlawful representation. [M.S.A. 19.776(405)]

Sec. 405. (a) Neither (1) the fact that an application for registration under sections 201 to 204 or a registration statement under sections 301 to 306 has been filed nor (2) the fact that a person or security is effectively registered constitutes a finding by the administrator that any document filed under this act is true, complete and not misleading. Neither any such fact nor the fact that an exemption or exception is available for a security

or a transaction means that the administrator has passed in any way upon the merits or qualifications of, or recommended or given approval to, any person, security or transaction.

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

451.806 Administration of act; unlawful disclosure of information. [M.S.A. 19.776(406)]

Sec. 406. (a) This act shall be administered by the Michigan corporation and securities commission, created by Act No. 13 of the Public Acts of 1935, as amended, being sections 451.1 to 451.4 of the Compiled Laws of 1948.

(b) It is unlawful for the administrator or any of its officers or employees to use for personal benefit any information which is filed with or obtained by the administrator and which is not made public. No provision of this act authorizes the administrator or any of its officers or employees to disclose any such information except among themselves or when necessary or appropriate in a proceeding or investigation under this act. No provision of this act either creates or derogates from any privilege which exists at common law or otherwise when documentary or other evidence is sought under a subpoena directed to the administrator or any of its officers or employees.

451.807 Same; investigation of violations, statements, publication. [M.S.A. 19.776(407)]

Sec. 407. (a) The administrator in its discretion:

(1) May make such public or private investigations within or outside of this state as it deems necessary to determine whether any person has violated or is about to violate any provision of this act or any rule or order hereunder, or to aid in the enforcement of this act or in the prescribing of rules and forms hereunder.

(2) May require or permit any person to file a statement in writing, under oath or otherwise as the administrator determines, as to all the facts and circumstances concerning the matter to be investigated.

(3) May publish information concerning any violation of this act or any rule or order hereunder.

Oaths, witnesses, evidence, records.

(b) For the purpose of any investigation or proceeding under this act, the administrator, or any officer designated by it, may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers, correspondence, memoranda, agreements or other documents or records which the administrator deems relevant or material to the inquiry.

Contumacy, refusal to obey a subpeona, contempt.

(c) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the circuit court for the county of Ingham, upon application by the administrator, may issue to the person an order requiring him to appear before the administrator, or the officer designated by it, there to produce documentary evidence if so ordered or to give evidence touching the matter under investigation or in question. Failure to obey the order of the court may be punished by the court as a contempt of court.

Privilege against self-incrimination, denial, immunity.

(d) No person is excused from attending and testifying or from producing any document or record before the administrator, or in obedience to the subpoena of the administrator, or any officer designated by it, or in any proceeding instituted by the administrator, on the ground that the testimony or evidence, documentary or otherwise, required of him may tend to incriminate him or subject him to a penalty or forfeiture; but no individual may be prosecuted or subjected to any penalty or forfeiture for or on account of any transaction, matter or thing concerning which he is compelled, after claiming his privilege against self-incrimination, to testify or produce evidence, documentary

or otherwise, except that the individual testifying is not exempt from prosecution and punishment for perjury or contempt committed in testifying.

451.808 Cease and desist order; injunction; restraining order; mandamus; redamages, interest. [M.S.A. 19.776(410)]

Sec. 408. Whenever it appears to the administrator that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this act or any rule or order hereunder, it may in its discretion issue a cease and desist order or bring an action in the circuit court for the county of Ingham to enjoin the acts or practices and to enforce compliance with this act or any rule or order hereunder. Upon a proper showing a permanent or temporary injunction, restraining order, or writ of mandamus shall be granted and a receiver or conservator may be appointed for the defendant or the defendant's assets. The court may not require the administrator to post a bond.

451.809 Penalty for violation; criminal prosecutions. [M.S.A. 19.776(409)]

Sec. 409. (a) Any person who wilfully violates any provision of this act except section 404, or who wilfully violates any rule or order under this act, or who wilfully violates section 404 knowing the statement made to be false or misleading in any material respect, shall upon conviction be fined not more than $5,000.00 or imprisoned not more than 3 years, or both.

(b) The administrator may refer such evidence as is available concerning violations of this act or of any rule or order hereunder to the attorney general or the proper prosecuting attorney, who may, with or without such a reference, institute the appropriate criminal proceedings under this act.

(c) Nothing in this act limits the power of the state to punish any person for any conduct which constitutes a crime by statute or at common law.

451.810 Offer or sale in violation of act; civil liability to buyer; measure of ceiver; conservator; no bond. [M.S.A. 19.776(408)]

Sec. 410. (a) Any person who:

(1) Offers or sells a security in violation of section 201 (a), 301 or 405 (b), or of any rule or order under section 403 which requires the affirmative approval of sales literature before it is used, or of any condition imposed under section 304 (d), 305 (f) or 305 (g), or

(2) Offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, the buyer not knowing of the untruth or omission, and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

Is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at 6% per year from the date of payment, costs and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at 6% per year from the date of disposition.

Joint and several liability of participants in sale; burden of proof of nonseller; contribution.

(b) Every person who directly or indirectly controls a seller liable under subsection (a), every partner, officer or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the nonseller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which

the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

Tender, time of making.

(c) Any tender specified in this section may be made at any time before entry of judgment.

Survival of actions.

(d) Every cause of action under this statute survives the death of any person who might have been a plaintiff or defendant.

Limitation of actions.

(e) No person may sue under this section more than 2 years after the contract of sale. No person may sue under this section (1) if the buyer received a written offer, before suit and at a time when he owned the security, to refund the consideration paid together with interest at 6% per year from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within 30 days of its receipt, or (2) if the buyer received such an offer before suit and at a time when he did not own the security, unless he rejected the offer in writing within 30 days of its receipt.

Unenforceability of illegal contract.

(f) No person who has made or engaged in the performance of any contract in violation of any provision of this act or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract.

Waiver of compliance void.

(g) Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this act or any rule or order hereunder is void.

Additional rights; cause of action created.

(h) The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, but this act does not create any cause of action not specified in this section or section 202 (e).

451.811 Judicial review of administrator's order; findings of fact conclusive; additional evidence. [M.S.A. 19.776(411)]

Sec. 411. (a) Any person aggrieved by a final order of the administrator may obtain a review of the order in the circuit court for the county of Ingham by filing in court, within 60 days after the entry of the order, a written petition praying that the order be modified or set aside in whole or in part. A copy of the petition shall be forthwith served upon the administrator, and thereupon the administrator shall certify and file in court a copy of the filing and evidence upon which the order was entered. When these have been filed, the court has exclusive jurisdiction to affirm, modify, enforce or set aside the order, in whole or in part. The findings of the administrator as to the facts, if supported by competent, material and substantial evidence, are conclusive. If either party applies to the court for leave to adduce additional material evidence, and shows to the satisfaction of the court that there were reasonable grounds for failure to adduce the evidence in the hearing before the administrator, the court may order the additional evidence to be taken before the administrator and to be adduced upon the hearing in such manner and upon such conditions as the court considers proper. The administrator may modify its findings and order by reason of the additional evidence and shall file in court the additional evidence together with any modified or new findings or order.

Stay of administrator's orders.

(b) The commencement of proceedings under subsection (a) does not, unless specifically ordered by the court, operate as a stay of the administrator's order.

451.812 Rules, forms, orders, making, amendment, or rescission; classification of securities, persons, matters. [M.S.A. 19.776(412)]

Sec. 412. (a) The administrator may from time to time make, amend and rescind such rules, forms and orders as are necessary to carry out the provisions of this act, including rules and forms governing registration statements, applications and reports, and defining any terms, whether or not used in this act, insofar as the definitions are not inconsistent with the provisions of this act. For the purpose of rules and forms, the administrator may classify securities, persons and matters within its jurisdiction, and prescribe different requirements for different classes.

Public interest, protection of investors; cooperation with other securities administrators and securities and exchange commission.

(b) No rule, form or order may be made, amended or rescinded unless the administrator finds that the action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes fairly intended by the policy and provisions of this act. In prescribing rules and forms the administrator may cooperate with the securities administrators of the other states and the securities and exchange commission with a view to effectuating the policy of this statute to achieve maximum uniformity in the form and content of registration statements, applications and reports wherever practicable.

Financial statements, consolidated statements, certified public accountants; accounting practices.

(c) The administrator may by rule or order prescribe (1) the form and content of financial statements required under this act, (2) the circumstances under which consolidated financial statements shall be filed, and (3) whether any required financial statements shall be certified by independent or certified public accountants. All financial statements shall be prepared in accordance with generally accepted accounting practices.

Rules and forms, publication.

(d) All rules and forms of the administrator shall be published.

Action or omission in good faith in conformity with rule, form, order, subsequent amendment, rescission, or determination of invalidity.

(e) No provision of this act imposing any liability applies to any act done or omitted in good faith in conformity with any rule, form or order of the administrator, notwithstanding that the rule, form or order may later be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

Hearing, public, discretion of administrator.

(f) Every hearing in an administrative proceeding shall be public unless the administrator in its discretion grants a request joined in by all the respondents that the hearing be conducted privately.

451.813 Document, filing. [M.S.A. 19.776(413)]

Sec. 413. (a) A document is filed when it is received by the administrator.

Register of applications for registration, registration statements, and denial, suspension, or revocation orders; public inspection.

(b) The administrator shall keep a register of all applications for registration and registration statements which are or have ever been effective under this act and all denial, suspension or revocation orders which have been entered under this act. The register shall be open for public inspection.

Same; availability to public, administrator's rules.

(c) The information contained in or filed with any registration statement, application or report may be made available to the public under such rules as the administrator prescribes.

Certified copies of register entries or documents, use as evidence.

(d) Upon request and at such reasonable charges as it prescribes, the administrator shall furnish to any person photostatic or other copies, certified under its seal of office if requested, of any entry in the register or any document which is a matter of public record. In any proceeding or prosecution under this act, any copy so certified is prima facie evidence of the contents of the entry or document certified.

Interpretative opinions.

(e) The administrator in its discretion may honor requests from interested persons for interpretative opinions.

451.814 Sale or offer to sell made in this state; offer to buy made and accepted in this state; law applicable. [M.S.A. 19.776(414)]

Sec. 414. (a) Sections 101, 201 (a), 301, 405 and 410 apply to persons who sell or offer to sell when (1) an offer to sell is made in this state, or (2) an offer to buy is made and accepted in this state.

Purchase or offer to buy made in this state; offer to sell made and accepted in this state; law applicable.

(b) Sections 101, 201 (a) and 405 apply to persons who buy or offer to buy when (1) an offer to buy is made in this state, or (2) an offer to sell is made and accepted in this state.

Offer to sell or to buy; when deemed made in this state.

(c) For the purpose of this section, an offer to sell or to buy is made in this state, whether or not either party is then present in this state, when the offer (1) originates from this state or (2) is directed by the offeror to this state and received at the place to which it is directed, or at any post office in this state in the case of a mailed offer.

Offer to buy or to sell; when deemed accepted in this state.

(d) For the purpose of this section, an offer to buy or to sell is accepted in this state when acceptance (1) is communicated to the offeror in this state and (2) has not previously been communicated to the offeror, orally or in writing, outside this state; and acceptance is communicated to the offeror in this state, whether or not either party is then present in this state, when the offeree directs it to the offeror in this state reasonably believing the offeror to be in this state and it is received at the place to which it is directed, or at any post office in this state in the case of a mailed acceptance.

Offer to sell or to buy; when deemed not made in this state.

(e) An offer to sell or to buy is not made in this state when (1) the publisher circulates or there is circulated on his behalf in this state any bona fide newspaper or other publication of general, regular and paid circulation which is not published in this state, or which is published in this state but has had more than 2/3 of its circulation outside this state during the past 12 months, or (2) a radio or television program originating outside this state is received in this state.

Investment advisers; when prohibited conduct deemed done in this state.

(f) Sections 102 and 201 (c), as well as section 405 so far as investment advisers are concerned, apply when any act instrumental in effecting prohibited conduct is done in this state, whether or not either party is then present in this state.

Irrevocable consent to service of process; effectiveness of service.

(g) Every applicant for registration under this act and every issuer which proposes to offer a security in this state through any person acting on an agency basis in the common-law sense shall file with the administrator, in such form as it by rule prescribes, an irrevocable consent appointing the administrator or its successor in office to be his attorney to receive service of any lawful process in any noncriminal suit, action or proceeding against him or his successor executor or administrator which arises under this act or any

rule or order hereunder after the consent has been filed, with the same force and validity as if served personally on the person filing the consent. A person who has filed such a consent in connection with a previous registration need not file another. Service 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 in a suit, action or proceeding instituted by it, forthwith sends notice of the service and a copy of the process by registered mail to the defendant or respondent at his last address on file with the administrator, and (2) the plaintiff's affidavit of compliance with this subsection is filed in the case on or before the return day of the process, if any, or within such further time as the court allows.

Prohibited or actionable conduct; substituted service of process, effectiveness of service.

(h) When any person, including any nonresident of this state, engages in conduct prohibited or made actionable by this act or any rule or order hereunder, and he has not filed a consent to service of process under subsection (g) and personal jurisdiction over him cannot otherwise be obtained in this state, that conduct shall be considered equivalent to his appointment of the administrator or its successor in office to be his attorney to receive service of any lawful process in any noncriminal suit, action or proceeding against him or his successor executor or administrator which grows out of that conduct and which is brought under this act or any rule or order hereunder, with the same force and validity as if served on him personally. Service may be made by leaving a copy of the process in the office of the administrator, and it is not effective unless (1) the plaintiff, who may be the administrator in a suit, action or proceeding instituted by it, forthwith sends notice of the service and a copy of the process by registered mail to the defendant or respondent at his last known address or takes other steps which are reasonably calculated to give actual notice, and (2) the plaintiff's affidavit of compliance with this subsection is filed in the case on or before the return day of the process, if any, or within such further time as the court allows.

Continuance to afford opportunity to defend.

(i) When process is served under this section, the court, or the administrator in a proceeding before it, shall order such continuance as may be necessary to afford the defendant or respondent reasonable opportunity to defend.

451.815 Construction of act to effectuate uniformity. [M.S.A. 19.776(415)]

Sec. 415. This act shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this act with the related federal regulation.

451.816 Short title. [M.S.A. 19.776(416)]

Sec. 416. This act shall be known and may be cited as the "uniform securities act".

451.817 Savings clause. [M.S.A. 19.776(417)]

Sec. 417. Except as saved in this section:

Repeal.

(a) Act No. 220 of the Public Acts of 1923, as amended, being sections 451.101 to 451.133 of the Compiled Laws of 1948, is repealed.

Duration of effect of prior law.

(b) Prior law exclusively governs all suits, actions, prosecutions or proceedings which are pending or may be initiated on the basis of facts or circumstances occurring before the effective date of this act, except that no civil suit or action may be maintained to enforce any liability under prior law unless brought within any period of limitation which applied when the cause of action accrued and in any event within 2 years after the effective date of this act.

Effectiveness of registrations and administrative orders under prior law.

(c) All effective registrations under prior law, all administrative orders relating to such registrations, and all conditions imposed upon such registrations remain in effect so long as they would have remained in effect if this act had not been passed. They are considered to have been filed, entered or imposed under this act, but are governed by prior law.

Continuation of offer or sale begun before effective date of act governed by prior law.

(d) Prior law applies in respect of any offer or sale made within 1 year after the effective date of this act pursuant to an offering begun in good faith before its effective date on the basis of an exemption available under prior law.

Judicial review; limitation of actions.

(e) Judicial review of all administrative orders as to which review proceedings have not been instituted by the effective date of this act are governed by section 411, except that no review proceeding may be instituted unless the petition is filed within any period of limitation which applied to a review proceeding when the order was entered and in any event within 60 days after the effective date of this act.

451.818 Effective date of act. [M.S.A. 19.776(418)]

Sec. 418. This act shall take effect on January 1, 1965.

Approved June 3, 1964.

[No. 266.]

AN ACT to amend section 9 of chapter 1a of Act No. 357 of the Public Acts of 1947, entitled as amended "An act to establish a workmen's compensation department and a director thereof; to prescribe the powers and duties of said department and the director thereof; to transfer to the director of said department certain powers and duties under existing acts; to establish a workmen's compensation appeal board; to prescribe the powers and duties of said appeal board; to transfer to said appeal board certain powers and duties under existing acts; to provide for a commissioner of labor; to prescribe his powers and duties; to transfer to said commissioner of labor certain powers and duties under existing acts; to abolish the workmen's compensation commission as created by chapter 1 of Act No. 357 of the Public Acts of 1947," as added by Act No. 62 of the Public Acts of 1955, being section 408.9 of the Compiled Laws of 1948.

The People of the State of Michigan enact:

Section amended.

Section 1. Section 9 of chapter 1a of Act No. 357 of the Public Acts of 1947, as added by Act No. 62 of the Public Acts of 1955, being section 408.9 of the Compiled Laws of 1948, is hereby amended to read as follows:

CHAPTER 1A.

408.9 Workmen's compensation appeal board; membership, appointment, qualifications, terms, vacancies, chairman; additional members, terms, vacancies. [M.S.A. 17.6(15)]

Sec. 9. There is created a workmen's compensation appeal board of 3 members, who shall be attorneys at law, duly licensed to practice in the courts of this state. Each member of the board shall devote his entire time to and personally perform the duties of his office and shall engage in no other business or professional activity. Each member of said board shall qualify by taking and filing the constitutional oath of office. The governor shall, with the advice and consent of the senate, appoint said members for terms of 6 years and until the successor of each member whose term of office expires is

Exhibit 6

Uniform Securities Act, 1956

UNIFORM SECURITIES ACT

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 SIXTY-FIFTH YEAR
DALLAS, TEXAS
AUGUST 20-25, 1956
AMENDED AUGUST 18-23, 1958

WITH
COMMENTS

APPROVED BY THE AMERICAN BAR ASSOCIATION AT ITS MEETING AT
DALLAS, TEXAS, AUGUST 30, 1956
AMENDMENTS APPROVED AUGUST 29, 1958

The Committee which acted for the National Conference of Commissioners on Uniform State Laws in preparing the Uniform Securities Act and its Amendments was as follows:

EDWARD L. SCHWARTZ, 85 Devonshire St., Boston, Mass., *Chairman*
BROCKENBROUGH LAMB, JR., Mutual Bldg., Richmond 19, Va.
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HENRY P. THOMAS, Alexandria, Va.
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JOHN C. POLLOCK, Court House, Fargo, N. D., *Chairman, Section E.*

Copies of Uniform and Model Acts and other printed matter issued by the Conference may be obtained from

NATIONAL CONFERENCE OF COMMISSIONERS ON
UNIFORM STATE LAWS
1155 East Sixtieth Street
Chicago 37, Illinois

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REGISTRATION OF SECURITIES

PREFATORY NOTE

The Uniform Securities Act was drafted at the request of the Conference by Professor Louis Loss of the Harvard Law School together with Mr. Edward M. Cowett as Research Associate. The Act followed a two-year Study of State Securities Regulation made in consultation with an Advisory Committee containing representatives of the Conference, the American Bar Association, the National Association of Securities Administrators, the Securities and Exchange Commission, the Investment Bankers Association of America, and the National Association of Securities Dealers, Inc., as well as several practicing lawyers with experience in "blue sky law."

The comments included here are the official comments of the Conference. The Act together with the unofficial section-by-section comments of the draftsmen appear as an appendix in Loss and Cowett on "Blue Sky Law," published by Little, Brown & Co. in early 1957. The draftsmen's comments are considerably more detailed than the official comments and also describe generally the existing law. No inference of disagreement with the draftsmen's comments is to be drawn from the non-inclusion of all those comments here. The emphasis here is on brevity.

UNIFORM SECURITIES ACT

AN ACT

[Relating to securities; prohibiting fraudulent practices in relation thereto; requiring the registration of broker-dealers, agents, investment advisers, and securities; and making uniform the law with reference thereto:]

[*Be it enacted* . . .]

COMMENT

The Uniform Securities Act, as approved by the National Conference of Commissioners on Uniform State Laws on August 25, 1956, is in four parts. The first three parts represent the three basic "blue sky" philosophies: (I) the "fraud" approach, (II) registration of broker-dealers, agents, and investment advisers, and (III) registration of securities. Part IV contains those general provisions (definitions, exemptions, judicial review, investigatory, injunctive and criminal provisions, etc.) which are essential in varying degrees under any of the three basic philosophies.

The first three parts are designed to stand alone or in any combination. Appendix A specifies the changes required to be made in the Act if Part III is deleted. Appendix B specifies those portions of Part IV which are required for only a "fraud" type of statute (Part I).

The Act lends itself to four alternate treatments of investment advisers. These are specified in Appendix C.

A state which enacts only Part I and the relevant portions of Part IV should delete from the title the words: "requiring the registration of broker-dealers, agents, investment advisers, and securities." A state which enacts only Parts I and II and the relevant portions of Part IV should substitute for those words: "requiring the registration of broker-dealers, agents, and investment advisers."

PART I

FRAUDULENT AND OTHER PROHIBITED PRACTICES

SECTION 101. [*Sales and Purchases.*] It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly

(1) to employ any device, scheme, or artifice to defraud,

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

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

COMMENT TO § 101

Section 101 is substantially the Securities and Exchange Commission's Rule X-10B-5, 17 Code Fed. Regs. § 240.10b-5, which in turn was modeled upon § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), except that the rule was expanded to cover the purchase as well as the sale of any security. There are no exemptions from § 101.

The sanctions for the conduct which is made "unlawful" by § 101 (or any other section which makes conduct "unlawful") are found in Parts II, III and IV of the statute. Those sanctions include administrative proceedings of various sorts under §§ 204 and 306 when a registration of a broker-dealer, agent, investment adviser or security is pending or effective under Part II or III; judicial injunction under § 408; and criminal prosecution under § 409. Section 410(h) provides that "unlawful" conduct does not result in civil liability except as provided in § 410.

SECTION 102. [*Advisory Activities.*]

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

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

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

COMMENT TO § 102(a)

This provision is modeled on §§ 206(1) and 206(2) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6(1) and (2), except that it avoids the use of the term "investment adviser." The definition of "investment adviser" in § 401(f) contains a number of exceptions which look to the registration requirement in Part II. But, as in § 101, there are no exemptions from fraud.

(b) It is unlawful for any investment adviser to enter into, extend, or renew any investment advisory contract unless it provides in writing

(1) that the investment adviser shall not be compensated on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client;

(2) that no assignment of the contract may be made by the investment adviser without the consent of the other party to the contract; and

(3) that the investment adviser, if a partnership, shall notify the other party to the contract of any change in the membership of the partnership within a reasonable time after the change.

Clause (1) does not prohibit an investment advisory contract which provides for compensation based upon the total value of a fund averaged over a definite period, or as of definite dates or taken as of a definite date. "Assignment," as used in clause (2), includes any direct or indirect transfer or hypothecation of an

investment advisory contract by the assignor or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; but, if the investment adviser is a partnership, no assignment of an investment advisory contract is considered to result from the death or withdrawal of a minority of the members of the investment adviser having only a minority interest in the business of the investment adviser, or from the admission to the investment adviser of one or more members who, after admission, will be only a minority of the members and will have only a minority interest in the business.

COMMENT TO § 102(b)

Clauses (1)-(3), together with the first sentence thereafter, are modeled on § 205 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-5. The definition of "assignment" in the last sentence is taken from the definition in § 202(a)(1) of the federal statute, 15 U.S.C. § 80b-2(a)(1). Section 102(b) does not require that the entire contract be in writing. An informal exchange of letters containing the three specified provisions would be sufficient.

(c) It is unlawful for any investment adviser to take or have custody of any securities or funds of any client if

(1) the [Administrator] by rule prohibits custody; or

(2) in the absence of rule, the investment adviser fails to notify the [Administrator] that he has or may have custody.

COMMENT TO § 102(c)

The Act does not prohibit the same person from being both a broker-dealer and an investment adviser. See the comment under § 201(c). Section 102(c)(1) is sufficiently flexible so that any rules adopted thereunder might be made inapplicable to persons acting in both capacities, or applicable only with respect to those clients who are charged specially for investment advice. Concerning the distinction between broker-dealers and investment advisers, see the comment under § 401(f).

PART II

REGISTRATION OF BROKER-DEALERS, AGENTS, AND INVESTMENT ADVISERS.

SECTION 201. [*Registration Requirement.*]

(a) It is unlawful for any person to transact business in this state as a broker-dealer or agent unless he is registered under this act.

COMMENT TO § 201(a)

"Agent" and "broker-dealer" are defined in §§ 401(b) and 401(c). The scope of § 201(a) with reference to the phrase "to transact business in this state" is specified in §§ 414(a) and 414(b).

(b) It is unlawful for any broker-dealer or issuer to employ an agent unless the agent is registered. The registration of an agent is not effective during any period when he is not associated with a particular broker-dealer registered under this act or a particular issuer. When an agent begins or terminates a connection with a broker-dealer or issuer, or begins or terminates those activities which make him an agent, the agent as well as the broker-dealer or issuer shall promptly notify the [Administrator].

COMMENT TO § 201(b)

When an agent shifts from one broker-dealer or issuer to another, the last sentence requires all three persons—the agent, the old employer and the new employer—to notify the Administrator.

(c) It is unlawful for any person to transact business in this state as an investment adviser unless (1) he is so registered under this act, (2) he is registered as a broker-dealer without the imposition of a condition under section 204(b)(5), or (3) his only clients in this state are investment companies as defined in the Investment Company Act of 1940 or insurance companies.

COMMENT TO § 201(c)

Clause (2): The Act permits the same person to exercise both broker-dealer and advisory functions and to do so without dual registration. Clause (2) ties in with § 204(b)(5), which authorizes the Administrator to condition a particular applicant's registration as a broker-dealer upon his not transacting business as an investment adviser if the Administrator finds that he is not qualified as an investment adviser.

Clause (3): This clause is based on § 203(b)(2) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-3(b)(2), which exempts an investment adviser from registration if his only clients are investment companies and insurance companies. But even such an investment adviser is subject to § 102. Clause (3) also ties into § 401(f)(6); see paragraph 12 of the comment under § 414(a)-(f).

The scope of § 201(c) with reference to the phrase "to transact business in this state" is specified in § 414(f).

(d) Every registration expires one year from its effective date unless renewed. [The [Administrator] by rule or order may prepare an initial schedule for registration renewals so that subsequent renewals of registrations effective on the effective date of this Act may be staggered by calendar months. For this purpose the [Administrator] by rule may reduce the registration fee proportionately.]

COMMENT

The bracketed language is intended for those states where every registration today expires on December 31 or some other fixed date of each year. When any such state goes over to the scheme of § 201(d), the bracketed language will prevent its continuing to be deluged with a mass of renewal applications on the first of every year. Section 418(c) will automatically take care of the situation, without the bracketed language, in those states which already provide that every registration expires one year from its effective date unless renewed.

SECTION 202. [*Registration Procedure.*]

(a) A broker-dealer, agent, or investment adviser may obtain an initial or renewal registration by filing with the [Administrator] an application together with a consent to service of process pursuant to section 414(g). The application shall contain whatever information the [Administrator] by rule requires concerning such matters as (1) the applicant's form and place of organization; (2) the applicant's proposed method of doing business; (3) the qualifications and business history of the applicant; in the case of a broker-dealer or investment adviser, the qualifications and business history of any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser; and, in the case of an investment adviser, the qualifications and business history of any employee; (4) any injunction or administrative order or conviction of a misdemeanor involving a security or any aspect of the securities business and any conviction of a felony; and (5) the applicant's financial condition and history. The [Administrator] may by rule or order require an applicant for initial registration to publish an announcement of the application in one or more specified newspapers published in this state. If no denial order is in effect and no proceeding is pending under section 204, registration becomes effective at noon of the thirtieth day after an application is filed. The [Administrator] may by rule or order specify an earlier effective date, and [he] may by order defer the effective date until noon of the thirtieth day after the filing of any amendment. Registration of a broker-dealer automatically constitutes registration of any agent who is a partner, officer, or director, or a person occupying a similar status or performing similar functions.

COMMENT TO § 202(a)

Second sentence: This sentence is a conglomerate of a number of the present statutes, as well as the comparable provisions of the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 together with the SEC's Forms BD and ADV for broker-dealers and investment advisers respectively. The language is sufficiently broad to cover everything required by those statutes and forms, and at the same time is sufficiently specific to facilitate the adoption of a uniform form for each of the three types of registration.

Clause (3): The phrase "any person occupying a similar status or performing similar functions," which modifies "partner, officer, or director" here and elsewhere in the Act, contemplates unincorporated, non-partnership organizations like Massachusetts trusts.

Last sentence: Section 401(b), which defines "agent," provides in its last sentence: "A director, officer, or partner of a broker-dealer or issuer, to a person occupying a similar status or performing similar functions, is an agent only if he otherwise comes within this definition." The reasons for that provision are stated in the comment to that section. But, since § 202(a)(3) contemplates that the qualifications and business history of partners, officers and directors will be disclosed in the application for registration of the partnership or corporation, there is no need to have the same information filed twice. Consequently, under the last sentence of § 202(a) the firm's registration automatically constitutes registration of any agent who is a partner, officer, or director; and, by virtue of this sentence in conjunction with the last sentence of § 401(b), the Administrator, if he deems it appropriate, may institute a proceeding to deny or revoke the registration of a particular partner, officer or director without disturbing the status of the firm. At the same time, the disqualification of a director, officer or partner, as distinct from an ordinary agent, is also a basis for proceeding against the *firm's* registration if the Administrator finds it in the public interest to do so.

[(b) Every applicant for initial or renewal registration shall pay a filing fee of $..... in the case of a broker-dealer, $..... in the case of an agent, and $..... in the case of an investment adviser. When application is denied or withdrawn, the [Administrator] shall retain $..... of the fee.]

COMMENT TO § 202(b)

The last sentence does not apply when a registration is suspended, revoked or canceled under § 204.

(c) A registered broker-dealer or investment adviser may file an application for registration of a successor, whether or not the successor is then in existence, for the unexpired portion of the year. There shall he no filing fee.

COMMENT TO § 202(c)

Section 202(c) is designed to avoid unnecessary interruptions of business by removing any doubt as to the propriety of a predecessor's filing an application for the registration of the successor—for example, when a contemplated change in the membership of a partnership may be considered to result in a new partnership under the local partnership law, or when a partnership or an individual contemplates incorporation. Particularly if the states which adopt this act adopt uniform registration forms which are coordinated with those of the SEC, they may also wish to coordinate their procedure on successions. See SEC Rule X-15B-4, 17 Code Fed. Regs. § 240.15b-4. The regular procedure in § 202(a) concerning the time when an application for registration becomes effective applies also under § 202(c).

(d) The [Administrator] may by rule require a minimum capital for registered broker-dealers and investment advisers.

COMMENT TO § 202(d)

A few states have rules which, instead of prescribing a fixed minimum capital, follow the formula of the SEC and some of the stock exchanges in prescribing a ratio of 15-1 or 20-1 between aggregate indebtedness and net capital. Ill. Rule D-1B; Minn. Reg. VI(a); Wis. Adm. Code s. § 1.01(2). Any state which wants to give its Administrator authority to adopt debt-capital ratio rules should add

the following language at the end of Section 202(d): "or prescribe a ratio between net capital and aggregate indebtedness."

(e) The [Administrator] may by rule require registered broker-dealers, agents, and investment advisers to post surety bonds in amounts up to $10,000, and may determine their conditions. Any appropriate deposit of cash or securities shall be accepted in lieu of any bond so required. No bond may be required of any registrant whose net capital, which may be defined by rule, exceeds $25,000. Every bond shall provide for suit thereon by any person who has a cause of action under section 410 and, if the [Administrator] by rule or order requires, by any person who has a cause of action not arising under this act. Every bond shall provide that no suit may be maintained to enforce any liability on the bond unless brought within two years after the sale or other act upon which it is based.

COMMENT TO § 202(e)

Second sentence: The Administrator has no discretion whether to accept a deposit of cash or securities in lieu of a bond, but he does have reasonable discretion to determine whether the amount of the deposit and the type of securities deposited are appropriate.

Third sentence: This sentence applies whether or not the Administrator adopts minimum capital rules under § 202(d) or defines "net capital" under § 412(a) for purposes of the third sentence of § 202(e). If he remains silent, the question whether a broker-dealer has a net capital of $25,000 should be determined in accordance with sound accounting principles.

Conditions of the bond: The first and fourth sentences leave the conditions of the bond to the rule-making authority of the Administrator. But the fourth sentence is designed to avoid the frequently ambiguous provisions concerning who may sue on the bond by making those conditions of any required bond coterminous with the liability provisions of § 410 *so far as causes of action under the Act are concerned.* It is left to the Administrator to determine by rule or order whether suits should be allowed also for *defalcations not involving sales of securities*—for example embezzlement of customers' funds or securities. Thus, except for non-statutory causes of action, § 202(e) merely uses the bonding provision to reinforce any recovery which might be obtained under § 410; it creates no new civil liabilities. Since § 410 imposes civil liabilities only upon sellers of securities, any bond required of a person who is solely an investment adviser could apply only to such non-statutory defalcations as the Administrator might prescribe.

Statute of limitations: Since § 410(d) provides that every cause of action under this statute survives the death of any person who might have been a plaintiff or defendant, any bond required under § 202(e) must provide that suit may be brought for the specified two-year period even though the person who is bonded dies before the expiration of that period.

SECTION 203. [*Post-Registration Provisions.*]

(a) Every registered broker-dealer and investment adviser shall make and keep such accounts, correspondence, memoranda, papers, books, and other records as the [Administrator] by rule prescribes. All records so required shall be preserved for three years unless the [Administrator] by rule prescribes otherwise for particular types of records.

COMMENT TO § 203(a)

This section is modeled on § 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78q(a). It is broad enough to permit a continuation of the practice which exists in several states of requiring registered broker-dealers to keep lists of the securities they are handling.

(b) Every registered broker-dealer and investment adviser shall file such financial reports as the [Administrator] by rule prescribes.

(c) If the information contained in any document filed with the [Administrator] is or becomes inaccurate or incomplete in any material respect, the registrant shall promptly file a correcting amendment unless notification of the correction has been given under section 201(b).

(d) All the records referred to in subsection (a) are subject at any time or from time to time to such reasonable periodic, special, or other examinations by representatives of the [Administrator], within or without this state, as the [Administrator] deems necessary or appropriate in the public interest or for the protection of investors. For the purpose of avoiding unnecessary duplication of examinations, the [Administrator], insofar as [he] deems it practicable in administering this subsection, may cooperate with the securities administrators of other states, the Securities and Exchange Commission, and any national securities exchange or national securities association registered under the Securities Exchange Act of 1934.

COMMENT TO § 203(d)

Section 203(d) is modeled on § 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78q(a). This is a visitatorial power which is to be distinguished from the power to investigate and issue subpoenas under § 407. No subpoena is necessary under § 203(d). Failure to submit to a reasonable inspection is a violation of the Act, which may result in an action by the Administrator for a mandatory injunction under § 408 or, if willful, a revocation of the broker-dealer's or investment adviser's registration under § 204(a)(2)(B) or a criminal prosecution under § 409.

In some states special fees are charged to defray the cost of examinations. The Act specifically provides for fees only in connection with registration under Parts II and III. Any additional fee provision which may be desired should be inserted in § 406(c).

SECTION 204. [*Denial, Revocation, Suspension, Cancelation, and Withdrawal of Registration.*]

(a) The [Administrator] may by order deny, suspend, or

revoke any registration if [he] finds (1) that the order is in the public interest and (2) that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser

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

(B) has willfully violated or willfully failed to comply with any provision of this act or a predecessor act or any rule or order under this act or a predecessor act;

(C) has been convicted, within the past ten years, of any misdemeanor involving a security or any aspect of the securities business, or any felony;

(D) is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in or continuing any conduct or practice involving any aspect of the securities business;

(E) is the subject of an order of the [Administrator] denying, suspending, or revoking registration as a broker-dealer, agent, or investment adviser;

(F) is the subject of an order entered within the past five years by the securities administrator of any other state or by the Securities and Exchange Commission denying or revoking registration as a broker-dealer, agent, or investment adviser, or the substantial equivalent of those terms as defined in this act, or is the subject of an order of the Securities and Exchange Commission suspending or expelling him from a national securities exchange or national securities association registered under the Securities Exchange Act of 1934, or is the subject of a United States Post Office fraud order; but (i) the [Administrator] may not institute a revocation or suspension proceeding under clause (F) more than one year from the date of the order relied on, and (ii) [he] may not enter an order under clause (F) on the basis of an order under another state act unless that order was based on facts which would currently constitute a ground for an order under this section;

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

(H) is insolvent, either in the sense that his liabilities exceed his assets or in the sense that he cannot meet his obligations as they mature; but the [Administrator] may not enter

an order against a broker-dealer or investment adviser under this clause without a finding of insolvency as to the broker-dealer or investment adviser; or

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

The [Administrator] may by order deny, suspend, or revoke any registration if [he] finds (1) that the order is in the public interest and (2) that the applicant or registrant

(J) has failed reasonably to supervise his agents if he is a broker-dealer or his employees if he is an investment adviser; or

(K) has failed to pay the proper filing fee; but the [Administrator] may enter only a denial order under this clause, and [he] shall vacate any such order when the deficiency has been corrected.

The [Administrator] may not institute a suspension or revocation proceeding on the basis of a fact or transaction known to [him] when registration became effective unless the proceeding is instituted within the next thirty days.

Comment to § 204(a)

First Clause (1): This clause authorizes the Administrator to proceed against an entire firm merely because an individual partner, officer, director or controlling person is disqualified under one of the specific clauses, but it requires a finding that such action is in the public interest. The disqualification of any other agent, or of an employee of an investment adviser, may not automatically be used against the broker-dealer or the investment adviser. But, when the agent's or employee's disqualification is due to lack of reasonable supervision, the Administrator may proceed against the broker-dealer or the investment adviser under Clause (J). The Administrator's finding on "public interest" will presumably not be judicially reviewable except upon a showing of abuse of discretion. But the requirement that such a finding be made in all cases emphasizes that not every minor or technical infraction is meant to result in a denial, suspension or revocation order.

Clause (A): The completeness and accuracy of the application for registration are to be tested as of its *effective date* in a *suspension* or *revocation* proceeding. That is to say, the fact that an application for registration has become misleading by virtue of developments occurring *after* its effective date is not a ground for action under Clause (A). Action in such a case would have to be predicated under Clause (B) upon violation of § 203(c). On the other hand, in a proceeding to *deny* effectiveness to a pending application for registration, the completeness and accuracy of the application cannot be tested as of the effective date. This explains the first "or" clause in Clause (A).

Clause (B): As the federal courts and the SEC have construed the term "willfully" in § 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b), all that is required is proof that the person acted intentionally in the sense that he was aware of what he was doing. Proof of evil motive or intent to violate the law, or knowledge that the law was being violated, is not required. The princi-

pal function of the word "willfully" is thus to serve as a legislative hint of self-restraint to the Administrator.

Clause (D): The present tense of the word "is" means that an injunction which has expired or been vacated is no longer a ground for action under Clause (D).

Clause (E): This clause is designed to make it clear that, when a person who has had his registration revoked applies for a new registration after an interval, the Administrator does not have to establish again the ground which led to the earlier denial or revocation order.

Clause (F): As in Clause (E), the opening word "is" means that a suspension order which has expired by its terms or an order of any kind which has been vacated is not a ground for action under Clause (F).

Clause (H): The "but" clause makes it clear that a broker-dealer's or investment adviser's insolvency may be used against the broker-dealer or investment adviser, and that an agent's insolvency may be used against the agent, but that 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 under Clause (2).

Clause (J): This clause represents a codification of the view held by a number of Administrators, as well as the SEC, to the effect that a registrant must be held responsible for violations resulting from inadequate supervision of subordinates. This Act, unlike § 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b), does not authorize the Administrator to proceed against the registration of a *broker-dealer* merely because one of his *agents* has violated the statute (unless the agent happens to be a director, officer or partner). But, when an agent's violation is found to be due to a violation of the broker-dealer's duty of reasonable supervision, and when the Administrator finds that it is in the public interest to proceed against the broker-dealer's registration, he may do so under Clause (J). This is not to say that proof of a violation by the agent is essential to an order under Clause (J).

(b) The following provisions govern the application of section 204(a)(2)(I):

(1) The [Administrator] may not enter an order against a broker-dealer on the basis of the lack of qualification of any person other than (A) the broker-dealer himself if he is an individual or (B) an agent of the broker-dealer.

(2) The [Administrator] may not enter an order against an investment adviser on the basis of the lack of qualification of any person other than (A) the investment adviser himself if he is an individual or (B) any other person who represents the investment adviser in doing any of the acts which make him an investment adviser.

(3) The [Administrator] may not enter an order solely on the basis of lack of experience if the applicant or registrant is qualified by training or knowledge or both.

(4) The [Administrator] shall consider that an agent who will work under the supervision of a registered 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 on the basis of experience as a broker-dealer or agent. When [he] finds that an applicant for initial or renewal registration as a broker-dealer is not qualified as an investment adviser, [he] may by order condition the applicant's registration as a broker-dealer upon his not transacting business in this state as an investment adviser.

(6) The [Administrator] may by rule provide for an examination, which may be written or oral or both, to be taken by any class of or all applicants, as well as persons who represent or will represent an investment adviser in doing any of the acts which make him an investment adviser.

COMMENT TO § 204(b)

Clause (1)-(2): These clauses are a limitation upon Clause (2) of § 204(a). Some firms have limited partners or directors who simply supply capital without taking an active role in the firm's business. There is no need for such persons to be qualified.

Clause (5): This is essential in order to avoid double registration by people who act both as broker-dealers and as investment advisers. See the comment under § 201(c)(2).

Clause (6): Examinations may be required of any reasonably defined class of applicants. For example, the Administrator may want to examine only applicants for registration as investment advisers, in which event he will wish to examine also those applicants for broker-dealer registration who intend to perform advisory services for special compensation, so that he may properly administer § 204(b)(5).

(c) The [Administrator] may by order summarily postpone or suspend registration pending final determination of any proceeding under this section. Upon the entry of the order, the [Administrator] shall promptly notify the applicant or registrant, as well as the employer or prospective employer if the applicant or registrant is an agent, that it has been entered and of the reasons therefor and that within fifteen days after the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the [Administrator], the order will remain 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, may modify or vacate the order or extend it until final determination.

(d) If the [Administrator] finds that any registrant or applicant for registration is no longer in existence or has ceased to do business as a broker-dealer, agent, or investment adviser, or is subject to an adjudication of mental incompetence or to the control of a committee, conservator, or guardian, or cannot be located after reasonable search, the [Administrator] may by order cancel the registration or application.

COMMENT TO § 204(d)

This provision is modeled on § 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b). It is designed to regularize the procedure for getting rid of "dead-wood" in the files.

(e) Withdrawal from registration as a broker-dealer, agent, or investment adviser becomes effective thirty days after receipt of an application to withdraw or within such shorter period of time as the [Administrator] may determine, unless a revocation or suspension proceeding is pending when the application is filed or a proceeding to revoke or suspend or to impose conditions upon the withdrawal is instituted within thirty days after the application is filed. If a proceeding is pending or instituted, withdrawal becomes effective at such time and upon such conditions as the [Administrator] by order determines. If no proceeding is pending or instituted and withdrawal automatically becomes effective, the [Administrator] may nevertheless institute a revocation or suspension proceeding under section 204(a)(2)(B) within one year after withdrawal became effective and enter a revocation or suspension order as of the last date on which registration was effective.

COMMENT TO § 204(e)

This provision is modeled on § 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b), and SEC Rule X-15B-6, 17 Code Fed. Regs. § 240.15b-6, although the last sentence goes somewhat further. This provision does not affect an applicant's privilege of withdrawing his application for registration *before it becomes effective*. It is simply designed to make it possible to prevent withdrawal of an effective registration under fire. The last sentence is designed to take care of the case where the Administrator does not know of any reason to object to the withdrawal application until after it has become effective; but it is limited to situations where the Administrator can prove a willful violation under § 204(a)(2)(B).

(f) No order may be entered under any part of this section except the first sentence of subsection (c) without (1) appropriate prior notice to the applicant or registrant (as well as the employer or prospective employer if the applicant or registrant is an agent), (2) opportunity for hearing, and (3) written findings of fact and conclusions of law.

COMMENT TO § 204(f)

Here, as in other procedural provisions of the statute, the Administrator will also have to consider the requirements of any local Administrative Procedure Act, and these provisions may have to be varied depending upon the language of any such legislation.

PART III

REGISTRATION OF SECURITIES

SECTION 301. [*Registration Requirement.*] It is unlawful for any person to offer or sell any security in this state unless (1) it is registered under this act or (2) the security or transaction is exempted under section 402.

COMMENT TO § 301

Section 301 forbids offers as well as sales prior to the effectiveness of a registration statement. "Offer" and "sale" are defined in § 401(j). The 1954 amendment of the Securities Act of 1933 to permit certain types of offers during the waiting period between the filing and the effectiveness of the registration statement is recognized in a special exemption for securities which are in process of registration under both the federal and state statutes. See the comment under § 402(b)(12). "Security" is defined in § 401(1). The scope of § 301 with respect to the phrase "in this state" is specified in § 414(a), (c), (d) and (e).

SECTION 302. [*Registration by Notification.*]

(a) The following securities may be registered by notification, whether or not they are also eligible for registration by coordination under section 303:

(1) any security whose issuer and any predecessors have been in continuous operation for at least five years if (A) there has been no default during the current fiscal year or within the three preceding fiscal years in the payment of principal, interest, or dividends on any security of the issuer (or any predecessor) with a fixed maturity or a fixed interest or dividend provision, and (B) the issuer and any predecessors during the past three fiscal years have had average net earnings, determined in accordance with generally accepted accounting practices, (i) which are applicable to all securities without a fixed maturity or a fixed interest or dividend provision outstanding at the date the registration statement is filed and equal at least five percent of the amount of such outstanding securities (as measured by the maximum offering price or the market price on a day, selected by the registrant, within thirty days before the date of filing the registration statement, whichever is higher, or book value on a day, selected by the registrant, within ninety days of the date of filing the registration statement to the extent that there is neither a readily determinable market price nor a cash offering price), or (ii) which, if the issuer and any predecessors have not had any security of the type specified in clause (i) outstanding for three full fiscal years, equal at least five percent of the amount (as measured in clause (i)) of all securities which will be outstanding if all the securities being offered or proposed to be offered (whether or not they are proposed to be registered or offered in this state) are issued;

(2) any security (other than a certificate of interest or participation in an oil, gas or mining title or lease or in payments out of production under such a title or lease) registered for non-issuer distribution if (A) any security of the same class has ever been registered under this act or a predecessor act, or (B) the security being registered was originally issued pursuant to an exemption under this act or a predecessor act.

COMMENT TO § 302(a)

In general: The introductory language of § 302(a) makes it clear that, when a particular security is eligible for registration by notification under § 302 as well as registration by coordination under § 303, it is discretionary with the person filing the registration statement to decide which procedure to use.

Clause (1): Section 302(a)(1) contains essentially a single earnings test, regardless of the type of security being registered. It applies in substance to any security whose issuer has been in continuous operation for five years if (A) there has been no default during the past three full fiscal years on any senior security and (B) the issuer during the past three fiscal years has had average earnings of five percent on its common stock. If the issuer has no outstanding securities of the types specified in Clause(A), it is necessary to satisfy only Clause (B). Under Clause (i) the five-percent test is applied to all outstanding securities at the date the registration statement is *filed*, and those securities are measured by the *offering price* (when additional securities are being offered) or by the *market price*, whichever is higher. In order to permit the calculation to be made so as to determine whether the notification procedure is available, the parenthetical clause within Clause (i) permits the person filing the registration statement to use the market price on any day within thirty days before the date of filing. The phrase "maximum offering price" means the highest price at which any of the securities are offered when they are offered to different people at different prices, as when they are offered to existing stockholders at a lower price than to the public generally. The phrase does not mean the maximum *proposed* offering price referred to in § 303(c)(3). See the comment under that section. But as a practical matter, since the market price and hence the offering price may go up while the registration statement is pending, it will not be safe to rely on the notification procedure unless the five-percent test is satisfied on the basis of the *maximum proposed offering price*. The five-percent test is applied to *book value* only when there is no readily determinable market price for the security being offered and there is no cash offering price either, as when the offering is made in exchange with security holders of another issuer, or with existing security holders of the same issuer under such circumstances that the exemption in § 402(b)(11) is not available.

Clause (1)(B)(ii): Clause (ii) is designed to take care of the case where a corporate registrant (or perhaps a business trust or a limited partnership) has succeeded within the past three years to a business previously conducted by a sole proprietor or a general partnership, so that the five-year requirement at the beginning of § 302(a)(1) would be satisfied but it would be impossible to satisfy the three-year earnings test for want of any outstanding securities during all of that period. Under Clause (ii) the five-percent earnings test is applied in such a case to all securities to be outstanding *after the conclusion of the offering.*

Clause (1) as applied to senior securities: Under Clause (B) the five-percent earnings test on common stock must be satisfied even though the security being offered is a preferred stock or a bond. This affords some margin of safety beyond the requirement in Clause (A) that there shall have been no default.

Clause (2): Oil, gas and mineral interests are excluded because they have no "issuer" as that term is defined in § 401(g)(2) and hence all distributions of such securities would be eligible for notification if they were not excluded.

(b) A registration statement under this section shall 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 414(g):

(1) a statement demonstrating eligibility for registration by notification;

(2) with respect to the issuer and any significant subsidiary: its name, address, and form of organization; the state (or foreign jurisdiction) and the date of its organization; and the general character and location of its business;

(3) with respect to any person on whose behalf any part of the offering is to be made in a non-issuer distribution: his name and address; the amount of securities of the issuer held by him as of the date of the filing of the registration statement; and a statement of his reasons for making the offering;

(4) a description of the security being registered;

(5) the information and documents specified in clauses (8), (10), and (12) of section 304(b); and

(6) in the case of any registration under section 302(a)(2) which does not also satisfy the conditions of section 302(a)(1), a balance sheet of the issuer as of a date within four months prior to the filing of the registration statement, and a summary of earnings for each of the two fiscal years preceding the date of the balance sheet and for any period between the close of the last fiscal year and the date of the balance sheet, or for the period of the issuer's and any predecessors' existence if less than two years.

COMMENT TO § 302(b)

This section is designed to supply enough information to enable the Administrator to apply the stop-order standards which uniformly govern all registration statements whether by notification, qualification or coordination. In the case of a primary offering being registered under § 302(a)(1), clause (1) requires basic financial information by way of demonstrating eligibility for the notification procedure. Clause (6) assures a modicum of financial information in the case of a non-issuer distribution which is eligible for the notification procedure solely because of § 302(a)(2). With respect to non-issuer distributions, see the comment under § 305(i).

(c) If no stop order is in effect and no proceeding is pending under section 306, a registration statement under this section automatically becomes effective at [three o'clock Eastern Standard Time] in the afternoon of the second full business day after the

filing of the registration statement or the last amendment, or at such earlier time as the [Administrator] determines.

COMMENT TO § 302(c)

States in other time zones should substitute "two o'clock Central Standard Time" or "one o'clock Mountain Standard Time" or "noon Pacific Standard Time." Flexibility to take care of emergencies or unusual situations is afforded by authorizing the Administrator to accelerate the effective date. He may do this almost routinely as the SEC does, so as not to require a waiting period of two days after the filing of the price amendment.

SECTION 303. [*Registration by Coordination.*]

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

COMMENT TO § 303(a)

Section 303 streamlines the *content* of the registration statement and the *procedure* by which it becomes effective, but not the *substantive standards* governing its effectiveness. The same stop-order standards specified in § 306 govern all three types of registration—notification, coordination and qualification.

The phrase "in connection with the same offering" does not require that the federal and state registration statements either be filed simultaneously or become effective simultaneously. Thus a registration statement by coordination might be filed in a particular state shortly after the effectiveness of the federal registration statement, although the Administrator would be free to decide that it was not "the same offering" if the interval was too great.

In the case of those investment companies which offer their securities continually by filing periodic amendments to their federal registration statements under the special procedure afforded by § 24(e) of the Investment Company Act of 1940 [see the comment under § 305(k)], conceptually each such amendment represents a new "offering." That is to say, every amendment filed with the SEC under § 24(e) is in substance a new registration statement. Hence it is contemplated that securities so registered with the SEC may be registered under this Act by coordination so long as the interval between the filing of the SEC amendment and the filing under this Act is not too great. Any question as to the propriety of this construction may be readily resolved by the adoption of a definitional rule under § 412(a) providing, in substance, that the term "registration statement" as used in § 303(a) includes an amendment filed under § 24(e) of the Investment Company Act of 1940.

(b) A registration statement under this section shall 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 414(g):

(1) three copies of the latest form of prospectus filed under the Securities Act of 1933;

(2) if the [Administrator] by rule or otherwise requires, a copy of the articles of incorporation and by-laws (or their substantial equivalents) currently in effect, a copy of any agreements with or among underwriters, a copy of any indenture or other instrument governing the issuance of the security to be registered, and a specimen or copy of the security;

(3) if the [Administrator] requests, any other information, or copies of any other documents, filed under the Securities Act of 1933; and

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

COMMENT TO § 303(b)

Section 303(b) limits the Administrator to requiring only such information as is filed with the SEC. Concerning § 303(b)(4), see the comment under § 303(c).

(c) A registration statement under this section automatically becomes effective at the moment the federal registration statement becomes effective if all 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; 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 such shorter period as the [Administrator] permits by rule or otherwise and the offering is made within those limitations. 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. "Price amendment" means the final federal amendment 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. Upon failure to receive the required notification and post-effective amendment with respect to the price amendment, the [Administrator] may enter a stop order, without notice or hearing, retroactively denying effectiveness to the registration statement or suspending its effectiveness until compliance with this subsection, if [he] promptly notifies the registrant by telephone or telegram (and promptly confirms by letter or telegram when [he] notifies by telephone) of the

issuance of the order. If the registrant proves compliance with the requirements of this subsection as to notice and post-effective amendment, the stop order is void as of the time of its entry. The [Administrator] may by rule or otherwise waive either or both of the conditions specified in clauses (2) and (3). If the federal registration statement becomes effective before all the conditions in this subsection are satisfied and they are not waived, the registration statement automatically becomes effective as soon as 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 [he] then contemplates the institution of a proceeding under section 306; but this advice by the [Administrator] does not preclude the institution of such a proceeding at any time.

COMMENT TO § 303(c)

Section 303(c) is designed to achieve simultaneous effectiveness at the federal and state levels without impinging upon the Administrator's duty to test the registration statement under the substantive standards imposed by § 306.

In order for the registration statement to become effective automatically when it becomes effective at the SEC, all the conditions specified in Clauses (1)-(3) must be satisfied unless the Administrator waives one or more of them.

Under § 303(b)(4) the registration statement when it is filed must be accompanied by an undertaking to forward all amendments to the federal registration statement. There is an exception for an amendment which merely delays the federal effective date. This refers to the practice whereby, if twenty days have expired since the filing of the last federal amendment and the registration statement has not yet been corrected to the satisfaction of the SEC, the registrant files an amendment merely changing the filing date, thus starting another twenty-day period running and avoiding the necessity of the Commission's instituting a proceeding to prevent automatic effectiveness. Sometimes amendments are mailed to the SEC and sometimes they are filed manually. When they are mailed they are not "filed" under § 413(a) until they are received, and in that event they will have to be forwarded to the Administrator not later than the first business day after they are *sent* to the SEC. Under § 306(a)(2)(H) failure to comply with the required undertaking is *per se* a basis for a stop order.

Clause (3) and the next three sentences are addressed to the problem of getting to the Administrator the content of the federal *price amendment* in the short interval (seldom more than twenty-four hours) which usually elapses between its filing and the effectiveness of the federal registrant statement. Clause (3) enables the Administrator to apply the stop-order test in § 306(a)(2)(F) by comparing the *maximum* underwriting commissions with the *minimum* offering price, and to apply the test in § 306(a)(2)(E) by reference to the maximum proposed offering price. Section 410(a)(1) imposes an absolute civil liability upon any person who "offers or sells a security in violation of section * * * 301," and § 410(f) makes the contract unenforceable. But under the fourth and fifth sentences the

validity of offers and sales in the state is not affected unless the registrant was at fault.

The last sentence makes it possible for counsel for the registrant or the underwriter to give a firm opinion to his client that all the conditions of § 303(c) have been satisfied, although it *requires* nothing further of the registrant.

SECTION 304. [*Registration by Qualification.*]

(a) Any security may be registered by qualification.

(b) A registration statement under this section shall 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 414(g):

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

(2) with respect to every director and officer of the issuer, or person occupying a similar status or performing similar functions: his name, address, and principal occupation for the past five years; the amount of securities of the issuer held by him as of a specified date within thirty days of the filing of the registration statement; the amount of the securities covered by the registration statement to which he has indicated his intention to subscribe; and a description of any material interest in any material transaction with the issuer or any significant subsidiary effected within the past three years or proposed to be effected;

(3) with respect to persons covered by clause (2): the remuneration paid during the past twelve months and estimated to be paid during the next twelve months, directly or indirectly, by the issuer (together with all predecessors, parents, subsidiaries, and affiliates) to all those persons in the aggregate;

(4) with respect to any person owning of record, or beneficially if known, ten percent or more of the outstanding shares of any class of equity security of the issuer: the information specified in clause (2) other than his occupation;

(5) with respect to every promoter if the issuer was organized within the past three years: the information specified in clause (2), any amount paid to him within that period or intended to be paid to him, and the consideration for any such payment;

(6) with respect to any person on whose behalf any part of the offering is to be made in a non-issuer distribution: his name and address; the amount of securities of the issuer held by him as of the date of the filing of the registration statement; a description of any material interest in any material transaction with the issuer or any significant subsidiary effected within the past three years or proposed to be effected; and a statement of his 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 any subsidiary has issued any of its securities within the past two years or is obligated to issue any of 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 any proportion of the offering is to be made to any person or class of persons other than the underwriters, with a specification of any such person or class; the basis upon which the offering is to be made if otherwise than for cash; the estimated aggregate underwriting and selling discounts or commissions and finders' fees (including separately cash, securities, contracts, or anything else of value to accrue to the underwriters or finders in connection with the offering) or, if the selling discounts or commissions are variable, the basis of determining them and their maximum and minimum amounts; the estimated amounts of other selling expenses, including legal, engineering, and accounting charges; the name and address of 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 any such agreement whose terms have not yet been determined; and a description of the plan of distribution of any securities which are to be offered otherwise than through an underwriter;

(9) the estimated cash proceeds to be received by the issuer from the offering; the purposes for which the proceeds are to be used by the issuer; the amount to be used for each purpose; the order or priority in which the proceeds will be used for the purposes stated; the amounts of any funds to be raised from other sources to achieve the purposes stated; the sources of any such funds; and, if any part of the proceeds is to be used to acquire any property (including goodwill)

otherwise than in the ordinary course of business, the names and addresses of the vendors, the purchase price, the names of any persons who have received commissions in connection with the acquisition, and the amounts of any such commissions and any other expense in connection with the acquisition (including the cost of borrowing money to finance the acquisition);

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

(11) the dates of, parties to, and general effect concisely stated of, every management or other material contract made or to be made otherwise 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 past two years, together with a copy of every such contract; and a description of any pending litigation or proceeding to which the issuer is a party and which materially affects its business or assets (including any such litigation or proceeding known to be contemplated by governmental authorities);

(12) 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;

(13) a specimen or copy 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;

(14) 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 shall state whether the security when sold will be legally issued, fully paid, and non-assessable, and, if a debt security, a binding obligation of the issuer;

(15) the written consent of any accountant, engineer, appraiser, or other person whose profession gives authority to a statement made by him, if any such 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;

(16) a balance sheet of the issuer as of a date within four months prior to the filing of the registration statement; a profit and loss statement and analysis of surplus for each of

the three fiscal years preceding the date of the balance sheet and for any period between the close of the last fiscal year and the date of the balance sheet, or for the period of the issuer's and any predecessors' existence if less than three years; and, if any part of the proceeds of the offering is to be applied to the purchase of any business, the same financial statements which would be required if that business were the registrant; and

(17) such additional information as the [Administrator] requires by rule or order.

COMMENT TO § 304(b)

Section 304(b) is modeled on Schedule A of the Securities Act of 1933, 15 U.S.C. § 77aa, SEC Form S-1, which is the basic registration form under that act, and a number of the state statutes. Section 305 contains a number of provisions applicable to registration generally, including authority in § 305(e) to reduce the content of the registration statement by rule or otherwise. And § 412(a) gives authority to classify, and adopt different forms for different types of, issues and issuers.

(c) A registration statement under this section becomes effective when the [Administrator] so orders.

(d) The [Administrator] may by rule or order require as a condition of registration under this section that a prospectus containing any designated part of the information specified in subsection (b) be sent or given to each person to whom an offer is made before or concurrently with (1) the first written offer made to him (otherwise than by means of a public advertisement) by or for the account of the issuer or any other person on whose behalf the offering is being made, or by any underwriter or broker-dealer who is offering part of an unsold allotment or subscription taken by him as a participant in the distribution, (2) the confirmation of any sale made by or for the account of any such person, (3) payment pursuant to any such sale, or (4) delivery of the security pursuant to any such sale, whichever first occurs.

COMMENT TO § 304(d)

Section 304(d) simply authorizes the Administrator to require the use of a prospectus in those unusual cases where he deems it in the public interest. This Act, unlike the federal statute, is not primarily a disclosure act.

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 registered broker-dealer.

COMMENT TO § 305(a)

Section 305 contains a number of provisions which are equally applicable to all three types of registration, or in a few cases to two of the three types.

The reference here to "any other person on whose behalf the offering is to be made" is designed for non-issuer distributions. See the comment under § 305(i). This section makes it possible for a local broker-dealer to file a registration statement independently of the issuer or underwriters, especially in coordination cases, so that the issuer and underwriters will not be able to veto the making of an offering and the establishment of a market in any state in which *they* do not choose to register.

[(b) Every person filing a registration statement shall pay a filing fee of . . . . percent of the maximum aggregate offering price at which the registered securities are to be offered in this state, but the fee shall in no case be less than $. . . . . or more than $. . . . . When a registration statement is withdrawn before the effective date or a pre-effective stop order is entered under section 306, the [Administrator] shall retain $. . . . . of the fee.]

COMMENT TO § 305(b)

On the fee problem with respect to convertible securities and offerings by way of warrants or rights, see the comment under § 401(j)(5).

(c) Every registration statement shall specify (1) the amount of securities to be offered in this state; (2) the states in which a registration statement or similar document in connection with the offering has been or is to be filed; and (3) any adverse order, judgment, or decree entered in connection with the offering by the regulatory authorities in each state or by any court or the Securities and Exchange Commission.

COMMENT TO § 305(c)

This section, like every other provision having to do with the content of the registration statement, must be read in the light of the fact that the accuracy and completeness of the registration statement are judged under § 306(a)(2)(A) as of its *effective date* unless a proceeding to deny effectiveness is instituted *before* the effective date. That is to say, the registration statement must be kept current with changing developments *until* the effective date, but it need not be amended *thereafter* except to correct inaccuracies or deficiencies which existed as of the effective date. If the Administrator wants some or all registration statements to be brought up to date periodically, he may do so by requiring reports under § 305(j).

Clause (3) does not require that notice be given with respect to any order permitting withdrawal of a registration statement. The Administrator may nevertheless require such information in qualification cases under § 304(b)(17).

(d) Any document filed under this act or a predecessor act [within five years preceding the filing of a registration state-

ment] may be incorporated by reference in the registration statement to the extent that the document is currently accurate.

COMMENT TO § 305(d)

The language in brackets is included only because some states do not keep files indefinitely. If a particular state does not keep files for as long as five years, or if it keeps them longer, some other appropriate figure should be substituted for "five." But if files are kept indefinitely, the bracketed language should be omitted.

(e) The [Administrator] may by rule or otherwise permit the omission of any item of information or document from any registration statement.

(f) In the case of a non-issuer distribution, information may not be required under section 304 or 305(j) unless it is known to the person filing the registration statement or to the persons on whose behalf the distribution is to be made, or can be furnished by them without unreasonable effort or expense.

COMMENT TO § 305(f)

See paragraph 10 of the comment under § 305(i).

(g) The [Administrator] may by rule or order require as a condition of registration by qualification or coordination (1) that any security issued within the past three years or to be issued to a promoter for a consideration substantially different from the public offering price, or to any person for a consideration other than cash, be deposited in escrow; and (2) that the proceeds from the sale of the registered security in this state be impounded until the issuer receives a specified amount from the sale of the security either in this state or elsewhere. The [Administrator] may by rule or order determine the conditions of any escrow or impounding required hereunder, but [he] may not reject a depository solely because of location in another state.

COMMENT TO § 305(g)

The "but" clause at the end of the section is designed to break the impasse which arises when each of several Administrators imposes an escrow or impounding requirement and insists that the depository be in his state.

(h) The [Administrator] may by rule or order require as a condition of registration that any security registered by qualification or coordination be sold only on a specified form of subscription or sale contract, and that a signed or conformed copy of each contract be filed with the [Administrator] or preserved for any period up to three years specified in the rule or order.

COMMENT TO § 305(h)

This provision is included to take care of the few states in which this regulatory device is used. No implication is intended that this authority should be used by the Administrator in states in which it is not traditional.

(i) Every registration statement is effective for one year from its effective date, or any longer period during which the security is being offered or distributed in a non-exempted transaction by or for the account of the issuer or other person on whose behalf the offering is being made or by any underwriter or broker-dealer who is still offering part of an unsold allotment or subscription taken by him as a participant in the distribution, except during the time a stop order 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 non-issuer transaction (1) so long as the registration statement is effective and (2) between the thirtieth day after the entry of any stop order suspending or revoking the effectiveness of the registration statement under section 306 (if the registration statement did not relate in whole or in part to a non-issuer distribution) and one year from the effective date of the registration statement. A registration statement may not be withdrawn for one year from its effective date if any securities of the same class are outstanding. A registration statement may be withdrawn otherwise only in the discretion of the [Administrator].

(j) So long as a registration statement is effective, the [Administrator] may by rule or order 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.

COMMENT TO § 305(i), § 305(j) AND RELATED SECTIONS REFERRING TO NON-ISSUER DISTRIBUTIONS

The statutory scheme with respect to non-issuer distributions and the related question of how long a registration statement remains effective is as follows:

1. Section 301(a) applies broadly to any offer or sale by any person. Thus, it is literally unlawful for A to sell five shares of X Corp. to B unless there is registration or an exemption.

2. The term "non-issuer" is defined in § 401(h) to mean simply "not directly or indirectly for the benefit of the issuer."

3. Section 402(b)(1) exempts from registration "any isolated non-issuer transaction, whether effected through a broker-dealer or not."

4. When the non-issuer distribution is something more than an "isolated transaction," however that phrase is construed, it may still be exempted under one of the following sections: 402(a)(8), 402(b)(3), 402(b)(6), 402(b)(7), 402(b)(8), or 402(b)(9). See the comments under those sections.

5. Apart from these exemptions of general applicability, § 402(b)(2) affords an

exemption which is specifically designed for certain non-issuer distributions. An Administrator who chooses to do so may keep track of the securities sold under this exemption by requiring under § 203(a) that registered broker-dealers prepare and keep lists of those securities.

6. If no exemption is available for the non-issuer distribution, the security must be registered. Under the first sentence of § 305(i) every registration statement is effective for at least one year and for any longer period during which the security is being distributed, except while a stop order is in effect. Under Clause (1) of the second sentence all outstanding securities "of the same class" as the registered security are considered to be registered for the purpose of any non-issuer transaction so long as the registration statement remains effective. And § 305(j) gives the Administrator power by rule or order to require the registrant to file reports so long as the registration remains effective. With respect to the applicability of § 305(j) to convertible securities and rights offerings, see the comment under § 401(j)(5). The effect is that as long as a registration statement is effective, no matter who has filed it or how many units of the class have been registered, all securities *of the same class* can be legally traded by anybody *as if they were registered*.

7. Clause (2) of the second sentence of § 305(i) is designed to take care of the situation where the Administrator finds it necessary to enter a stop order during the year after the effective date. When the registration which thus becomes the subject of a stop order was itself filed in connection with the non-issuer distribution, it would substantially nullify the effect of the stop order to continue to permit a secondary market on the class registration theory of the first sentence of § 305(i). But, when the registration statement related entirely to a primary distribution by the issuer, and a substantial part of the offering was made in the state before the stop order was entered, Clause (2) avoids indefinitely locking the buyers in. Clause (2) stops all trading based on the class registration theory of the first sentence of § 304(i), as distinct from trading based on the "isolated transaction" exemption in § 402(b)(1) or some other exemption, for thirty days after the entry of the stop order, so that the public may become aware of the stop order and the reason for its entry. Thereafter such trading may resume until the year has expired.

8. If securities of the class being registered are outstanding when the registration statement becomes effective, or if some of the registered securities have been sold, post-effective *withdrawal* of the registration statement would interfere with the privilege of persons generally to engage in non-issuer trading for a minimum period of one year after the effective date. Since sellers might not always know of the withdrawal, they might thus be subjected to civil liability through no fault of their own. For this reason § 305(i) provides that a registration statement may not be withdrawn for one year from its effective date if any securities of the same class are outstanding.

9. If no exemption is available for a non-issuer distribution and *a registration statement for securities of the same class is not effective*, there arises for the first time the necessity of filing a *special* registration statement to permit a non-issuer distribution. As in the case of a distribution for the account of the issuer, registration may be affected here by coordination, notification or qualification. Concerning the exclusion of oil, gas and mining interests from § 302(a)(2), see the comment under that section. A registration for a non-issuer distribution, like any other registration, is considered to register all outstanding securities of the same class, and thus to permit anybody to trade for a minimum of one year or however much longer it may take to complete the registered non-issuer distribution. It is thus immaterial whether the registration statement specifically covers 100 shares or 100,000 shares, because the Administrator may not permit the registration statement to become effective unless the statutory standards are satisfied.

10. Section 305(f) is designed only to take care of the case where the seller cannot obtain certified financial statements and other data normally required. The phrase "without unreasonable effort or expense" is borrowed from § 10(a)(3) of the Securities Act of 1933, 15 U.S.C. § 77j(a)(3). In the case of a non-issuer distribution by a person who is in a control relationship with the issuer or otherwise has access to required information, that phrase is not meant to apply to the expense which is merely incident to supplying the information required to register. Moreover, § 305(f) does not excuse the filing of the financial data required by § 302(b)(6) if a non-issuer distribution is registered by *notification*; for § 305(f) applies by its terms only to §§ 304 (registration by qualification) and 305(j) (reports). The person filing the registration statement can always register by qualification. Although he may not be able to obtain the financial data required by § 302(b)(6) to demonstrate eligibility for the notification procedure, he may be able to obtain other information which the Administrator might wish to require under § 304.

(k) A registration statement relating to a security issued by a face-amount certificate company or a redeemable security issued by an open-end management company or unit investment trust, as those terms are defined in the Investment Company Act of 1940, may be amended after its effective date so as to increase the securities specified as proposed to be offered. Such an amendment becomes effective when the [Administrator] so orders. Every person filing such an amendment shall pay a filing fee, calculated in the manner specified in subsection (b), with respect to the additional securities proposed to be offered.

COMMENT TO § 305(k)

Investment companies of the types here specified are distinguished by the fact that they are continually offering their securities. Therefore, they do not lend themselves readily to the concept of registering a security in connection with a proposed distribution. For that reason Congress in 1954 added a new § 24(e) to the Investment Company Act of 1940, 15 U.S.C. § 80a-24(e), providing an amendment procedure for registration statements filed under the Securities Acts of 1933 by investment companies of these types. Since these investment companies typically offer in many states, the same provision is incorporated in § 305(k). Normally the investment company will presumably wish to use the coordination procedure under § 303. See the last paragraph of the comment under § 303(a). But it will find § 305(k) useful when it runs out of locally registered securities in a particular state before it has to file an amendment to its federal registration statement.

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, any registration statement if [he] finds (1) that the order is in the public interest and (2) that

(A) the registration statement as of its effective date or as

of any earlier date in the case of an order denying effectiveness, or any amendment under section 305(k) as of its effective date, or any report under section 305(j) is incomplete in any material respect or contains any statement which was, in the light of the circumstances under which it was made, false or misleading with respect to any material fact;

(B) any provision of this act or any rule, order, or condition lawfully imposed under this act has been willfully violated, in connection with the offering, by (i) the person filing the registration statement, (ii) the issuer, any partner, officer, or director of the issuer, any person occupying a similar status or performing similar functions, or any 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 (iii) any underwriter;

(C) the security registered or sought to be registered is the subject of an administrative stop order or similar order or a permanent or temporary injunction of any court of competent jurisdiction entered under any other federal or state act applicable to the offering; but (i) the [Administrator] may not institute a proceeding against an effective registration statement under clause (C) more than one year from the date of the order or injunction relied on, and (ii) [he] may not enter an order under clause (C) on the basis of an order or injunction entered under any other state act unless that order or injunction was based on facts which would currently constitute a ground for a stop order under this section;

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

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

(F) 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;

(G) when a security is sought to be registered by notification, it is not eligible for such registration;

(H) when a security is sought to be registered by coordination, there has been a failure to comply with the undertaking required by section 303(b)(4); or

(I) the applicant or registrant has failed to pay the proper filing fee; but the [Administrator] may enter only a denial order under this clause and [he] shall vacate any such order when the deficiency has been corrected.

The [Administrator] may not institute a stop-order proceeding against an effective registration statement on the basis of a fact or transaction known to him when the registration statement became effective unless the proceeding is instituted within the next thirty days.

Comment to § 306(a)

Section 306(a) applies equally to all three types of registration.

Clause (A): The completeness and accuracy of the registration statement are to be tested as of its *effective date* in a *suspension* or *revocation* proceeding. That is to say, the fact that a registration statement has become misleading by virtue of developments occurring *after* its effective date is not a ground for the issuance of a stop order revoking its effectiveness under Clause (A). Post-effective amendments are not necessary except to reflect inaccuracies as of the effective date. If a particular Administrator wants the registration statement to be kept more or less currently accurate so long as it remains effective, he may require reports as often as quarterly by rule or order under § 305(j). In that event, filing a misleading report would be a basis for a stop order under Clause (A) and failure to file such a report would be a basis for a stop order under Clause (B). On the other hand, in a proceeding to *deny* effectiveness to a pending registration statement, its completeness and accuracy cannot be tested as of the effective date. This explains the first "or" clause in Clause (A).

Clause (B): Concerning the meaning of "willfully," see the comment under § 204(a)(2)(B). Under Clause (ii) a violation by the issuer has the same consequences whether the issuer has filed the registration statement itself or has had a local broker-dealer file the registration statement for it. But, when the registration is filed by a local broker-dealer who is acting independently, a provision authorizing the issuance of a stop order for a violation by the issuer or somebody connected with the issuer would be inconsistent with the statutory purpose of permitting (particularly in cases of registration by coordination) the making of an offering and the establishment of a market in any state in which a registered broker-dealer is willing to effect registration. See the comment under § 305(a).

Clause (C): The word "is" at the beginning of Clause (C) means that a stop order or injunction which has expired by its terms or been vacated is not a ground for action under this clause.

Clause (D): The reference here is to something like a racetrack or gambling casino which is conducted in a state where such an enterprise is illegal. The "public interest" standard in Clause (1) must always be considered. Thus the fact that a large department store had recently violated a statute on resale price maintenance of minimum wages would not justify action under Clause (D). Moreover, Clause (D) is not meant to apply to an enterprise which is lawful where conducted, although it would be illegal if conducted in the state where the registration statement is filed.

Clause (E): Section 401(d) provides that the term "fraud" is not limited to common-law deceit. But this clause is not designed to be as broad as the "sound business principles" standard or the "fair, just, and equitable" standard found in some statutes.

Clause (F): This clause is broad enough to cover the statement of policy on options which was adopted in 1946 by the National Association of Securities Administrators, as well as its 1955 statement of policy on so-called "cheap stock." 29 Proceedings of NASA 84-90; 38 id. 113-15.

(b) The [Administrator] may by order summarily postpone or suspend the effectiveness of the registration statement pending final determination of any proceeding under this section. Upon the entry of the order, the [Administrator] shall promptly notify each person specified in subsection (c) that it has been entered and of the reasons therefor and that within fifteen days after the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the [Administrator], the order will remain 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 (c), may modify or vacate the order or extend it until final determination.

(c) No stop order may be entered under any part of this section except the first sentence of subsection (b) without (1) appropriate prior notice to the applicant or registrant, the issuer, and the person on whose behalf the securities are to be or have been offered, (2) opportunity for hearing, and (3) written findings of fact and conclusions of law.

COMMENT TO § 306(c)

This section is comparable to § 204(f) and the comment there is equally applicable here.

(d) The [Administrator] may vacate or modify a stop order if [he] finds that the conditions which prompted entry have changed or that it is otherwise in the public interest to do so.

PART IV

GENERAL PROVISIONS

SECTION 401. [*Definitions.*] When used in this act, unless the context otherwise requires:

(a) "[Administrator]" [substitute any other appropriate term, such as "Commission," "Commissioner," "Secretary," etc.] means the [official or agency designated in section 406(a)].

(b) "Agent" means any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities. "Agent" does not include an individual who represents an issuer in (1) effecting transactions in a security exempted by clause (1), (2), (3), (10), or (11) of section 402(a), (2) effecting transactions exempted by section 402(b), or (3) effecting transactions with existing employees, partners, or directors of the issuer if no

commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state. A partner, officer, or director of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is an agent only if he otherwise comes within this definition.

COMMENT TO § 401(b)

Whether a particular individual who represents a broker-dealer or issuer is an "agent" or is himself a "broker-dealer" depends upon much the same factors which create an agency relationship at common law. That is to say, the question turns essentially on whether the individual has manifested a consent to the broker-dealer or issuer to act subject to his control. See *Restatement of Agency* § 1. The last sentence does not require every partner, officer or director to file a separate application for registration, because the last sentence of § 202(a) provides that registration of a broker-dealer automatically constitutes registration of any agent who is a partner, officer or director. See the comment under § 202(a).

(c) "Broker-dealer" means any person engaged in the business of effecting transactions in securities for the account of others or for his own account. "Broker-dealer" does not include (1) an agent, (2) an issuer, (3) a bank, savings institution, or trust company, or (4) a person who has no place of business in this state if (A) he effects transactions in this state exclusively with or through (i) the issuers of the securities involved in the transactions, (ii) other broker-dealers, or (iii) banks, savings institutions, trust companies, insurance companies, investment companies as defined in the Investment Company Act of 1940, pension or profit-sharing trusts, or other financial institutions or institutional buyers, whether acting for themselves or as trustees, or (B) during any period of twelve consecutive months he does not direct more than fifteen offers to sell or buy into this state in any manner to persons other than those specified in clause (A), whether or not the offeror or any of the offerees is then present in this state.

COMMENT TO § 401(c)

With respect to the distinction between a person who is "engaged in the business of effecting transactions * * * for his own account" and an ordinary investor who buys and sells with some frequency, see Loss, *Securities Regulation* (1955 with 1955 Supp.), pp. 720-22.

Clause (4): See paragraph 12 of the comment under § 414(a)-(f). The reference in Clause (B) to fifteen offers during any period of twelve consecutive months in the case of persons without a place of business in the state is not intended to carry any implication that a person who effects more than fifteen transactions for his own account in the course of ordinary investment during any period of twelve months is for that reason alone a "broker-dealer."

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

COMMENT TO § 401(d)

Section 401(d) codifies the holdings that "fraud" as used in federal and state securities statutes, as well as the federal mail fraud statute, is not limited to common-law deceit. See the cases cited in Loss, *Securities Regulation* (1951 with 1955 Supp.), p. 817, notes 30-31.

(e) "Guaranteed" means guaranteed as to payment of principal, interest, or dividends.

(f) "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities. "Investment adviser" does not include (1) a bank, savings institution, or trust company; (2) a lawyer, accountant, engineer, or teacher whose performance of these services is solely incidental to the practice of his profession; (3) a broker-dealer whose performance of these services is solely incidental to the conduct of his business as a broker-dealer and who receives no special compensation for them; (4) a publisher of any bona fide newspaper, news magazine, or business or financial publication of general, regular, and paid circulation; (5) a person whose advice, analyses, or reports relate only to securities exempted by section 402(a)(1); (6) a person who has no place of business in this state if (A) his only clients in this state are other investment advisers, broker-dealers, banks, savings institutions, trust companies, insurance companies, investment companies as defined in the Investment Company Act of 1940, pension or profit-sharing trusts, or other financial institutions or institutional buyers, whether acting for themselves or as trustees, or (B) during any period of twelve consecutive months he does not direct business communications into this state in any manner to more than five clients other than those specified in clause (A), whether or not he or any of the persons to whom the communications are directed is then present in this state; or (7) such other persons not within the intent of this paragraph as the [Administrator] may by rule or order designate.

COMMENT TO § 401(f)

In general: Section 401(f) has been taken almost verbatim from the definition in § 202(a)(11) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11). On the administrative construction of the federal definition, see Loss, *Securities Regulation* (1951 with 1955 Supp.), pp. 788-92. Clause (6) has been added; see paragraph 12 of the comment under § 414(a)-(f).

Clause (3): The model of this clause in the federal act has been thus explained in an opinion of the SEC's General Counsel (Investment Advisers Act Release No. 2):

> "[This clause] amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business. On the other hand, that portion of clause [(3)] which refers to 'special compensation' amounts to an equally clear recognition that a broker or dealer who is specially compensated for the rendition of advice should be considered an investment adviser and not be excluded from the purview of the Act merely because he is also engaged in effecting market transactions in securities. It is well known that many brokers and dealers have investment advisory departments which furnish investment advice for compensation in the same manner as does an investment adviser who operates solely in an advisory capacity. The essential distinction to be borne in mind in considering borderline cases * * * is the distinction between compensation for advice itself and compensation for services of another character to which advice is merely incidental."

Clause (4): The word "paid," which does not appear in the federal definition, has been added to emphasize that a person who periodically distributes a "tipster sheet" free as a way to get paying clients is not excluded from the definition as a "publisher."

(g) "Issuer" means any person who issues or proposes to issue any security, except that (1) with respect to certificates of deposit, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or persons performing similar functions or of the fixed, restricted management, or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which the security is issued; and (2) with respect to certificates of interest or participation in oil, gas, or mining titles or leases or in payments out of production under such titles or leases, there is not considered to be any "issuer."

COMMENT TO § 401(g)

The phraseology is taken almost verbatim from § 2(4) of the Securities Act of 1933, 15 U.S.C. § 77b(4). The peculiar types of securities other than those dealt with in Clause (1)—for example, equipment-trust certificates—may be handled under the rule-making power in § 412(a).

(h) "Non-issuer" means not directly or indirectly for the benefit of the issuer.

COMMENT TO § 401(h)

See the comment under § 305(i).

(i) "Person" means an individual, a corporation, a partnership, an association, a joint-stock company, a trust where the

interests of the beneficiaries are evidenced by a security, an unincorporated organization, a government, or a political subdivision of a government.

(j)(1) "Sale" or "sell" includes every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value.

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

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

(4) A purported gift of assessable stock is considered to involve an offer and sale.

(5) Every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, as well as every sale or offer of a security which gives the holder a present or future right or privilege to convert into another security of the same or another issuer, is considered to include an offer of the other security.

(6) The terms defined in this subsection do not include (A) any bona fide pledge or loan; (B) any 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 when each stockholder may elect to take the dividend in cash or property or in stock; (C) any act incident to a class vote by stockholders, pursuant to the certificate of incorporation or the applicable corporation statute, on a merger, consolidation, reclassification of securities, or sale of corporate assets in consideration of the issuance of securities of another corporation; or (D) any act incident to a judicially approved reorganization in which a security is issued in exchange for one or more outstanding securities, claims, or property interests, or partly in such exchange and partly for cash.

COMMENT TO § 401(j)

Clauses (1)-(2): The phraseology is borrowed substantially from § 2(3) of the Securities Act of 1933, 15 U.S.C. § 77b(3), as amended in 1954 to split the definitions of "sale" and "offer." See the comment under § 402(b)(12).

Clause (5): This clause provides that there is always an "offer" of the security called for by a conversion privilege or the warrant. Hence that security must be registered (unless some exemption is available) before the convertible security or the warrants are offered. Even if the warrants are themselves distributed without consideration, so that the warrants are not "sold," a gift of a warrant involves an offer to sell the stock called for by the warrant. Hence registration of the *stock* is necessary before the warrants may even be given away. Moreover, since the security called for is being continuously "offered" so long as the conversion privilege or the purchase right remains exercisable, the security called for remains registered all that time under § 305(i), and the person who files the registration statement is subject to the Administrator's power to require the filing of reports under § 305(j).

Under certain conditions, however, § 402(b)(11) exempts offers to existing security holders, specifically including "persons who at the time of the transaction are holders of convertible securities, non-transferable warrants, or transferable warrants exercisable within not more than ninety days of their issuance." That exemption does not excuse *registration* of the second security (that is, the security called for by the warrant or conversion privilege) unless the offering of the first security itself (that is, the warrants or the convertible security) comes within the exemption; for there is a present "offer" of the second security under § 401(j)(5) and the offerees are not yet existing security holders. But the exemption under § 402(b)(11) will normally be available *when the conversion privilege or warrant is exercised*. Hence, if the *first* security is not being offered or distributed more than one year from the effective date of the registration statement, the effectiveness of the registration statement terminates at the end of the one-year period under § 305(i) and the power to require reports terminates at the same time.

The registration fee in the case of warrants or rights 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 themselves if they are not given away. In the convertible security situation, since no consideration is given for the second security except the surrender of the first, the fee should be based solely on the offering price of the convertible security and there should be no double fee.

(k) "Securities Act of 1933," "Securities Exchange Act of 1934," "Public Utility Holding Company Act of 1935," and "Investment Company Act of 1940" mean the federal statutes of those names as amended before or after the effective date of this act.

(l) "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "Security" does not include any 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.

COMMENT TO § 401(l)

This section is identical with § 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1), except for oil, gas and mineral interests and the addition of the last sentence. Section 2(1) was modeled on the definitions in some of the state statutes, and the federal definition has in turn influenced many of the new state statutes enacted since 1933. Moreover, substantially that definition—particularly the phrase "investment contract"—has been broadly construed by both state and federal courts. See, *e.g.*, *SEC* v. *W. J. Howey Co.*, 328 U.S. 293 (1946); for citations to other federal and state cases, as well as a discussion of the administrative construction of the several phrases in the definition, see Loss, *Securities Regulation* (1951 with 1955 Supp.), pp. 299-329.

Oil, gas and mineral interests: Section 2(1) of the Securities Act of 1933 uses the phrase "fractional undivided interest in oil, gas, or other mineral rights." The phrase in this statute is modeled on the language in § 25008(a) of the California act—"certificate of interest in an oil, gas, or mining title or lease"—which may be slightly broader than the federal phrase and in any event is by far the most commonly found phrase in the state statutes. The words which have been added to the California language are intended to make it clear that so-called "oil payments" are securities whether or not they may be regarded as interests *in a title or lease*. Very few states go so far as to include entire leasehold interests. However, it is clear that even entire leasehold interests may be offered under such circumstances that a security is involved in the nature of an "investment contract." *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344 (1943); for other cases, see Loss, *Securities Regulation* (1951 with 1955 Supp.), p. 312, n. 31.

The last sentence has been explicitly phrased so as not to exclude from the definition the so-called "variable annuities" which have recently been developed. See also the comment under § 402(a)(5). If it is desired to exclude variable annuities along with orthodox annuities on the ground that the former are sufficiently regulated by the insurance authorities in the particular state, the bracketed language should be deleted.

(m) "State" means any state, territory, or possession of the United States, the District of Columbia, and Puerto Rico.

SECTION 402. [*Exemptions.*]

(a) The following securities are exempted from sections 301 and 403:

COMMENT TO § 402(a)

The distinction between *exemptions* and *exceptions from definitions* is important in view of the fact that the exemptions enumerated in § 402 are not exemptions from the anti-fraud provisions of §§ 101 and 410(a)(2). See the exceptions from the definition of "agent" in § 401(b), the definition of "broker-dealer" in § 401(c), the definition of "investment adviser" in § 401(f), the definitions of "sale" and "offer" in § 401(j)(6), and the definition of "security" in the last sentence of § 401(1).

(1) any security (including a revenue obligation) issued or guaranteed by the United States, any state, any political subdivision of a state, or any agency or corporate or other instrumentality of one or more of the foregoing; or any certificate of deposit for any of the foregoing;

(2) any security issued or guaranteed by Canada, any Canadian province, any political subdivision of any such province, any agency or corporate or other instrumentality of one or more of the foregoing, or any other foreign government with which the United States currently maintains diplomatic relations, if the security is recognized as a valid obligation by the issuer or guarantor;

(3) any security issued by and representing an interest in or a debt of, or guaranteed by, any bank organized under the laws of the United States, or any bank, savings institution, or trust company organized and supervised under the laws of any state;

COMMENT TO § 402(a)(3)

Each of the exemptions in Clauses (3)-(5) applies only if the security represents an interest in or a debt of the particular issuer, or is guaranteed by the particular issuer. The purpose is to make it clear that these exemptions do not apply when, for example, a bank acting as depository for a protective committee in a reorganization issues certificates of deposit, which in no sense represent an interest in or a claim against the bank. The exemption for bank securities in Illinois was so construed even before it was specifically limited as it now is. *Jaffe* v. *Goldner*, 251 Ill. App. 188 (1929); see also *Commissioner of Banks* v. *Chase Securities Corp.*, 298 Mass. 285, 301-05, 10 N. E. 2d 472, 485-87 (1937), appeal dismissed, 302 U.S. 660. But it required an amendment in California [§ 25100(c)] to override a contrary interpretation. *Young* v. *Three for One Royalties*, 31 P. 2d 789 (Cal. 1934), rehearing denied with opinion, 1 Cal. 2d 639, 36 P. 2d 1065 (1934).

(4) any security issued by and representing an interest in or a debt of, or guaranteed by, any federal savings and loan association, or any building and loan or similar association organized under the laws of any state and authorized to do business in this state;

COMMENT TO § 402(a)(4)

See the comment under § 402(a)(3).

(5) any security issued by and representing an interest in or a debt of, or guaranteed by, any insurance company organized under the laws of any state and authorized to do business in this state; [but this exemption does not apply to an annuity contract, investment contract, or similar security under which the promised payments are not fixed in dollars but are substantially dependent upon the investment results of a segregated fund or account invested in securities;]

COMMENT TO § 402(a)(5)

See the comment under § 402(a)(3). With respect to the status of insurance policies and annuities, see the comment under the last sentence of § 401(l). By

virtue of that section, the orthodox insurance policy or annuity is not a "security" and the blue sky law has no impact on it, whereas securities issued by insurance companies are exempted from registration under the conditions of § 402(a)(5) and hence are subject to the fraud provisions. The purpose of the "but" clause in § 402(a)(5) is to make it clear that the so-called "variable annuities" which have recently been developed, and which *are* securities under § 401(1), are not exempted.

If the bracketed language in § 401(1) is deleted (see the comment under that section), the bracketed language in § 402(a)(5) should be deleted for the same reason.

(6) any security issued or guaranteed by any federal credit union or any credit union, industrial loan association, or similar association organized and supervised under the laws of this state;

COMMENT TO § 402(a)(6)

The reference to federal credit unions is to those organized under 12 U.S.C. § 1751 *et seq.*

(7) any security issued or guaranteed by any railroad, other common carrier, public utility, or holding company which is (A) subject to the jurisdiction of the Interstate Commerce Commission; (B) a registered holding company under the Public Utility Holding Company Act of 1935 or a subsidiary of such a company within the meaning of that act; (C) regulated in respect of its rates and charges by a governmental authority of the United States or any state; or (D) regulated in respect of the issuance or guarantee of the security by a governmental authority of the United States, any state, Canada, or any Canadian province;

COMMENT TO § 402(a)(7)

Twelve of the forty statutes with some sort of public-utility exemption refer specifically to regulation by municipal as well as state authority. The others do not necessarily exclude the possibility of municipal regulation. The reference in § 402(a)(7) to "a governmental authority of * * * any state" is broad enough to include a municipal authority.

(8) any 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 exchanges)]; any other security of the same issuer which is of senior or substantially equal rank; any security called for by subscription rights or warrants so listed or approved; or any warrant or right to purchase or subscribe to any of the foregoing;

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

(10) any commercial paper which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which evidences an obligation to pay cash within nine months of the date of issuance, exclusive of days of grace, or any renewal of such paper which is likewise limited, or any guarantee of such paper or of any such renewal;

COMMENT TO § 402(a)(10)

This exemption is modeled on § 3(a)(3) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(3). On the SEC construction of the phrase "current transaction," see Loss, *Securities Regulation* (1951 with 1955 Supp.), p. 356. See also § 402(b)(8), which exempts an offer or sale of any security to banks and other institutional buyers. The two exemptions substantially overlap.

(11) any investment contract issued in connection with an employees' stock purchase, savings, pension, profit-sharing, or similar benefit plan if the [Administrator] is notified in writing thirty days before the inception of the plan or, with respect to plans which are in effect on the effective date of this act, within sixty days thereafter (or within thirty days before they are reopened if they are closed on the effective date of this act);

COMMENT TO § 402(a)(11)

This exemption is designed to solve the problem which arises in those states whose Administrators take the position, also taken by the SEC, that employees' benefit plans of various kinds involve an offer of a security in the nature of an "investment contract," at least if participation is voluntary with each employee and he must contribute under the plan in order to participate. See Loss, *Securities Regulation* (1951 with 1955 Supp.), pp. 326-29.

[(12) insert any desired exemption for cooperatives.]

(b) The following transactions are exempted from sections 301 and 403:

(1) any isolated non-issuer transaction, whether effected through a broker-dealer or not;

COMMENT TO § 402(b)(1)

See the comment under § 305(i).

(2) any non-issuer distribution of an outstanding security if (A) a recognized securities manual contains the names of the issuer's officers and directors, a balance sheet of the issuer as of a date within eighteen months, and a profit and loss state-

ment for either the fiscal year preceding that date or the most recent year of operations, or (B) the security 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 preceding fiscal 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;

COMMENT TO § 402(b)(2)

See the comment under § 305(i).

(3) any non-issuer transaction effected by or through a registered broker-dealer pursuant to an unsolicited order or offer to buy; but the [Administrator] may by rule require that the customer acknowledge upon a specified form that the sale was unsolicited, and that a signed copy of each such form be preserved by the broker-dealer for a specified period;

COMMENT TO § 402(b)(3)

If necessary, the Administrator may use his rule-making authority under § 412(a) to define the term "solicitation." On the construction of the term in § 4(2) of the Securities Act of 1933, 15 U.S.C. § 77d(2), see Loss, *Securities Regulation* (1951 with 1955 Supp.), pp. 405-06. In one important respect § 402(b)(3) is broader than § 4(2) of the federal statute, which the SEC has always interpreted as exempting only the *broker's* part of the transaction. In the SEC's view, the *selling customer* must find his own exemption—normally the exemption in § 4(1) of the federal act which is comparable to the exemption in § 402(b)(1) of this Act for "any isolated non-issuer transaction." Section 402(b)(3) is not intended to be so limited. Of course, the exemption can in no case be used by an *issuer*, since it is limited to "any non-issuer transaction."

(4) any transaction between the issuer or other person on whose behalf the offering is made and an underwriter, or among underwriters;

(5) any transaction in a bond or other evidence of indebtedness secured by a real or chattel mortgage or deed of trusts, or by an agreement for the sale of real estate or chattels, 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;

COMMENT TO § 402(b)(5)

This exemption is severely restricted by the requirement that everything be both offered and sold as a unit. But it permits a *public* offering *as a unit*.

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

(7) any transaction executed by a bona fide pledgee without any purpose of evading this act;

(8) any offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profit-sharing trust, or other financial institution or institutional buyer, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity;

COMMENT TO § 402(b)(8)

The term "institutional buyer" is broad enough to cover, for example, a college purchasing for its endowment fund or perhaps a labor union investing its surplus funds on a substantial scale. The term may be either left to *ad hoc* interpretation or defined by an interpretative rule under § 412(a).

(9) any transaction pursuant to an offer directed by the offeror to not more than ten persons (other than those designated in paragraph (8)) in this state during any period of twelve consecutive months, whether or not the offeror or any of the offerees is then present in this state, if (A) the seller reasonably believes that all the buyers in this state (other than those designated in paragraph (8)) are purchasing for investment, and (B) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective buyer in this state (other than those designated in paragraph (8)); but the [Administrator] may by rule or order, as to any security or transaction or any type of security or transaction, withdraw or further condition this exemption, or increase or decrease the number of offerees permitted, or waive the conditions in Clauses (A) and (B) with or without the substitution of a limitation on remuneration;

COMMENT TO § 402(b)(9)

The figure ten is in substance only a *prima facie* figure. An Administrator, for example, may want to reduce it for uranium stocks or oil royalties or increase it for a close corporation which wants to solicit twenty or thirty friends and relatives of the owners for additional capital. The section does not require a written representation by each buyer that he is taking for investment, but it would be prudent on the part of the seller to obtain something in writing. Moreover, one who in good faith buys for investment can later change his mind and resell, although the shorter the interval the harder it will be to show that there was a *bona fide* change of mind. Clause (B) is not intended to preclude solicitation by directors or officers or employees of the issuer so long as it is only an incidental function of their regular duties and they receive no additional compensation. It is also relevant whether such persons are specially hired in connection with the offering, particularly if they have a background in the securities business either as professional promoters or otherwise.

(10) any offer or sale of a preorganization certificate or

subscription if (A) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective subscriber, (B) the number of subscribers does not exceed ten, and (C) no payment is made by any subscriber;

COMMENT TO § 402(b)(10)

Sections 402(b)(9) and 402(b)(10), though interrelated, serve different purposes. Since the purpose of § 402(b)(10) is to enable a new enterprise to obtain the minimum number of subscriptions required by the corporation law, the limitation is on the number of subscribers rather than the number of offerees. Hence there may be a publicly advertised offering of preorganization subscriptions. But there may be no *payment* until effective registration *unless another exemption is available.* One of the other exemptions which might be available is § 402(b)(9). In that event registration would not be required at all. But § 402(b)(10) itself simply *postpones* registration; it does not *excuse* registration altogether.

(11) any transaction pursuant to an offer to existing security holders of the issuer, including persons who at the time of the transaction are holders of convertible securities, nontransferable warrants, or transferable warrants exercisable within not more than ninety days of their issuance, if (A) no commission or other remuneration (other than a standby commission) is paid or given directly or indirectly for soliciting any security holder in this state, or (B) the issuer first files a notice specifying the terms of the offer and the [Administrator] does not by order disallow the exemption within the next five full business days;

COMMENT TO § 402(b)(11)

The reference to a "standby commission" in Clause (A) is designed to permit payment to an underwriter for his risk and services in connection with his commitment to take down any portion of the offering which is not taken down by the security holders. As to what constitutes the payment of remuneration otherwise, see the comment under § 402(b)(9). The specific authority to disallow by order under Clause (B) is not subject to the general procedure set out in § 402(c) for denying any of the exemptions specified in § 402(b).

(12) any offer (but not a sale) of a security for which registration statements have been filed under both this act and the Securities Act of 1933 if no stop order or refusal order is in effect and no public proceeding or examination looking toward such an order is pending under either act.

COMMENT TO § 402(b)(12)

The Securities Act of 1933 and the SEC rules severely restrict the types of written offers that may be made before the effective date.

(c) The [Administrator] may by order deny or revoke any exemption specified in clause (9) or (11) of subsection (a) or

in subsection (b) with respect to a specific security or transaction. No such order may be entered without appropriate prior notice to all interested parties, opportunity for hearing, and written findings of fact and conclusions of law, except that the [Administrator] may by order summarily deny or revoke any of the specified exemptions pending final determination of any proceeding under this subsection. Upon the entry of a summary order, the [Administrator] shall promptly notify all interested parties that it has been entered and of the reasons therefor and that within fifteen days of the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the [Administrator], the order will remain 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 all interested persons, may modify or vacate the order or extend it until final determination. No order under this subsection may operate retroactively. No person may be considered to have violated section 301 or 403 by reason of any offer or sale effected after the entry of an order under this subsection if he sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the order.

COMMENT TO § 402(c)

Section 402(c) permits the Administrator by order to deny or revoke the exemption for any of the exempted transactions, as well as two types of exempted securities, but only with respect to a specific case. He has no authority by rule or otherwise to revoke any statutory exemption generally.

(d) In any proceeding under this act, the burden of proving an exemption or an exception from a definition is upon the person claiming it.

COMMENT TO § 402(d)

This codifies existing law. See the cases cited in Loss, *Securities Regulation* (1951 with 1955 Supp.), p. 414, n. 365.

SECTION 403. [*Filing of Sales and Advertising Literature.*] The [Administrator] by rule or order may require the filing of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature or advertising communication addressed or intended for distribution to prospective investors, including clients or prospective clients of an investment adviser, unless the security or transaction is exempted by section 402.

COMMENT TO § 403

Many statutes require advertising and sales literature to be *approved* by the Administrator before it is used. Some require merely *filing* prior to use. Some, particularly with respect to securities registered by notification, require sales literature to be filed either concurrently with or after its use. Section 403 affords the necessary flexibility, in conjunction with the authority in § 412(a) to classify, so that the Administrator may by rule or order apply any or all of these formulas to certain types of securities. Consistently with the "unless" clause, any rules or orders under this section can apply only to the person filing a registration statement or his principal.

SECTION 404. [*Misleading Filings.*] It is unlawful for any person to make or cause to be made, in any document filed with the [Administrator] or in any proceeding under this act, any statement which is, at the time and in the light of the circumstances under which it is made, false or misleading in any material respect.

SECTION 405. [*Unlawful Representations Concerning Registration or Exemption.*]

(a) Neither (1) the fact that an application for registration under part II or a registration statement under Part III has been filed nor (2) the fact that a person or security is effectively registered constitutes a finding by the [Administrator] that any document filed under this act is true, complete, and not misleading. Neither any such fact nor the fact that an exemption or exception is available for a security or a transaction means that the [Administrator] has passed in any way upon the merits or qualifications of, or recommended or given approval to, any person, security, or transaction.

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

SECTION 406. [*Administration of Act.*]

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

(b) It is unlawful for the [Administrator] or any of [his] officers or employees to use for personal benefit any information which is filed with or obtained by the [Administrator] and which is not made public. No provision of this act authorizes the [Administrator] or any of [his] officers or employees to disclose any such information except among themselves or when necessary or appropriate in a proceeding or investigation under this act. No provision of this act either creates or derogates from any privilege

which exists at common law or otherwise when documentary or other evidence is sought under a subpoena directed to the [Administrator] or any of his officers or employees.

COMMENT TO § 406(b)

The "except" clause in the second sentence takes care of cases in which the Administrator or a member of his staff is subpoenaed. The law of evidence is not clear in such cases whether and to what extent non-public information in the files of a governmental agency is privileged. The last sentence 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.

[(c) Insert a provision, if desired, covering fees for examinations, filings under section 403, and other miscellaneous filings for which no fees are specified elsewhere in this act.]

COMMENT TO § 406(c)

The only fees specifically provided for in this statute are the registration fees under §§ 202(b) and 305(b). Many statutes specify a wide variety of additional fees for certain filings, examinations, interpretative opinions and other special purposes.

SECTION 407. [*Investigations and Subpoenas.*]

(a) The [Administrator] in [his] discretion (1) may make such public or private investigations within or outside of this state as [he] deems necessary to determine whether any person has violated or is about to violate any provision of this act or any rule or order hereunder, or to aid in the enforcement of this act or in the prescribing of rules and forms hereunder, (2) may require or permit any person to file a statement in writing, under oath or otherwise as the [Administrator] determines, as to all the facts and circumstances concerning the matter to be investigated, and (3) may publish information concerning any violation of this act or any rule or order hereunder.

(b) For the purpose of any investigation or proceeding under this act, the [Administrator] or any officer designated by [him] may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, agreements, or other documents or records which the [Administrator] deems relevant or material to the inquiry.

(c) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the [insert name of appropriate court], upon application by the [Administrator], may issue to the person an order requiring him to appear before the [Administrator], or the officer designated by [him], there to produce documentary evidence if so ordered or to give evidence touching the matter

under investigation or in question. Failure to obey the order of the court may be punished by the court as a contempt of court.

(d) No person is excused from attending and testifying or from producing any document or record before the [Administrator], or in obedience to the subpoena of the [Administrator] or any officer designated by [him], or in any proceeding instituted by the [Administrator], on the ground that the testimony or evidence (documentary or otherwise) required of him may tend to incriminate him or subject him to a penalty of forfeiture; but no individual may be prosecuted or subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he is compelled, after claiming his privilege against self-incrimination, to testify or produce evidence (documentary or otherwise), except that the individual testifying is not exempt from prosecution and punishment for perjury or contempt committed in testifying.

COMMENT TO § 407

Section 407 is modeled generally on § 21(a)-(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(a)-(d).

The immunity provision in § 407(d) is of the broader variety which forecloses subsequent prosecution and not merely the use of the compelled testimony. Compare *Counselman* v. *Hitchcock*, 142 U.S. 547 (1892), with *Ullmann* v. *United States*, 350 U.S. 422 (1956). The words "or contempt" in the "except" clause at the end do not appear in § 21(d) of the Securities Exchange Act of 1934, but they do appear in the 1954 revision of § 3486 of the United States Criminal Code, 68 Stat. 745, 18 U.S.C. § 3486, the statute construed in the *Ullmann* case. The purpose is to assure against a witness' obtaining immunity, answering a few questions and then balking. See *United States* v. *Bryan*, 339 U.S. 323, 335 *et seq.* (1950).

The compulsion of testimony under state process does not grant immunity from federal prosecution so far as the Fifth Amendment is concerned. *Feldman* v. *United States*, 322 U.S. 487 (1944) (prosecution under mail fraud statute); *Dunham* v. *Ottinger*, 243 N.Y. 423, 438, 154 N.E. 298, 302 (1926), cert. dismissed for want of a substantial federal question, 276 U.S. 592 (the compulsory testimony provision of the New York blue sky law satisfies the Fifth Amendment so long as it guarantees against state prosecution). On the other hand, compulsion of testimony under state process may violate the self-incrimination clause of the state constitution if there is no guarantee against a resulting federal prosecution. *People* v. *Den Uyl*, 318 Mich. 645, 29 N.W. 2d 284, 2 A.L.R. 2d 625 (1947); *State* ex rel. *Mitchell* v. *Kelly*, 71 So. 2d 887, 895 *et seq.* (Fla. 1954).

SECTION 408. [*Injunctions.*] Whenever it appears to the [Administrator] that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this act or any rule or order hereunder, [he] may in [his] discretion bring an action in the [insert name of appropriate court] to enjoin the acts or practices and to enforce compliance with this act or any rule or order hereunder. Upon a proper showing a permanent or temporary injunction, restraining order or writ of mandamus shall be granted and a receiver or conservator may be appointed for the defendant or the defendant's assets. The court may not require the [Administrator] to post a bond.

COMMENT TO § 408

Section 408 is modeled on §§ 21(e) and 21(f) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78u(e), 78u(f).

SECTION 409. [*Criminal Penalties.*]

(a) Any person who willfully violates any provision of this act except section 404, or who willfully violates any rule or order under this act, or who willfully violates section 404 knowing the statement made to be false or misleading in any material respect, shall upon conviction be fined not more than $5,000 or imprisoned not more than three years, or both; but no person may be imprisoned for the violation of any rule or order if he proves that he had no knowledge of the rule or order. [No indictment or information may be returned under this act more than five years after the alleged violation.]

(b) The [Administrator] may refer such evidence as is available concerning violations of this act or of any rule or order hereunder to the [attorney general or the proper district attorney], who may, with or without such a reference, institute the appropriate criminal proceedings under this act.

(c) Nothing in this act limits the power of the state to punish any person for any conduct which constitutes a crime by statute or at common law.

COMMENT TO § 409

On the meaning of "willfully," see the comment under § 204(a)(2)(B). The sentence in brackets in § 409(a) is an optional provision for any state which does not have a general criminal statute of limitations.

SECTION 410. [*Civil Liabilities.*]

(a) Any person who

(1) offers or sells a security in violation of section 201(a), 301, or 405(b), or of any rule or order under section 403 which requires the affirmative approval of sales literature before it is used, or of any condition imposed under section 304(d), 305(g), or 305(h), or

(2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not

misleading (the buyer not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission,

is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six percent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at six percent per year from the date of disposition.

COMMENT TO § 410(a)

For a detailed breakdown of the civil liabilities under the present statutes, with annotations of some of the leading cases, see Loss, *Securities Regulation* (1951 with 1955 Supp.), pp. 962-82.

Clause (1): Clause (1) imposes civil liability when the *offer* violates one of the specified provisions even though the sale does not. The making of a non-exempted offer before the effective date can create no civil rights in the offeree unless the offer results in a sale. But when it does, this language means that the buyer may recover even though no contract was made until after the effective date.

Clause (2): This clause is almost identical with § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77l(2), which was also borrowed almost verbatim in § 451.116 of the Michigan statute and § 13.1-522(a)(2) of the new Virginia act. For a comparison of § 12(2) of the federal statute with equitable rescission, from which it was adapted, see Loss, *Securities Regulation* (1951 with 1955 Supp.), pp. 997-1001, 1003-11. Section 410(a)(2), like § 101, the general fraud provision, applies regardless of whether the security is registered, exempted, or sold in violation of the registration requirements.

Measure of damages: The measure of damages, when the plaintiff is not in a position to tender back the security, is the same under Clauses (1) and (2). It is designed to be the substantial equivalent of rescission.

(b) Every person who directly or indirectly controls a seller liable under subsection (a), every partner, officer, or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the non-seller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

COMMENT TO § 410(b)

The defense of lack of knowledge is modeled on § 15 of the Securities Act of 1933, 15 U.S.C. § 77o, and § 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(a). The last sentence, with reference to contribution, is a safeguard to avoid the common-law rule which prohibits contribution among joint tort-feasors.

(c) Any tender specified in this section may be made at any time before entry of judgment.

(d) Every cause of action under this statute survives the death of any person who might have been a plaintiff or defendant.

COMMENT TO § 410(d)

This section is designed to codify the majority view of the few cases which have ruled on the question of survivability under the state and federal securities statutes. For the cases, see Loss, *Securities Regulation* (1951 with 1955 Supp.), pp. 1077-78. Although the question whether a statutory cause of action is *assignable* involves much the same considerations as whether it survives the death of either party, that question is left to the general law, whether decisional or under the general assignment statutes which exist in some states.

(e) No person may sue under this section more than two years after the contract of sale. No person may sue under this section (1) if the buyer received a written offer, before suit and at a time when he owned the security, to refund the consideration paid together with interest at six percent per year from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within thirty days of its receipt, or (2) if the buyer received such an offer before suit and at a time when he did not own the security, unless he rejected the offer in writing within thirty days of its receipt.

COMMENT TO § 410(e)

The purpose of § 410(e)(2) is to take care of the case where the buyer has already disposed of the security before the rescission offer is made to him. In such a case the buyer is not foreclosed from bringing suit if he is not satisfied with the seller's computation of damages, but in order to do so he must reject the rescission offer within thirty days so that the seller may know where he stands.

(f) No person who has made or engaged in the performance of any contract in violation of any provision of this act or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract.

COMMENT TO § 410(f)

This result has been quite generally reached by the courts even in the absence of a specific provision. See the cases cited in Loss, *Securities Regulation* (1951 with 1955 Supp.), p. 967, n. 63.

(g) Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this act or any rule or order hereunder is void.

(h) The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, but this act does not create any cause of action not specified in this section or section 202(c).

COMMENT TO § 410(h)

The mere presence of certain specific liability provisions in a statute is no assurance that other liabilities will not be implied by the courts under the doctrine which creates a common-law tort action for violation of certain criminal statutes. *Restatement of Torts* §§ 286-88. Notwithstanding the presence of several specific liability provisions in each of the several SEC statutes, the federal courts have implied a civil cause of action by a defrauded seller against the buyer under SEC Rule X-10B-5. See Loss, *Securities Regulation* (1951 with 1955 Supp.), pp. 1052-66. The "but" clause in § 410(h) is designed to assure that no comparable development is based on violation of § 101 of this Act.

SECTION 411. [*Judicial Review of Orders.*]

(a) Any person aggrieved by a final order of the [Administrator] may obtain a review of the order in the [insert name of appropriate court] by filing in court, within sixty days after the entry of the order, a written petition praying that the order be modified or set aside in whole or in part. A copy of the petition shall be forthwith served upon the [Administrator], and thereupon the [Administrator] shall certify and file in court a copy of the filing and evidence upon which the order was entered. When these have been filed, the court has exclusive jurisdiction to affirm, modify, enforce, or set aside the order, in whole or in part. The findings of the [Administrator] as to the facts, if supported by competent, material and substantial evidence, are conclusive. If either party applies to the court for leave to adduce additional material evidence, and shows to the satisfaction of the court that there were reasonable grounds for failure to adduce the evidence in the hearing before the [Administrator], the court may order the additional evidence to be taken before the [Administrator] and to be adduced upon the hearing in such manner and upon such conditions as the court considers proper. The [Administrator] may modify [his] findings and order by reason of the additional evidence and shall file in court the additional evidence together with any modified or new findings or order.

[The judgment of the court is final, subject to review by the (insert name of appropriate court).]

(b) The commencement of proceedings under subsection (a) does not, unless specifically ordered by the court, operate as a stay of the [Administrator's] order.

COMMENT TO § 411

This section is modeled partly on § 12 of the Model Administrative Procedure Act, 54 Handbook of National Conference of Commissioners on Uniform State Laws 334 (1944), and partly on § 25 of the Securities Exchange Act of 1934, 15 U.S.C. § 78y.

SECTION 412. [*Rules, Forms, Orders, and Hearings.*]

(a) The [Administrator] may from time to time make, amend, and rescind such rules, forms, and orders as are necessary to carry out the provisions of this act, including rules and forms governing registration statements, applications, and reports, and defining any terms, whether or not used in this act, insofar as the definitions are not inconsistent with the provisions of this act. For the purpose of rules and forms, the [Administrator] may classify securities, persons, and matters within [his] jurisdiction, and prescribe different requirements for different classes.

(b) No rule, form, or order may be made, amended, or rescinded unless the [Administrator] finds that the action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes fairly intended by the policy and provisions of this act. In prescribing rules and forms the [Administrator] may cooperate with the securities administrators of the other states and the Securities and Exchange Commission with a view to effectuating the policy of this statute to achieve maximum uniformity in the form and content of registration statements, applications, and reports wherever practicable.

(c) The [Administrator] may by rule or order prescribe (1) the form and content of financial statements required under this act, (2) the circumstances under which consolidated financial statements shall be filed, and (3) whether any required financial statements shall be certified by independent or certified public accountants. All financial statements shall be prepared in accordance with generally accepted accounting practices.

(d) All rules and forms of the [Administrator] shall be published.

(e) No provision of this act imposing any liability applies to any act done or omitted in good faith in conformity with any rule, form, or order of the [Administrator], notwithstanding that the rule, form, or order may later be amended or rescinded or be

determined by judicial or other authority to be invalid for any reason.

(f) Every hearing in an administrative proceeding shall be public unless the [Administrator] in [his] discretion grants a request joined in by all the respondents that the hearing be conducted privately.

COMMENT TO § 412

(a): Section 412(a) is largely modeled on the rule-making provisions of the SEC statutes. Some states have Administrative Procedure Acts which cut across this area. An order, of course, is directed to one or more particular persons, and a rule or form is of general applicability. Hence, when the Administrator is authorized to adopt rules or forms, he may not act by order, and vice versa.

(d): Local Administrative Procedure Acts may provide specific procedures for publishing rules and forms. In the absence of any such statute, § 412(d) leaves the procedure of publication to each Administrator.

(e): Section 412(e) is modeled on the comparable provisions in the SEC acts and many other federal administrative statutes.

SECTION 413. [*Administrative Files and Opinions.*]

(a) A document is filed when it is received by the [Administrator].

(b) The [Administrator] shall keep a register of all applications for registration and registration statements which are or have ever been effective under this act and all denial, suspension, or revocation orders which have been entered under this act. The register shall be open for public inspection.

(c) The information contained in or filed with any registration statement, application, or report may be made available to the public under such rules as the [Administrator] prescribes.

(d) Upon request and at such reasonable charges as [he] prescribes, the [Administrator] shall furnish to any person photostatic or other copies (certified under [his] seal of office if requested) of any entry in the register or any document which is a matter of public record. In any proceeding or prosecution under this act, any copy so certified is prima facie evidence of the contents of the entry or document certified.

(e) The [Administrator] in [his] discretion may honor requests from interested persons for interpretative opinions.

COMMENT TO § 413

Section 413(a) prescribes no particular method of filing, although the Administrator is free to do so by rule under § 412(a). Section 413(b) refers to a register of the applications and registration statements, not the physical documents.

SECTION 414. [*Scope of the Act and Service of Process.*]

(a) Sections 101, 201(a), 301, 405, and 410 apply to persons who

sell or offer to sell when (1) an offer to sell is made in this state, or (2) an offer to buy is made and accepted in this state.

(b) Sections 101, 201(a), and 405 apply to persons who buy or offer to buy when (1) an offer to buy 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 buy is made in this state, whether or not either party is then present in this state, when the offer (1) originates from this state or (2) is directed by the offeror to this state and received at the place to which it is directed (or at any post office in this state in the case of a mailed offer).

(d) For the purpose of this section, an offer to buy or to sell is accepted in this state when acceptance (1) is communicated to the offeror in this state and (2) has not previously been communicated to the offeror, orally or in writing, outside this state; and acceptance is communicated to the offeror in this state, whether or not either party is then present in this state, when the offeree directs it to the offeror in this state reasonably believing the offeror to be in this state and it is received at the place to which it is directed (or at any post office in this state in the case of a mailed acceptance).

(e) An offer to sell or to buy is not made in this state when (1) the publisher circulates or there is circulated on his behalf in this state any bona fide newspaper or other publication of general, regular, and paid circulation which is not published in this state, or which is published in this state but has had more than two-thirds of its circulation outside this state during the past twelve months, or (2) a radio or television program originating outside this state is received in this state.

(f) Sections 102 and 201(c), as well as section 405 so far as investment advisers are concerned, apply when any act instrumental in effecting prohibited conduct is done in this state, whether or not either party is then present in this state.

COMMENT TO § 414(a)-(f)

Section 414 defines and delimits the application of the Act in interstate or international transactions with only some of their elements in the state. It is not limited in its impact to the civil liability provisions of § 410. Section 414 and its appendages, §§ 401(c)(4) and 401(f)(6), determine the scope of the Act for all kinds of proceedings—civil, criminal, injunctive and administrative. It is quite clear that a person may violate the law of a given state, even criminally, without ever being within the state or performing within the state every act necessary to complete the offense. *Strassheim* v. *Daly*, 221 U.S. 280 (1911). So far as applying the Act in civil or injunctive or administrative proceedings is concerned, see the comment under §§ 414(g) and 414(h).

Section 414(a)-(f) can best be explained in the context of a civil action under § 410(a) by a buyer in State B against a selling broker-dealer in State S:

1. The basic approach of § 414(a)(1) is to apply the specified sections when "an offer to sell is made in this state."

2. Section 414(c) provides, in substance, that an offer which originates in State S and is directed to State B is made in both states. Hence the statute of State B applies under § 414(c)(2) in the hypothetical case.

3. By the same token, the statute of State S also applies to the offer under § 414(c)(1), on the theory that State S should not be used as a base of operations for defrauding persons in other states. It is thus quite possible for more than one statute to apply to a given transaction.

4. Section 414(e)(1) deals with the problem of offers in the form of newspaper and magazine advertisements. It provides, in substance, that an advertisement in a regular newspaper or periodical is not an "offer" in any state other than the state of publication. Thus a seller may insert an advertisement in the New York Times and have it circulated freely in other states.

5. A slight variation of this problem occurs in connection with magazines of national circulation. The place of publication of these magazines is purely fortuitous so far as the purposes of § 414 are concerned. Accordingly, § 414(e)(1) refers also to a publication which is published *within* the state but has more than two-thirds of its circulation *outside* the state.

6. Section 414(e)(2) treats radio and television programs originating outside the state in the same way as newspapers or magazines published outside the state. For purposes of this section a radio or television program is considered to originate in the state where the microphone or television camera is, not at any relay station.

7. The door left open in § 414(e) is then closed somewhat by § 414(a)(2), which provides in effect that a person in State B who makes an offer to *buy* as a result of an advertisement he sees in a paper published in State S (or a radio or television program originating in State S) may render the statute applicable if the seller then accepts the offer "in this state" (that is, State B). And § 414(d) specifies when an offer is "accepted in this state."

8. If the selling dealer in State S merely sends a confirmation or delivers the security into State B, or the buyer in State B sends a check in payment from within State B, the statute of State B does not apply except when under § 414(d) the confirmation or delivery constitutes the seller's acceptance of the buyer's offer to buy.

9. The parenthetical references in §§ 414(c) and 414(d) to "any post office in this state" are designed to make it clear that, when a person in State X directs an offer or acceptance to a person in State Y who has moved or gone temporarily to State Z, the act of State Y does apply and the act of State Z does not. This prevents entrapment of innocent persons who have no reason to believe that a communication will be forwarded into another state whose act has not been complied with.

10. The applicability of the statute to *buyers* as distinct from *sellers* is covered by § 414(b), which is precisely the converse of § 414(a). Here, of course, there is no civil liability.

11. Section 414(f) applies only to *investment advisers*.

12. Sections 401(c)(4) and 401(f)(6) exclude from the definitions of "broker-dealer" and "investment adviser" certain persons who have no place of business in the state. Clause (A) of each section has much the same rationale as the exemption in § 402(b)(8) for sales to institutional buyers or broker-dealers. Clause (A) of § 401(c)(4), insofar as it refers to issuers or other broker-dealers, has the additional purpose of making it unnecessary for an out-of-state underwriter to register as a broker-dealer before negotiating with an issuer in the state or setting up a selling group with local broker-dealers in it. Clause (B) of each

section is designed to permit a New York broker-dealer or investment adviser, for example, to take care of a few customers who live in New Jersey or are vacationing in Florida without registering as a broker-dealer or investment adviser in those states, as he would otherwise have to do under § 414.

13. Nothing in the statute requires or permits one state to enforce the criminal provisions of another state's blue sky law.

(g) Every applicant for registration under this act and every issuer which proposes to offer a security in this state through any person acting on an agency basis in the common-law sense shall file with the [Administrator], in such form as [he] by rule prescribes, an irrevocable consent appointing the [Administrator] or [his] successor in office to be his attorney to receive service of any lawful process in any non-criminal suit, action, or proceeding against him or his successor executor or administrator which arises under this act or any rule or order hereunder after the consent has been filed, with the same force and validity as if served personally on the person filing the consent. A person who has filed such a consent in connection with a previous registration need not file another. Service 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] in a suit, action, or proceeding instituted by [him], forthwith sends notice of the service and a copy of the process by registered mail to the defendant or respondent at his last address on file with the [Administrator], and (2) the plaintiff's affidavit of compliance with this subsection is filed in the case on or before the return day of the process, if any, or within such further time as the court allows.

COMMENT TO § 414(g)

The *issuer* does not have to file a consent to service unless it proposes to offer the security in the state through somebody acting on an agency basis in the common-law sense.

(h) When any person, including any nonresident of this state, engages in conduct prohibited or made actionable by this act or any rule or order hereunder, and he has not filed a consent to service of process under subsection (g) and personal jurisdiction over him cannot otherwise be obtained in this state, that conduct shall be considered equivalent to his appointment of the [Administrator] or [his] successor in office to be his attorney to receive service of any lawful process in any non-criminal suit, action, or proceeding against him or his successor executor or administrator which grows out of that conduct and which is brought under this act or any rule or order hereunder, with the same force and validity as if served on him personally. Service

may be made by leaving a copy of the process in the office of the [Administrator], and it is not effective unless (1) the plaintiff, who may be the [Administrator] in a suit, action, or proceeding instituted by [him], forthwith sends notice of the service and a copy of the process by registered mail to the defendant or respondent at his last known address or takes other steps which are reasonably calculated to give actual notice, and (2) the plaintiff's affidavit of compliance with this subsection is filed in the case on or before the return day of the process, if any, or within such further time as the court allows.

COMMENT TO § 414(h)

The purpose of § 414(h) is to provide for substituted service of process when a seller in State S directs an offer into State B in violation of the registration provisions of State B or fraudulently. Under § 414(h) the buyer may sue the seller in State B and then bring suit on the judgment in State S. The section has been closely modeled on the type of nonresident motorist statute whose constitutionality was sustained in *Hess* v. *Pawlowski*, 274 U.S. 352 (1927). Recent cases indicate that it is due process of law for a court of State B to enter a judgment in the hypothetical case discussed in this paragraph if the person in State S effected only an isolated transaction in State B without ever entering the state. In addition to the nonresident motorist precedents, see *Travelers Health Ass'n* v. *Commonwealth of Virginia* ex rel. *State Corporation Commission*, 339 U.S. 643 (1950); *International Shoe Co.* v. *State of Washington*, 326 U.S. 310 (1945); *Parmalee* v. *Iowa State Traveling Mens Ass'n*, 206 F. 2d 518 (5th Cir. 1953), cert. denied, 346 U.S. 877; *Schutt* v. *Commercial Travelers Mutual Accident Ass'n*, 206 F. 2d 158 (2d Cir. 1956). If this is correct, a court in State S will have to give full faith and credit to the judgment of the court of State B.

(i) When process is served under this section, the court, or the [Administrator] in a proceeding before [him], shall order such continuance as may be necessary to afford the defendant or respondent reasonable opportunity to defend.

SECTION 415. [*Statutory Policy.*] This act shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this act with the related federal regulation.

SECTION 416. [*Short Title.*] This act may be cited as the Uniform Securities Act.

SECTION 417. [*Severability of Provisions.*] If any provision of this act or the application thereof to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.

SECTION 418. [*Repeal and Saving Provisions.*]

(a) The [identify the existing act or acts] is [are] repealed except as saved in this section.

(b) Prior law exclusively governs all suits, actions, prosecutions, or proceedings which are pending or may be initiated on the basis of facts or circumstances occurring before the effective date of this act, except that no civil suit or action may be maintained to enforce any liability under prior law unless brought within any period of limitation which applied when the cause of action accrued and in any event within two years after the effective date of this act.

(c) All effective registrations under prior law, all administrative orders relating to such registrations, and all conditions imposed upon such registrations remain in effect so long as they would have remained in effect if this act had not been passed. They are considered to have been filed, entered, or imposed under this act, but are governed by prior law.

(d) Prior law applies in respect of any offer or sale made within one year after the effective date of this act pursuant to an offering begun in good faith before its effective date on the basis of an exemption available under prior law.

(e) Judicial review of all administrative orders as to which review proceedings have not been instituted by the effective date of this act are governed by section 411, except that no review proceeding may be instituted unless the petition is filed within any period of limitation which applied to a review proceeding when the order was entered and in any event within sixty days after the effective date of this act.

SECTION 419. [*Time of Taking Effect.*] This act shall take effect on [insert date, which should be at least sixty or ninety days after enactment].

COMMENT TO § 419

If the act is adopted in a particular state before the more essential uniform forms and rules have been drafted, the effective date should be suitably delayed.

APPENDIX A

Accommodation of the Act to the Deletion of Part III (Registration of Securities)

Preamble	Change the third clause to read: "requiring the registration of broker-dealers, agents, and investment advisers;"
Sec. 202(a):	In the first sentence change "414(g)" to "314(g)"
Sec. 202(e):	In the fourth sentence change "410" to "310"
Part III:	Delete this part and renumber Part IV as Part III, Sec. 401 as Sec. 301, etc.
Sec. 401(b):	Delete the first two sentences and substitute: "'Agent' means any individual other than a broker-dealer who represents a broker-dealer or issuer (except as provided in section 302) in effecting or attempting to effect purchases or sales of securities."
Sec. 401(f):	In Clause (5) change "402(a)(1)" to "302(a)(1)"
Sec. 401(h):	Delete this subsection and renumber the following subsections of Sec. 401 accordingly.
Sec. 402(a):	Change the introductory clause to read: "Agents of issuers with respect to the following securities are excepted from sections 301(b) and 303:" Delete Clauses (4)-(9) and (12); renumber the remaining clauses accordingly; and at the end of Clause (11), to be renumbered (5), change the semicolon to a period.
Sec. 402(b):	Change the introductory clause to read: "Agents of issuers with respect to the following transactions are excepted from sections 301(b) and 303:" Delete Clauses (1)-(3) and (7) and renumber the remaining clauses accordingly. Change Clause (6), to be renumbered (3), to read: "any transaction by a receiver or trustee in bankruptcy;" At the end of Clause (12), to be renumbered (8), change the period to a semi-colon and add the following new Clause (9): "any transaction effected with existing employees, partners, or directors of the issuer if no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state."

Sec. 402(c):	Delete this subsection and renumber Sec. 402(d) accordingly.
Sec. 402(d):	Delete "an exemption or"
Sec. 403:	Change this section to read: "The [Administrator] may by rule or order require any registered broker-dealer or agent to file any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature addressed or intended for distribution to prospective investors, except with respect to the securities and transactions specified in section 302."
Sec. 405(a):	Change the first sentence to read: "Neither (1) the fact that an application for registration has been filed nor (2) the fact that a person is ***." In the second sentence delete "exemption or" and "for a security or a transaction"
Sec. 406(c):	Delete the reference to Sec. 403.
Sec. 409(a):	Change "404" to "304" twice.
Sec. 410(a):	Change Clause (1) to read: "(1) offers or sells a security in violation of section 201(a) or 305(b), or"
Sec. 413(b):	Delete "and registration statements"
Sec. 413(c):	Change this subsection to read: "The information contained in or filed with any application or report ***."
Sec. 414(a):	Change this subsection to read: "Sections 101, 201(a), 305, and 310 are ***."
Sec. 414(b):	Change "405" to "305"
Sec. 414(f):	Change "405" to "305"
Sec. 418(d):	Delete this subsection and renumber Sec. 418(e) accordingly.
Sec. 418(e):	Change "411" to "311"

APPENDIX B

Accommodation of the Act to the Deletion of Parts II and III

Any state which desires nothing more than a "fraud" type of statute may adopt only Part I and a few provisions of Part IV, which would be renumbered as Part II. Only the provisions in the following table should be retained. They should be renumbered as indicated. Otherwise they should be unchanged except as indicated.

Present Provision	*Renumbered Provision if Sec. 102 Is Retained in Full*	*Renumbered Provision if Sec. 102(b) and Sec. 102(c) Are Deleted*
Preamble	Preamble	Preamble
Sec. 101	Sec. 101	Sec. 101
Sec. 102(a)	Sec. 102(a)	Sec. 102
Sec. 102(b)	Sec. 102(b)	. . . . .
Sec. 102(c)	Sec. 102(c)	. . . . .
Sec. 401(a)	Sec. 201(a)	Sec. 201(a)
Sec. 401(d)	Sec. 201(b)	Sec. 201(b)
Sec. 401(f)	Sec. 201(c)	. . . . .
Sec. 401(i)	Sec. 201(d)	Sec. 201(c)
Sec. 401(j)	Sec. 201(e)	Sec. 201(d)
Sec. 401(k)	Sec. 201(f)	. . . . .
Sec. 401(l)	Sec. 201(g)	Sec. 201(e)
Sec. 401(m)	Sec. 201(h)	. . . . .
Sec. 402(d)	Sec. 202	Sec. 202
Sec. 406(a)-(b)	Sec. 203(a)-(b)	Sec. 203(a)-(b)
Sec. 407(a)-(d)	Sec. 204(a)-(d)	Sec. 204(a)-(d)
Sec. 408	Sec. 205	Sec. 205
Sec. 409(a)-(c)	Sec. 206(a)-(c)	Sec. 206(a)-(c)
Sec. 410(a)-(h)	Sec. 207(a)-(h)	Sec. 207(a)-(h)
Sec. 412	Sec. 208	. . . . .
Sec. 414(a)-(f)	Sec. 209(a)-(f)	Sec. 208(a)-(f)
Sec. 414(h)	Sec. 209(g)	Sec. 208(g)
Sec. 415	Sec. 210	Sec. 209
Sec. 416	Sec. 211	Sec. 210
Sec. 417	Sec. 212	Sec. 211
Sec. 418(a)-(b)	Sec. 213(a)-(b)	Sec. 212(a)-(b)
Sec. 419	Sec. 214	Sec. 213

Preamble — Change the preamble to read: "[An Act Relating to securities; prohibiting fraudulent practices in relation thereto; and making uniform the law with reference thereto.]"

Sec. 401(f): If Sec. 102(b) and Sec. 102(c) are retained (see Appendix C), change Sec. 401(f) as follows:

Change Clause (3) to read: "a person engaged as a broker or dealer in the business of effecting transactions in securities if the performance of these services is solely incidental to the conduct of his business as a broker or dealer and he receives no special compensation for these services;"

Change Clause (5) to read: "a person whose advice, analyses, or reports relate only to securities (including revenue obligations) issued or guaranteed as to payment of principal, interest, or dividends by the United States, any state, or any agency or corporate or other instrumentality of one or more of the foregoing, or certificates of deposit for any of the foregoing;"

In Clause (6) delete "broker-dealers," and substitute "brokers, dealers,"

Sec. 401(k): If Sec. 401(f) is retained, change Sec. 401(k) to read: "'Investment Company Act of 1940' means the federal statute of that name as amended before or after the effective date of this act."

Sec. 402(d): Since Sec. 402(d) is the only provision of Sec. 402 to be retained, delete the letter "(d)" and change the section heading to read: "[*Burden of Proving Exceptions*]"

Delete "an exemption or"

Sec. 406(b): In the first sentence delete "filed with or"

Sec. 407: This entire section should be retained with the following changes in Sec. 407(a):

In Clause (1) delete "and forms"

In Clauses (1) and (3) delete "or any rule or order hereunder" and, if Sec. 102(c) is retained, substitute "or any rule under section 102(c)"

Sec. 408: Delete "or any rule or order hereunder" twice in the first sentence and, if Sec. 102(c) is retained, substitute "or any rule under section 102(c)"

Sec. 409(a): Change the first sentence to read as follows: "Any person who willfully violates any provision of this act [or any rule under section 102(c)] shall upon conviction be fined not more than $5,000 or imprisoned

not more than three years, or both [; but no person may be imprisoned for the violation of any rule under section 102(c) if he proves that he had no knowledge of the rule]." The bracketed language in the first sentence should be included only if Sec. 102(c) is retained.

SEC. 409(b): Delete "or of any rule or order hereunder" and, if Sec. 102(c) is retained, substitute "or of any rule under section 102(c)"

SEC. 410(a): Delete Clause (1) and the figure "(2)" and arrange Sec. 410(a) as one continuous paragraph without indentation.

SEC. 410(b): Delete "broker-dealer or agent" and substitute "broker or dealer or employee of a broker or dealer"

SEC. 410(f): Delete "or any rule or order hereunder" and, if Sec. 102(c) is retained, substitute "or any rule under section 102(c)"

SEC. 410(g): Delete "or any rule or order hereunder" and, if Sec. 102(c) is retained, substitute "or any rule under section 102(c)"

SEC. 410(h): Delete "or section 202(c)"

SEC. 412: If Sec. 102(c) is retained, change the entire Sec. 412 to read:

"Sec. 412. [*Rules and Orders.*] The [Administrator] may from time to time make, amend, and rescind such rule and orders as are necessary to carry out the provisions of sections 102(c) and 201(c). For the purpose of rules under section 102(c), the [Administrator] may classify investment advisers and prohibit custody by all investment advisers or by one or more classes. No rule or order may be made, amended, or rescinded unless the [Administrator] finds that the action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes fairly intended by the policy and provisions of this act. All rules shall be published."

SEC. 414(a): Change this section to read: "Section 101 applies ***."

SEC. 414(b): Change this section to read: "Section 101 applies ***."

SEC. 414(f): Change this section to read: "Section 102 applies ***."

SEC. 414(h): In the first sentence delete "or any rule or order hereunder" twice and, if Sec. 102(c) is retained, substitute "or any rule under section 102(c)"

In the first sentence delete "and he has not filed a consent to service of process under subsection (g)"

Delete "suit, action, or proceeding" twice and substitute "suit or action"

Add at the end: "When process is served under this subsection, the court shall order such continuance as may be necessary to afford the defendant reasonable opportunity to defend."

APPENDIX C

ACCOMMODATION OF THE ACT TO THE DELETION OF SOME OR ALL OF THE PROVISIONS RELATING TO INVESTMENT ADVISERS

The Act lends itself to four alternative treatments of investment advisers. In decreasing order of strictness they are as follows:

1. If Parts I and II are adopted as they stand, investment advisers will be subject to the prohibitions of certain fraudulent and other practices in Sec. 102 and will also be registered along with broker-dealers under Part II.

2. It is possible to adopt all of Sec. 102 without requiring investment advisers to be registered. The changes required to accomplish this are enumerated in Appendix C-1.

3. It is possible to adopt only Sec. 102(a), which prohibits fraudulent advisory activities by any person without using the term "investment adviser," and forego not only the registration of investment advisers but also Sec. 102(b) and Sec. 102(c), which deal with investment advisory contracts and custody of clients' funds and securities. The changes required to accomplish this are enumerated in Appendix C-2.

4. It is possible to delete all references to investment advisers or investment advice, including Sec. 102(a). The changes required to accomplish this are enumerated in Appendix C-3.

APPENDIX C-1

PREAMBLE	Delete "investment advisers,"
SEC. 201(c):	Delete this subsection and renumber Sec. 201(d) accordingly.
SEC. 202(a):	Change the first sentence to read: "A broker-dealer or agent may obtain ***."
	Change Clause (3) to read: "the qualifications and business history of the applicant and, in the case of a broker-dealer, any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer;"
SEC. 202(b):	Change the first sentence to read: "Every applicant for initial or renewal registration shall pay a filing fee of $. . . . . in the case of a broker-dealer and $. . . . . in the case of an agent."
SEC. 202(c):	Delete "or investment adviser"
SEC. 202(d):	Delete "and investment advisers"
SEC. 202(e):	Change the first sentence to read: "The Administrator may by rule require registered broker-dealers and agents to post ****."
SEC. 203(a):	Delete "and investment adviser"
SEC. 203(b):	Delete "and investment adviser"
SEC. 204(a):	In the first Clause (2) delete "or investment adviser" twice.
	Change Clause (E) to read: "*** revoking registration as a broker-dealer or agent;"
	In Clause (H) delete "or investment adviser" twice.
	In Clause (J) delete "or his employees if he is an investment adviser"
SEC. 204(b):	Delete Clauses (2) and (5) and renumber the remaining clauses accordingly.
	In Clause (6) delete everything after "applicants" except the period.
SEC. 204(d):	Change this subsection to read: "*** has ceased to do business as a broker-dealer or agent, or is subject ****."
SEC. 204(e):	Change the first sentence to read: "Withdrawal from registration as a broker-dealer or agent becomes effective ***."
SEC. 403:	Delete "including clients or prospective clients of an investment adviser."
SEC. 414(f):	Change this subsection to read: "Section 102 applies *** "

APPENDIX C-2

In addition to all the changes specified in Appendix C-1:

SEC. 102:	Delete Sec. 102(b) and Sec. 102(c) and the letter "(a)" in the first line.
SEC. 401(f):	Delete this subsection and renumber the remaining subsections of Sec. 401 accordingly.

APPENDIX C-3

In addition to all the changes specified in Appendix C-1:

SEC. 102:	Delete this section.
SEC. 401(f):	Delete this subsection and renumber the following subsections of Sec. 401 accordingly.
SEC. 405(b):	Delete "purchaser, customer, or client" and substitute "purchaser or customer"
SEC. 414(f):	Delete this subsection and renumber the following subsections of Sec. 414 accordingly.

Exhibit 7

MI COA Broadens Potential Exposure to Securities Fraud, SBM Business Law Section

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Michigan Court of Appeals Broadens Potential Exposure to Securities Fraud by Issuers and Sellers of Debt Instruments in Michigan

By Matthew P. Allen

If your Michigan business issues promissory notes or other evidence of indebtedness, or if you purchase such debt instruments, it is important to understand whether those debt instruments could be considered "securities" under the Michigan Uniform Securities Act ("MUSA"). If a debt instrument is deemed a security, the issuer could not only be liable to the purchaser for any damages caused by any misstatements or omissions made in connection with issuance, but also be sanctioned by Michigan's securities regulator or criminally prosecuted for securities fraud, selling securities without a license, and selling unregistered securities. A recently published Michigan Court of Appeals decision broadens the MUSA definition of a "security," significantly expanding potential liability under the statute.

In *LA Developers, LLC & David Byker v Department of Licensing & Regulatory Affairs* (2023),[1] the Michigan Court of Appeals changed the law in Michigan, holding that Michigan courts must now use the "family resemblance test" from the 1990 U.S. Supreme Court decision in *Reves v Ernst & Young* to determine whether a note is a security under the MUSA.

Pertinent Facts Related to the Note in *Byker*

In *Byker*, a real estate developer offered to buy plaintiff's $200,000 investment interest in a Costa Rican condominium development for $280,000. The developer gave plaintiff a note requiring the developer to make a down payment of 5% of the note amount ($14,000) to plaintiff, and 5% interest-only payments each year, with the remaining principal due in five years. The developer paid the down payment and annual interest payments for a total of $67,200, but refused to make the final balloon payment in year five. Plaintiff sued the developer and settled the dispute for $225,000. Plaintiff then filed a complaint with the Corporations, Securities, and Commercial Licensing Bureau of the Michigan Department of Licensing and Regulatory Affairs ("the Bureau"). The Bureau fined the developer $30,000, finding that the developer violated MUSA by making material misstatements and omissions when it offered to sell the plaintiff a note in exchange for her equity interest in the condo project.[2]

The developer asked for a hearing. Citing the 1978 Michigan Court of Appeals decision in *People v Breckenridge*,[3] the administrative law judge held that the Bureau lacked jurisdiction to fine the developer because the note was not a "security" under MUSA. The Bureau asked the administrator to affirm the sanctions order by finding that the note was a security under the federal *Reves* test. The administrator agreed with the Bureau and remanded the case to the ALJ to apply *Reves*, which the ALJ did and determined the notes were securities under *Reves*. The developer appealed to the Michigan circuit court, which held that the *Reves* test could not be applied because it conflicted with Michigan law on three points: 1) unlike the federal securities act interpreted by *Reves*, Michigan law did not presume that notes are securities; 2) Michigan law did not treat the fixed rate of interest under the note as profit; 3) Michigan law required public solicitation of venture capital to be used in a business enterprise. Therefore, the trial court ignored *Reves* and

followed *Breckenridge* and the 1988 Michigan Court of Appeals case styled *Ansorge v Kellogg*[4] to find that the note was not a security.[5]

Byker Found That the *Reves* Test Was Not Inconsistent with Michigan Law

Byker distinguished the three ways the trial court said *Reves* conflicted with Michigan law:

1. MUSA creates the same presumption that a note is a security that* Reves *found in the federal securities laws.

The trial court said that "nothing in [MUSA] suggests that the Legislature intended to create a presumption that promissory notes are securities."[6] *Byker* said the lower court overlooked the fact that *Reves* found the presumption because the federal act defined a "security" as "any note." MUSA defines a security as "a note." After finding no meaningful distinction between the use of "any" and "a" before note, *Byker* found no reason the same presumption *Reves* found in the federal act did not apply under MUSA. *Byker* noted that both the federal act and MUSA definition begin by stating that the definitions apply "unless the context otherwise requires." Thus, a plain reading of MUSA and the federal act provides that a note is a security "unless the context otherwise requires," which in the case of a note is whether the *Reves* test rebuts that presumption.[7]

2. A fixed rate of interest in a note does not compel a finding that it's not a security.

The trial court relied on the 1988 *Ansorge* decision from the Michigan Court of Appeals, which found that notes were loans and not securities because they were exchanged for cash and had a fixed interest rate. First, *Byker* cited the court rule that *Ansorge* isn't binding because it was decided before 1990, which is ironically the same year *Reves* was decided. Second, *Byker* found that *Ansorge* was limited to its facts related to notes issued by a fruit processing company to cherry growers, with the court observing that the fixed rate of return did not depend on the note issuer's profits in that case. But *Byker* did not read *Ansorge* to mean that fixed interest can never be "profit," and thus not an investment security. *Byker* found this was so even though the notes in *Reves* had interest rates that were "constantly revised" to keep them above local bank rates. *Byker* did not read *Reves* to mean a fixed rate can never constitute a "profit." *Byker* said that the lower court would need to review the entire transaction and determine "whether the transaction looks like a business investment or a purely commercial or consumer transaction."[8] And while the income or return on investment a note provides is relevant to applying the *Reves* test, *Byker* found that "it does not affect whether the *Reves* test is consistent with Michigan law."[9]

3. The trial court did not support its claim that Michigan securities involve solicitation of venture capital.

Quoting *Ansorge*, the trial court found *Reves* inconsistent with a quote in *Ansorge* that "the 'salient feature of a security sale in Michigan' is the public solicitation of venture capital.'" *Byker* quickly dispatched with this argument since the trial court did not explain "how this is inconsistent with the *Reves* test."[10]

Byker Found That It Should Adopt the *Reves* Test as Michigan Law

Byker said that since MUSA employs language similar to the federal act, adopting the *Reves* test furthers the Michigan Legislature's goal, recognized in *Breckenridge*, of promoting uniformity in federal and state securities standards. *Byker* noted earlier in its opinion that Section 608(2) of MUSA requires an interpretation "[m]aximizing uniformity in federal and state regulatory standards."[11] And because MUSA and the federal act define securities as notes, and both say that this definition applies "unless the context otherwise requires," the presumption recognized by *Reves* and the family resemblance test to rebut that presumption "is consistent with Michigan law and better serves the plain language of the Legislature's definition."[12] *Byker* also observed that the *Reves* presumption aligned with Section 503(1) of MUSA, which places the burden on a person claiming an "exemption, exception, preemption, or exclusion" to prove it.[13]

A recently published Michigan Court of Appeals decision broadens the MUSA definition of a "security," significantly expanding potential liability under the statute.

Byker Found That MUSA's Five-Factor Test to Determine Whether "Contracts" Are Securities Did Not Apply to Promissory Notes

The initial definition of "security" in MUSA and the federal act are substantially similar, including that both list a "note" as a security. But unlike the federal act interpreted by *Reves*, MUSA's definition ends with a list of six other categories of instruments that are or are not included in the term "security" under Michigan law. *See* MUSA, Section 102(c)(i)-(vi).[14] The first category creates a five-part test to determine whether a "contract or quasi-contractual arrangement" is a security. *See id*, Section 102(c)(i)(A)-(E).[15] *Byker* notes that the Michigan case of *Ansorge*, which the trial court relied on instead of *Reves*, used this five-factor test to determine whether the note in that case was a security. *Byker* holds that this was error because a plain reading of MUSA reveals that the five-factor test only applies to instruments that are a "contract or quasi contractual arrangement," and not note instruments. "If the five-factor test were intended to be applied to all instruments to determine if they are a 'security,' there would be no need for the Legislature to provide such an extensive list of items that are securities. Rather, it would merely have set forth the five factor test."[16] In support of this holding, *Byker* cites the 1990 Michigan Court of Appeals decision of *Noyd v Claxon, Morgan, Flockhart & Vanliere*,[17] which applied the five-part test to a "loan participation agreement" because it was a contract that was not a listed instrument in the main definition of security.[18]

But unlike the federal act interpreted by *Reves*, MUSA's definition ends with a list of six other categories of instruments that are or are not included in the term "security" under Michigan law.

Though Not Addressed by *Byker*, MUSA's Five-Factor Test Appears to Codify the 1946 U.S. Supreme Court Decision of *SEC v WJ Howey Co*, Which Is the Test to Determine Whether "Investment Contracts" Are Securities and Does Not Apply to Notes

The U.S. Supreme Court's 1946 decision in *SEC v WJ Howey Co*[19] involved a Florida citrus company that raised money by selling portions of its grove through a land sales contract and warranty deed, and then used a service contract to take a leasehold interest in the land with the sole right to harvest and market the citrus. The landowners/lessors were paid a percentage of the profits of the business by the company lessee based on their ownership interest. Because these investment contracts were not defined as a security under the 1933 Securities Act, the *Howey* Court constructed an "economic reality" test to determine whether these undefined "investment contracts" are securities. Each element of the *Howey* test for "investment contracts" is found in the five-part test for a "contract or quasi-contractual arrangement" under MUSA: a person furnishes capital; it is subject to the risk of the issuer's enterprise; a promotor is used to represent a valuable tangible benefit from the operation of the enterprise; the person furnishing the capital is not involved in the management of the enterprise; and the promotor anticipates a financial gain from the provision of capital.[21] One *Howey* factor—"investment in a common enterprise"—is found in a separate MUSA definition,[22] though that definition does not reference the critical contract component of the *Howey* test.

This is important because the U.S. Supreme Court would twice hold that the *Howey* test for investment contracts cannot be used to determine whether any other instruments are securities under federal law, which is exactly what *Byker* said about the five-part MUSA test for contracts. In its 1985 decision in *Landreth Timber Co v Landreth*, the U.S. Supreme Court held that the *Howey* test had to be limited to investment contacts because applying it to "traditional stock and all other types of instruments listed in the statutory definition would make the Act's enumeration of many types of instruments superfluous."[23] *Reves* applied *Landreth* in 1990 to say the same thing about promissory notes. In other words, the rationale employed by *Byker* to limit MUSA's five-part test to investment contracts is supported by the U.S. Supreme Court's rationale in *Reves* and *Landreth* that the *Howey* test is limited to investment contracts.

Though Not Addressed by *Byker*, *Reves* Did Not Address the "Evidence of Indebtedness" Instrument Included as a Security in MUSA But Not in the Federal Act Examined by *Reves*, Which Presents Another Argument in *Byker* On Remand

The federal 1934 Securities Exchange Act definition of security, interpreted by *Reves*,

does not include "evidence of indebtedness." So the *Reves* test on its face does not apply to that instrument. MUSA's definition of security does include "evidence of indebtedness," as does the federal 1933 Securities Act. As a general matter, the 1934 Exchange Act applies to purchases and sales of securities, while the 1933 Securities Act only applies to sales of securities by issuers. This presents an opportunity for a plaintiff to plead that the debt instrument at issue is "evidence of indebtedness," and thus a security under MUSA, even if that instrument fails to qualify as a note security under the *Reves* test. In *Smith v Manausa*,[24] a federal trial court in Kentucky found that an agreement to buy shares with a "corporate note" payable in nine months "clearly reveals a 'note' or 'evidence of indebtedness' under the 1933 Act."[25] The note in *Manausa* is similar to the note in *Byker* that was delivered in exchange for plaintiff's equity interest. Consider whether the Bureau on remand seeks to add an argument that the notes in *Byker* are also "evidence of indebtedness" under MUSA.

In its 1966 decision in *Beam v United States*,[26] the U.S. Court of Appeals for the Sixth Circuit found that a credit sales invoice used in a forgery scheme was not "evidence of indebtedness," and thus not a security, because it could not be negotiated and thus had no value in itself to the forger. In a 1991 federal trial court decision out of the Western District of Michigan, *Tucker Freight Lines, Inc v Walhout*,[27] the court found that wage deferral agreements by employees to their company were neither notes nor evidence of indebtedness because they did not induce a reasonable expectation of profit like an investment does. Interestingly, the *Walhout* court in a parenthetical said the *Reves* test for notes "seems applicable to all debt instruments, including evidence of indebtedness."[28] *Walhout* also applied the *Howey* test and held that the wage deferral agreements were not "investment contracts" because the employees did not expect profit from their agreements; they did not even expect interest payments in exchange for deferring their wages.

Finally, required reading on these issues is the 1996 opinion styled *Proctor & Gamble Co v Bankers Tr Co*,[29] issued by a federal trial court in Ohio, but written by the late federal trial court judge from Michigan, Hon. John Feikens. Judge Feikens skillfully applies *Reves, Howey*, and a test under the Ohio securities law similar to MUSA's five-part test, to separately analyze whether the complex derivative swap agreements in that case were "notes," "evidence of indebtedness," or "investment contracts." Judge Feikens found that the swaps were not "investment contracts" under *Howey* because they did not involve pooling money in a common enterprise of another company. Nor were they investment contracts under the Ohio securities test because the profit to be earned from the swap contracts—which is based on interest rate fluctuations from a complicated formula tied to commercial paper interest rates—did not depend on the performance or management of an underlying enterprise.[30] The swaps were not notes under the *Reves* test because they were not widely distributed, and the investors did not reasonably think the swap agreements were securities.[31] In finding that the swaps were not "evidence of indebtedness," Judge Feikens cited back to *Walhout* when he said that "[t]he test whether an instrument is within the category of 'evidence of indebtedness' is essentially the same as whether an instrument is a note."[32] The plaintiff argued the swaps were evidence of indebtedness "either because they may contain terms and conditions well beyond the typical terms of a note and beyond an ordinary investor's ability to understand, or because the debt obligation simply does not possess the physical characteristics of a note."[33] Judge Feikens rejected this "because that definition omits an essential element of debt instruments—the payment or repayment of principal."[34] And since swap agreements do not involve the payment of principal—since the interest rate tied to the commercial paper never changes hands, only interest payments based on that amount do—the agreements cannot be evidence of indebtedness and thus cannot be securities subject to the federal and Ohio securities laws.

Outline of *Reves* Family Resemblance Test That is Now Michigan Law

Both the federal securities laws and MUSA expressly define a "note" as a "security." After *Byker*, both federal and Michigan law presume that notes are securities, and the *Reves* test applies. Now, under *Reves*, the Michigan and federal presumption that a note is a security can be rebutted by a showing that the note "bears a strong resemblance" to the following list of notes that are not securities:

As a general matter, the 1934 Exchange Act applies to purchases and sales of securities, while the 1933 Securities Act only applies to sales of securities by issuers.

- Note delivered in consumer financing
- Note secured by a mortgage on a home
- Short term note secured by a lien on a small business or some of its assets
- Note evidencing a "character" loan to a bank customer[35]
- Short term notes secured by an assignment of accounts receivable
- Note which simply formalizes an open-account debt incurred in the ordinary course of business
- Notes evidencing loans by commercial banks for current operations[36]

The *Reves* Court developed four standards to determine whether an instrument "bears a strong resemblance" to the categories of loans above, or whether another category should be added to the list, sufficient to exempt the instrument from the definition of a security:

1. Assess the motivations of the buyer and seller

"If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security.' If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a 'security.'"[37]

2. Examine the "plan of distribution" of the instrument

Courts will assess whether the loan sale is an "instrument in which there is 'common trading for speculation or investment.'"[38] If the notes are marketed to a broad segment of the public, then it is more likely that the SEC or a court will find that the note is a security.

3. Examine the reasonable expectations of the investing public

"The Court will consider instruments to be 'securities' on the basis of such public expectations, even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not 'securities' as used in that transaction."[39] In other words, if the people to whom the notes are being sold consider them to be investments and "securities," then securities regulators or the court may weigh this factor in favor of considering the notes securities.

4. Existence of other regulatory schemes that protect the public

The existence of another regulatory scheme that "significantly reduces the risk of the instrument" may render "application of the Securities Acts unnecessary."[40] "[T]he existence of collateral is significant as a risk-reducing factor," and notes secured by a mortgage "leads to the Note resembling a note secured by a mortgage on a home" under the *Reves* family resemblance test, thus leading courts to conclude that secured notes are not securities.[41]

NOTES

1. No 358656, ___ Mich App ___, ___ NW2d ___ (May 18, 2023).
2. *See id.* at *1-2.
3. 81 Mich App 6, 263 NW2d 922 (1978).
4. 172 Mich App 63, 431 NW2d 402 (1988).
5. *See Byker,* at *2-6.
6. *Id.* at *8.
7. *See id.*
8. *Id.* at *9.
9. *Id.*
10. *Id.*
11. *Id.* at *5 & n7.
12. *Id.* at *10.
13. *See id.* & n29.
14. MCL 451.2102c(c)(i)-(vi).
15. MCL 451.2102c(c)(i)(A)-(E).
16. *Byker,* at *10.
17. 186 Mich App 333, 436 NW2d 268 (1990).
18. *Byker,* at *11.
19. 328 US 293 (1946).
20. *See id.* at 298-300.
21. *See* MCL 451.2102c(c)(i)(A)-(E).
22. MCL 451.2102c(c)(v).
23. 471 US 681, 692 (1985)
24. 385 F Supp 443 (ED Ky 1974).
25. *Id.* at 447 (cleaned up).
26. 364 F2d 756 (6th Cir 1966).
27. 789 F Supp 884 (WD Mich 1991).
28. *Id.* at 888.
29. 925 F Supp 1270 (SD Ohio 1996).
30. *See id.* at 1277-78.
31. *See id.* at 1278-80.
32. *Id.* at 1280.
33 *Id.*
34 *Id.*
35 "Typically, character loans are offered by banks 'in an attempt to cement or maintain an ongoing commercial relationship with the borrower.' In determining whether to extend such loans, banks exercise considerable expertise in evaluating potential borrowers and

the risks involved." *In re Goldsworthy*, SEC Release No. 45926, at *5 (May 15, 2002); *In re Stoiber*, SEC Release No. 39112 (Sept 22, 1997) ("Character loans, in particular, are generally given to longstanding large depositors, whose credit situation is known to the financial institution.").

36. *Reves,* at 65 (1990).

37. *Id.* at 66 (cleaned up).

38. *Id.*

39. *Id.*

40. *Id.* at 67.

41. *Eagle Trim, Inc v Eagle-Picher Indus, Inc*, 205 F Supp 2d 746, 753 (ED Mich 2002).

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Exhibit 8

Public Acts 1978 No. 481

compensation; and to repeal certain acts and parts of acts," as amended, being sections 418.101 to 418.941 of the Compiled Laws of 1970, by adding section 702.

The People of the State of Michigan enact:

Section added; worker's disability compensation act of 1969.

Section 1. Act No. 317 of the Public Acts of 1969, as amended, being sections 418.101 to 418.941 of the Compiled Laws of 1970, is amended by adding section 702 to read as follows:

418.702 Cessation of operation or dissolution of southeastern Michigan transportation authority; state guaranteed payment of claims for benefits; determination of amount; processing of claims; lien of state. [M.S.A. 17.237(702)]

Sec. 702. (1) If the southeastern Michigan transportation authority created pursuant to Act No. 204 of the Public Acts of 1967, as amended, being sections 124.401 to 124.425 of the Michigan Compiled Laws, ceases to operate or is dissolved, and a successor agency is not created to assume its assets, liabilities, and perform its functions, and if the southeastern Michigan transportation authority is authorized to secure the payment of compensation under section 611(1) (a), then the state hereby guarantees the payment of claims for benefits arising under this act against the southeastern Michigan transportation authority.

(2) The accident fund shall determine in detail as the director of the department of management and budget may require the amount necessary to pay the claims for benefits for which the state is responsible pursuant to subsection (1). The accident fund shall be responsible for the processing of these claims.

(3) The state shall be entitled to a lien which shall take precedence over all other liens on its portion of the assets of the southeastern Michigan transportation authority in satisfaction of the payment of claims for benefits under this section.

Approved October 23, 1978.

[No. 481]

AN ACT to amend the title and sections 102, 201, 202, 203, 204, 303, 305, 401, 402, 403, 405, 406, 408, 409, 410, 412 and 413 of Act No. 265 of the Public Acts of 1964, entitled as amended "An act to enact the uniform securities act relating to the issuance, offer, sale or purchase of securities and commodity contracts; to prohibit fraudulent practices in relation thereto; to establish civil and criminal penalties for violations of the act and of the rules promulgated pursuant to the act; to require the registration of broker-dealers, agents, investment advisers, commodity issuers, and securities; to make uniform the law with reference thereto; and to repeal certain acts and parts of acts," sections 102, 201, 202, 203, 204, 401, 403, 406, 410 and 412 as amended by Act No. 31 of the Public Acts of 1975, being sections 451.502, 451.601, 451.602, 451.603, 451.604, 451.703, 451.705, 451.801, 451.802, 451.803, 451.805, 451.806, 451.808, 451.809, 451.810, 451.812 and 451.813 of the Compiled Laws of 1970; and to add section 307.

The People of the State of Michigan enact:

Title and sections amended and added; uniform securities act.

Section 1. The title and sections 102, 201, 202, 203, 204, 303, 305, 401, 402, 403, 405, 406, 408, 409, 410, 412 and 413 of Act No. 265 of the Public Acts of 1964,

sections 102, 201, 202, 203, 204, 401, 403, 406, 410 and 412 as amended by Act No. 31 of the Public Acts of 1975, being sections 451.502, 451.601, 451.602, 451.603, 451.604, 451.703, 451.705, 451.801, 451.802, 451.803, 451.805, 451.806, 451.808, 451.809, 451.810, 451.812 and 451.813 of the Compiled Laws of 1970, are amended and section 307 is added to read as follows:

TITLE

An act to enact the uniform securities act relating to the issuance, offer, sale or purchase of securities and commodity contracts; to prohibit fraudulent practices in relation thereto; to establish civil and criminal penalties for violations of the act and civil penalties for violation of the rules promulgated pursuant to the act; to require the registration of broker-dealers and their principals, agents, investment advisers, commodity issuers, and securities; to make uniform the law with reference thereto; and to repeal certain acts and parts of acts.

451.502 Investment adviser; unlawful practices. [M.S.A. 19.776(102)]

Sec. 102. (a) It is unlawful for any person who receives any consideration from another person primarily for advising the other person as to the value of securities or commodity contracts or their purchase or sale, whether through the issuance of analyses or reports or otherwise:

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

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

(3) Acting as principal for his own account, knowingly to sell any security or commodity contract to or purchase any security or commodity contract from an investment advisory client, or acting as a broker for a person other than that client, knowingly to effect any sale or purchase of any security or commodity contract for the account of that client, without disclosing to the client in writing before the completion of the transaction the capacity in which he is acting and obtaining the consent of the client in writing to the transaction. The prohibitions of this subdivision shall not apply to a transaction with a customer of a broker-dealer if the broker-dealer is not acting as an adviser in relation to the transaction.

(b) It is unlawful for any investment adviser to enter into, extend, or renew any investment advisory contract unless it provides in writing:

(1) That the investment adviser shall not be compensated on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client;

(2) That no assignment of the contract may be made by the investment adviser without the consent of the other party to the contract; and

(3) That the investment adviser, if a partnership, shall notify the other party to the contract of any change in the membership of the partnership within a reasonable time after the change.

(c) It is unlawful for any investment adviser acting as a finder to:

(1) Take possession of funds or securities in connection with the transaction for which payment is made for services as a finder.

(2) Fail to disclose clearly and conspicuously in writing to all persons involved in the transaction as a result of his or her finding activities before the sale or purchase that the person is acting as a finder, a payment for services as a finder, the method and amount of payment, as well as any beneficial interest, direct or indirect, of the finder or a member of the finder's immediate family in the issue of the securities or commodities that are the subject of services as a finder.

(3) Participate in the offer, purchase or sale of a security or commodity in violation of section 301. However, if the investment adviser makes a reasonable effort to ascertain if a registration has been effected or an exemption order granted in this state, or alternatively the basis for an exemption claim and does not have knowledge that the proposed transaction would violate section 301, his or her activities as a finder shall not violate section 301.

(4) Participate in the offer, purchase or sale of a security or commodity without obtaining information relative to the risks of the transaction, the direct or indirect compensation to be received by promoters, partners, officers, directors or their affiliates, the financial condition of the issuer, and the use of proceeds to be received from investors, or fail to read any offering materials obtained. This section shall not require independent investigation or alteration of offering materials furnished to the finder.

(5) Fail to inform or otherwise insure disclosure to all persons involved in the transaction as a result of his or her finding activities of any material information which the finder knows, or in the exercise of reasonable care should know based on the information furnished to him or her, is material in making an investment decision, until conclusion of the transaction.

(6) Locate, introduce or refer persons that the finder knows, or after a reasonable inquiry should know, are not suitable investors by reason of their financial condition, age, experience or need to diversify investments.

(7) The finder is not required to independently generate information.

(d) Subsection (b)(1) of this section shall not be construed to prohibit an investment advisory contract which provides for compensation based upon the total value of a fund averaged over a definite period, or as of definite dates, or taken as of a definite date, or shall not apply to an investment advisory contract with an investment company registered under the investment company act of 1940, or any person, except a trust, collective trust fund, or separate account referred to in section 3(c)(11) of the investment company act of 1940, if the contract relates to the investment of assets in excess of $1,000,000.00, and the contract provides for compensation based on the asset value of the company or fund under management averaged over a specific period and increasing and decreasing proportionately with the investment performance of the company or fund over a specific period in relation to the investment record of an appropriate index of securities prices, or such other measure of investment performance as the administrator by rule, regulation, or order may specify. For purposes of determining whether subsection (b)(1) applies to an investment advisory contract, the point from which increases and decreases in compensation are measured shall be the fee which is paid or earned when the investment performance of the company or fund is equivalent to that of the index or other measure of performance, and an index of securities prices shall be deemed appropriate unless the administrator by order shall determine otherwise. The definition of the term "assignment" and the other terms used in this section shall be the same as the definitions of those terms in the investment advisers act of 1940, as amended.

(e) Unless the administrator by rule or order permits such custody, it is unlawful for any investment adviser not registered as a broker-dealer to take or have custody of any securities or funds or commodity contracts of any client.

(f) It is unlawful for an agent registered with a broker-dealer to conduct business as an investment adviser except through the broker-dealer with which

the agent is registered and with the written consent of the broker-dealer filed with the administrator, in a form and subject to terms and conditions acceptable to the administrator.

451.601 Registration required; notice to administrator; compliance by investment adviser; duration of registration; annual report; reduction of filing fee; exemptions. [M.S.A. 19.776(201)]

Sec. 201. (a) It is unlawful for any person to transact business in this state as a broker-dealer, commodity issuer, or agent unless registered under this act.

(b) It is unlawful for any broker-dealer or issuer to employ an agent unless the agent is registered. The registration of an agent is not effective during any period when the agent is not associated with a particular broker-dealer registered under this act or a particular issuer. When an agent begins or terminates a connection with a broker-dealer or issuer, or begins or terminates those activities which make him an agent, the agent as well as the broker-dealer or issuer shall promptly notify the administrator in writing on a form prescribed by it.

(c) Unless a broker-dealer is a member of a national securities exchange as defined in the securities exchange act of 1934, as amended, the administrator may by rule or order require that a broker-dealer designate a person who shall be registered as a principal of the broker-dealer in charge of management, financial matters or compliance. If so required a broker-dealer shall at all times designate and maintain a principal. The registration of a principal is not effective during any period when the principal is not associated with a particular broker-dealer registered under this act. When a principal begins or terminates a connection with a broker-dealer, or begins or terminates activities and designation as a principal, the principal as well as the broker-dealer shall promptly notify the administrator in writing on a form prescribed by the administrator.

(d) It is unlawful for any person to transact business in this state as an investment adviser unless the person complies with 1 of the following:

(1) He is registered under this act.

(2) He is registered as a broker-dealer without the imposition of a condition under section 204(b)(5).

(3) His only clients in this state are investment companies as defined in the investment company act of 1940, being 15 U.S.C. section 80a-3, or insurance companies, banks, or trust companies.

(e) Every registration under this section shall be effective until it is withdrawn, terminated, revoked, or canceled. Every registrant shall be required to file or have filed an annual report with such information as the administrator may require. The administrator may by rule or order reduce the filing fee for registration applications received more than 6 months after the beginning of the fiscal year.

(f) Unless the administrator by rule provides for such regulation, the broker-dealer, commodity issuer, and agent registration provisions of this act shall not apply to a person engaged in the commodities business in this state, whose transactions with the public involve any of the following:

(1) A sale with delivery into the possession of the buyer of the commodity sold, within 10 days after the cash payment, if, with respect to the sales the seller:

(i) Does not guarantee or promise the repurchase of the commodity from the buyer in the future.

(ii) Does not promise or agree to act as a broker or dealer on behalf of the buyer in connection with a future resale of the commodity by the buyer.

(iii) Does not advertise the commodity except under a plan accepted by the administrator.

(iv) Does not pay a commission directly or indirectly for soliciting any prospective buyer.

(2) The sale of the commodity to, or the purchase of the commodity from, a person using or processing the commodity in a trade or business, including the resale of the commodity, other than for investment, whether or not for immediate delivery.

(g) There is exempted from the registration provisions of this act all commodities accounts, agreements, and transactions excluded from state jurisdiction pursuant to section 201 of the commodity futures trading act of 1974.

451.602 Application for registration; contents; announcement; fees; registration of successor; capital and bond requirements; action on bond; fingerprinting. [M.S.A. 19.776(202)]

Sec. 202. (a) A broker-dealer, principal, commodity issuer, agent, or investment adviser may obtain an initial registration by filing with the administrator an application together with a consent to service of process pursuant to section 414(g). The application shall contain whatever information the administrator by rule requires concerning such matters as:

(1) The applicant's form and place of organization;

(2) The applicant's proposed method of doing business;

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

(4) Any injunction or administrative order or conviction of a misdemeanor or of a felony; and

(5) The applicant's financial condition and history. The administrator may by rule or order require an applicant for initial registration to publish an announcement of the application in 1 or more specified newspapers published in this state. Registration becomes effective upon order of the administrator. The administrator may by rule or order establish classes of or otherwise condition the registration of broker-dealers, principals, commodities issuers, agents, or investment advisers.

(b) Every applicant for registration shall pay a filing fee and every registrant shall pay an annual fee of $250.00 in the case of a broker-dealer, $250.00 in the case of a commodity issuer, $25.00 in the case of a principal, $15.00 in the case of an agent, and $100.00 in the case of an investment adviser. A broker-dealer applicant who intends to maintain more than 1 office for the purpose of conducting his business within this state shall pay an additional filing fee of $75.00 for each additional office and when a registrant an annual fee of $75.00 for each additional office. Every applicant filing an application for registration of a successor pursuant to section 202(c) shall pay a filing fee of $50.00 for the unexpired portion of the year. The administrator, in connection with any examination pursuant to section 204(b)(6), may require by rule the payment of a reasonable fee sufficient to defray the expense of preparing, administering,

scoring, and disseminating information concerning the examination. The administrator may either collect this fee for, or direct that it be paid in whole or in part to, any agency cooperating in giving this examination.

(c) A registered broker-dealer, commodity issuer, or investment adviser may file an application for registration of a successor, whether or not the successor is then in existence. The administrator may grant or deny the application.

(d) The administrator may by rule require a minimum capital for registered broker-dealers, commodity issuers, and investment advisers and prescribe a ratio between net capital and aggregate indebtedness. If the registrant fails to comply with the minimum net capital requirement, the registrant shall immediately cease all investment advisory services, securities, or commodities business operations and promptly notify the administrator of its failure to maintain the required net capital, of the steps to be taken to cure the net capital deficiency, and of its anticipated date of reopening business operations. The registrant shall not reactivate its securities or commodities or investment advisory business without prior notification to the administrator.

(e) The administrator may by rule require registered broker-dealers, commodity issuers, principals, agents, and investment advisers to post surety bonds in amounts up to $100,000.00, and may determine their conditions. Any appropriate deposit of cash or securities shall be accepted in lieu of any bond required. A bond may not be required of any registrant whose net capital, which may be defined by rule, exceeds $100,000.00. Every bond shall provide for action thereon by any person who has a cause of action under section 410 and, if the administrator by rule or order requires, by any person who has a cause of action not arising under this act. Every bond shall provide that action may not be maintained to enforce any liability on the bond unless brought within 2 years after the sale or other act upon which it is based. If a civil action is maintained under the provisions of the bond, the court shall require the person maintaining an action against the principal or surety, or both, on the bond to place a notice in a newspaper of general circulation in the county where the registrant maintains its principal office, or if there is no principal office in this state, then in the county of each registered office in this state, for 3 successive days, stating that a claim has been made under the provisions of the bond; or the court may provide for alternative notice designed to advise prospective claimants against the broker-dealer or surety. The court shall for a period of 30 days thereafter permit other claimants against the bond to join the action and claim under the provisions of the bond.

(f) The administrator may by rule require registered broker-dealers and investment advisers to carry fidelity bonds in amounts up to $400,000.00 in the case of broker-dealers and up to $100,000.00 in the case of investment advisers covering the registrant's general partners and employees or covering its officers and employees.

(g) Unless the requirement is waived by rule or order of the administrator all persons, including but not limited to partners, officers, directors, and agents employed by a broker-dealer, commodity issuer, or investment adviser who are regularly employed within this state shall, as a condition of employment, be fingerprinted. The administrator may process the fingerprint cards with the federal bureau of investigation and the department of state police either directly or through the national association of securities dealers. The fingerprints or information relating to the fingerprints shall be used for the official use of the administrator only.

451.603 Preservation of records; filing financial reports; correction of information; examination of records; cooperation and exchange of information; summary suspension order; withdrawal or termination of registration; notice of appointment of trustee; notice of proceedings or sanctions; filing of advertising. [M.S.A. 19.776(203)]

Sec. 203. (a) Every registered broker-dealer, commodity issuer, and investment adviser shall make and keep such accounts, correspondence, memoranda, papers, books, and other records as the administrator by rule prescribes. All records so required shall be preserved for 3 years unless the administrator by rule prescribes otherwise for particular types of records.

(b) Every registered broker-dealer, commodity issuer, and investment adviser shall file such financial reports as the administrator by rule prescribes.

(c) If the information contained in any document filed with the administrator is or becomes inaccurate or incomplete in any material respect, the registrant shall promptly file a correcting amendment unless notification of the correction has been given under section 201(b).

(d) All the records referred to in subsection (a) are subject at any time or from time to time to such reasonable periodic, special, or other examinations by representatives of the administrator, within or without this state, as the administrator deems necessary or appropriate in the public interest or for the protection of investors. For the purpose of avoiding unnecessary duplication of examinations, the administrator, insofar as it deems it practicable in administering this subsection, may cooperate and exchange information with the securities and commodities administrators of other states, the securities and exchange commission, the commodity futures trading commission, and any national securities exchange or national securities association registered under the securities exchange act of 1934 and other appropriate law enforcement agencies. Failure of a registrant to promptly provide records for inspection shall be cause for a summary suspension order until conclusion of the examination of the records.

(e) A registered broker-dealer, commodity issuer, or investment adviser may not withdraw or terminate its registration unless the registrant has complied with all of the following:

(1) Filed a broker-dealer, commodity issuer, or investment adviser withdrawal form as prescribed by the administrator.

(2) Delivered all securities, commodities, and cash balances owing to all customers.

(3) Delivered all securities owing to other broker-dealers.

(4) Met other conditions as the administrator may by rule or order prescribe.

(5) Received a withdrawal order from the administrator approving the withdrawal request.

(f) Notwithstanding the provisions of subsection (e):

(1) A registrant may temporarily cease business by promptly advising the administrator in writing on or before the date of temporary cessation of business of the fact of cessation, the reasons for cessation, and the date or basis for reopening of the business.

(2) A registrant subject to a merger or acquisition where all obligations of the predecessor registrant are acquired by or transferred to the new broker-dealer, commodity issuer, or investment adviser which shall continue the business in an

uninterrupted fashion shall comply with the provisions of section 202(c) instead of this section.

(3) The administrator may modify the aforementioned requirements by rule or order, in unusual and appropriate circumstances.

(g) A registered broker-dealer shall immediately notify the administrator of the appointment of a trustee for the registrant pursuant to the securities investor protection act of 1970. A broker-dealer for whom such a trustee has been appointed shall file with the administrator a broker-dealer withdrawal form in accordance with subsection (e). A broker-dealer's registration continues effective until entry of the withdrawal order by the administrator.

(h) A registrant or applicant for registration shall promptly notify the administrator in writing if any proceedings have been commenced or any sanction imposed by securities administrators or commodities administrators of other states, other state regulatory agencies, the securities and exchange commission, the commodity futures trading commission, or any national securities exchange, commodities exchange, or national securities association registered under the securities exchange act of 1934.

(i) The administrator may by rule or order require a broker-dealer or investment adviser to file all advertising for review and acceptance before use. All advertising shall be filed with the administrator contemporaneously with its use.

451.604 Denial, suspension, or revocation of registration, or censure of registrant; grounds; application of subsection (a)(1)(I); postponement or suspension of registration pending final determination; order; notice; hearing; cancellation of registration or application; withdrawal from registration; conditions to entering of order; civil penalty; violation. [M.S.A. 19.776(204)]

Sec. 204. (a) The administrator may by order, if it finds the order in the public interest, deny, suspend, or revoke any registration, or censure a registrant, if it finds that:

(1) The applicant or registrant or, in the case of a broker-dealer, commodity issuer, or investment adviser, any partner, officer, principal, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer, commodity issuer, or investment adviser:

(A) Has filed an application for registration which as of its effective date, or as of any date after filing in the case of an order denying effectiveness, was incomplete in any material respect or contained any statement which was, in light of the circumstances under which it was made, false or misleading with respect to any material fact;

(B) Has violated or failed to comply with any provision of this act or a predecessor act or any rule or order under this act or a predecessor act;

(C) Has been convicted of any misdemeanor involving moral turpitude or any felony;

(D) Is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in or continuing any conduct or practice involving any aspect of the securities or commodity contracts business;

(E) Is the subject of an order of the administrator denying, suspending, or revoking registration as a broker-dealer, agent, or investment adviser;

(F) Is the subject of an order entered by the securities or commodities administrator of any other state or by the securities and exchange commission or the commodity futures trading commission denying, suspending, or revoking registration as a broker-dealer, future commission merchant, floor broker, commodity exchange, commodity solicitor, commodity option issuer, commodity salesman, commodity adviser, commodity trading adviser, commodity pool operator, agent or investment adviser, or the substantial equivalent of those terms as defined in this act, or is the subject of an order of the securities and exchange commission suspending or expelling him from a national securities exchange or national securities association registered under the securities exchange act of 1934, or in the case of an individual, is subject to an order by the securities and exchange commission barring the individual from association with a broker-dealer or investment adviser or equivalent order of the commodity futures trading commission or is the subject of an order of a national securities exchange or a national securities association registered under the securities act of 1934, suspending or expelling him from membership, or is the subject of a United States post office fraud order. The administrator may by order deny, suspend, or revoke any broker-dealer, commodity issuer, investment adviser, or principal registration if the applicant or registrant has been associated with a broker-dealer which was liquidated pursuant to the securities investor protection act of 1970, or if 1 or more of the applicant's or registrant's partners, officers, directors, or principals has been associated with a broker-dealer liquidated under that act, unless the association was terminated 12 months or more before the commencement of litigation under that act, or unless the associated person establishes that he or she did not engage in dishonest or unethical business practices or violate or fail to comply with any provisions of this act or a predecessor act, or any rule or order thereunder, during association with that broker-dealer;

(G) Has engaged in dishonest or unethical business practices;

(H) Is insolvent, either in the sense that his liabilities exceed his assets or in the sense that he cannot meet his obligations as they mature; but the administrator may not enter an order against a broker-dealer or investment adviser under this clause without a finding of insolvency as to the broker-dealer or investment adviser;

(I) Is not qualified on the basis of such factors as training, experience, and knowledge of the securities or commodities businesses, except as otherwise provided in subsection (b);

(J) Has delayed unreasonably delivery of securities or commodities to the extent that the registrant is in a position to control or direct the delivery of the securities. The burden of proof of inability to delivery shall rest with the registrant;

(K) Has represented that securities will be listed or that application for listing will be made, without basis in fact for the representation;

(L) Has induced excessive trading in a customer's account, or induced trading beyond the customer's known financial resources, if done with the intent to produce profits and commissions for the registrant or an agent in disregard of the customer's best interests as they reasonably appeared at the time of the transaction, and if improper under the then existing circumstances;

(M) Has recommended to a customer the purchase, sale, or exchange of any security or commodity contract without reasonable grounds to believe that the recommendation is suitable for the customer on the basis of information furnished

by the customer after reasonable inquiry as may be necessary under the circumstances concerning the customer's investment objectives, financial situation and needs, and other information known by the person making the recommendation;

(N) Has recommended speculative low priced securities to customers without knowledge of or an attempt to obtain information concerning the customer's other securities holdings, financial situation, investment objectives, and ability to bear the risks inherent in the purchase of those securities, or has recommended the securities in disregard of the information;

(O) Has executed a transaction on behalf of a customer without authority to do so;

(P) Has executed transactions pursuant to general discretionary authority for the account of a customer without first obtaining general discretionary authority in writing from the customer. However, written authority is not required if the discretionary authority relates solely to the execution of an order and is limited in scope;

(Q) Has acted on an agency basis for both the seller and the purchaser of a security or commodity contract without disclosing that fact to both on the confirmation;

(R) Has, while acting on an agency basis for a customer in any transaction, charged the customer more than a fair commission or service charge, taking into consideration all relevant circumstances including market conditions with respect to a security or commodity at the time of the transaction, the expense of executing the order and the value of any service rendered by reason of experience in and knowledge of the security or commodity, and the market therefor; or while acting on a principal basis for a customer in any transaction, has sold at an excessive markup in relation to the market price of the security or commodity at the time of sale in light of the volume of securities or commodities traded at that time;

(S) Has entered into a transaction with a customer in a security or commodity at a price not reasonably related to the market price of the security or commodity;

(T) Has extended credit to a customer in violation of the securities exchange act of 1934, or the regulations of the federal reserve board;

(U) Has employed in connection with the purchase or sale of a security or commodity a manipulative or deceptive device or contrivance;

(V) Has sold a security to or purchased a security from a customer without disclosing that the broker-dealer is acting as a market maker in that security or has a substantial position in the market;

(W) Has, while registered as an agent or investment adviser, borrowed money from a customer;

(X) Has made unauthorized use of the funds of a customer; or has hypothecated a customer's securities or commodity contract without having a lien thereon unless written consent of the customer was first obtained;

(Y) Has, while registered as an agent, effected securities or commodity contract transactions when those transactions were not recorded on the records of the employer broker-dealer;

(Z) Has operated an account under a fictitious name.

(2) The applicant or registrant has failed reasonably to supervise its agents if it is a broker-dealer or its employees if an investment adviser; or

(3) The applicant or registrant has failed to pay the proper filing fee; but the administrator may enter only a denial order under this clause, and it shall vacate such an order when the deficiency has been corrected.

(b) The following provisions govern the application of section 204(a)(1)(I):

(1) The administrator may not enter an order against a broker-dealer on the basis of the lack of qualification of any person other than the broker-dealer himself if he is an individual or an agent of the broker-dealer.

(2) The administrator may not enter an order against an investment adviser on the basis of the lack of qualification of any person other than the investment adviser himself if he is an individual or any other person who represents the investment adviser in doing any of the acts which make him an investment adviser.

(3) The administrator may not enter an order solely on the basis of lack of experience if the applicant or registrant is qualified by training or knowledge or both.

(4) The administrator shall consider that an agent who will work under the supervision of a registered 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 on the basis of experience as a broker-dealer or agent. When it finds that an applicant for registration as a broker-dealer is not qualified as an investment adviser, it may by order condition the applicant's registration as a broker-dealer upon his not transacting business in this state as an investment adviser.

(6) The administrator may by rule provide for an examination, which may be written or oral or both, to be taken by any class of or all applicants, as well as persons who represent or will represent an investment adviser in doing any of the acts which make him an investment adviser.

(c) The administrator may by order summarily postpone or suspend registration pending final determination of any proceeding under this section. Upon the entry of the order, the administrator shall promptly notify the applicant or registrant, as well as the employer or prospective employer if the applicant or registrant is an agent, that it has been entered and of the reasons therefor and that within 15 days after the receipt of a written request the matter will be set down for hearing. If a hearing is not requested and none is ordered by the administrator, the order will remain 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, may modify or vacate the order or extend it until final determination.

(d) If the administrator finds that any registrant or applicant for registration is no longer in existence or has ceased to do business as a broker-dealer, commodity issuer, principal, agent, or investment adviser, or is subject to an adjudication of mental incompetence or to the control of a committee, conservator, or guardian, or cannot be located after reasonable search, the administrator may by order cancel the registration or application.

(e) The administrator may institute a revocation or suspension proceeding under section 204(a)(1)(B) within 1 year after withdrawal from registration of a

broker-dealer, commodity issuer, principal, agent, or investment adviser became effective and enter a revocation or suspension order as of the last date on which registration was effective.

(f) An order may not be entered under any part of this section except the first sentence of subsection (c) without:

(1) Appropriate prior notice to the applicant or registrant, as well as to the employer or prospective employer if the applicant or registrant is an agent;

(2) Opportunity for hearing; and

(3) Written findings of fact and conclusions of law.

(g) The administrator may by order, if it finds the order to be in the public interest, impose a civil penalty of $1,000.00 on any registrant if it finds that the registrant, or in the case of a broker-dealer, commodity issuer, or investment adviser, any partner, officer, principal or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer, commodity issuer, or investment adviser, has engaged in conduct prohibited by sections 204(a)(1)(B), (G), or (J) to (Z).

(h) A violation of a provision of section 204 or action of the administrator pursuant to section 204 shall not subject a registrant to civil liability to a customer of the registrant, except as that violation or action is contrary to another provision of this act.

451.703 Registration by coordination. [M.S.A. 19.776(303)]

Sec. 303. (a) Any security for which a registration statement has been filed under the securities act of 1933 in connection with the same offering may be registered by coordination.

(b) A registration statement under this section shall 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 414(g):

(1) Three copies of the latest form of prospectus filed under the securities act of 1933;

(2) If the administrator by rule or otherwise requires, a copy of the articles of incorporation and bylaws, or their substantial equivalents, currently in effect, a copy of any agreements with or among underwriters, a copy of any indenture or other instrument governing the issuance of the security to be registered, and a specimen or copy of the security;

(3) If the administrator requests, any other information, or copies of any other documents, filed under the securities act of 1933; and

(4) An undertaking to forward all future amendments to the federal prospectus, other than an amendment which merely delays the effective date of the registration statement, promptly, and in any event not later than the first business day after the day they are forwarded to or filed with the securities and exchange commission, whichever first occurs.

(c) A registration statement under this section automatically becomes effective at the moment the federal registration statement becomes effective if all 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 20 days and all subsequent amendments except pricing amendments have been on file for at least 10 days.

(3) A statement of the maximum and minimum proposed offering prices and the maximum underwriting discounts and commissions has been on file for 2 full business days or such shorter period as the administrator permits by rule or otherwise 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 posteffective amendment containing the information and documents in the price amendment. "Price amendment" means the final federal amendment 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. Upon failure to receive the required notification and posteffective amendment with respect to the price amendment, the administrator may enter a stop order, without notice or hearing, retroactively denying effectiveness to the registration statement or suspending its effectiveness until compliance with this subsection, if it promptly notifies the registrant by telephone or telegram, and promptly confirms by letter or telegram when it notifies by telephone, of the issuance of the order. If the registrant proves compliance with the requirements of this subsection as to notice and posteffective amendment, the stop order is void as of the time of its entry. The administrator may by rule or otherwise waive either or both of the conditions specified in subsection (c)(2) and (3). If the federal registration statement becomes effective before all the conditions in this subsection are satisfied and they are not waived, the registration statement automatically becomes effective as soon as 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 it then contemplates the institution of a proceeding under section 306; but this advice by the administrator does not preclude the institution of such a proceeding at any time.

(e) The registrant may waive automatic effectiveness by written notice to the administrator. The waiver may be withdrawn by filing a written notice of withdrawal 5 business days before the effective date of the withdrawal.

451.705 Registration statement; filing; fee; contents; conditions; effective period; withdrawal; reports, information, and progress of offering; amendment; election; registration fee; filing fee. [M.S.A. 19.776(305)]

Sec. 305. (a) A registration statement may be filed by the issuer, any other person on whose behalf the offering is to be made, or a registered broker-dealer.

(b) Every person filing a registration statement shall pay a filing fee of 1/10 of 1% of the maximum aggregate offering price at which the registered securities are to be offered in this state, but the fee shall in no case be less than $50.00 or more than $500.00. When an application for registration is withdrawn before the effective date or a preeffective stop order is issued, the administrator shall retain a fee of $50.00 if the initial review has not been commenced, and the full filing fee after review has been commenced.

(c) Every registration statement shall specify:

(1) The amount of securities to be offered in this state.

(2) The states in which a registration statement or similar document in connection with the offering has been or is to be filed.

(3) Any withdrawal or any adverse order, judgment, or decree entered in connection with the offering by the regulatory authorities in each state or by any court or the securities and exchange commission.

(d) Any document filed under this act or a predecessor act within 5 years preceding the filing of a registration statement may be incorporated by reference in the registration statement to the extent that the document is currently accurate.

(e) The administrator may by rule or otherwise permit the omission of any item of information or document from any registration statement.

(f) The administrator may by rule or order require as a condition of registration by qualification or coordination:

(1) That any security issued or to be issued to a promoter for a consideration substantially different from the public offering price, or to any person for a consideration other than cash, be deposited in escrow; and

(2) That the proceeds from the sale of the registered security in this state be impounded until the issuer receives a specified amount from the sale of the security either in this state or elsewhere. The administrator may by rule or order determine the conditions of any escrow or impounding required hereunder, and, after prior notice and opportunity for hearing, may order the cancellation in whole or in part of any such security deposited in escrow where necessary for the protection of security holders. The administrator may not reject a depository solely because of location in another state.

(g) The administrator may by rule or order impose conditions under which a security registered by qualification may be sold, if it finds that such conditions are reasonable and in the public interest.

(h) Every registration statement is effective for 1 year from its effective date, or any longer period during which the security is being offered or distributed in a nonexempted transaction by or for the account of the issuer or other person on whose behalf the offering is being made or by any underwriter or broker-dealer who is still offering part of an unsold allotment or subscription taken by him as a participant in the distribution, except during the time a stop order 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 (1) so long as the registration statement is effective and (2) between the thirtieth day after the entry of any stop order suspending or revoking the effectiveness of the registration statement under section 306, if the registration statement did not relate in whole or in part to a nonissuer distribution, and 1 year from the effective date of the registration statement. A registration statement may not be withdrawn for 1 year from its effective date if any securities of the same class are outstanding. A registration statement may be withdrawn otherwise only in the discretion of the administrator.

(i) So long as a registration statement is effective, the administrator may by rule or order 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.

(j) A registration statement relating to a security may be amended after its effective date so as to increase the securities specified as proposed to be offered. As to securities not yet sold, such an amendment becomes effective when the administrator so orders. In the case of securities which are sold in an amount in excess of the amount or number of securities specified in an effective registration

statement, as proposed to be offered, the person or persons who filed the registration statement may, in accordance with rules the administrator shall promulgate as necessary or appropriate in the public interest and for the protection of investors, elect to have the registration of those securities deemed effective as of the time of their sale, upon payment to the administrator, within 6 months after the sale, of a registration fee equal to the difference between the registration fee previously paid and the amount of the fee which would have otherwise been applicable to those additional securities had they been included in the registration statement, if any, plus a late registration fee of $250.00. Upon such an election and payment, the registration statement shall be considered to have been in effect with respect to those shares. Every person filing an amendment under this subsection shall pay a filing fee, calculated in the manner specified in subsection (b), with respect to the additional securities.

451.707 Preliminary prospectus. [M.S.A. 19.776(307)]

Sec. 307. An applicant for registration or exemption may deliver a preliminary prospectus to offerees before the effectiveness of a registration or exemption order if either of the following conditions are satisfied:

(a) If the applicant has filed a registration statement under section 302 or 303 and a stop order is not in effect under this act or the securities act of 1933 or a public proceeding or examination looking toward such an order is not pending under either act.

(b) If the applicant has filed a registration statement under section 304 or filed a request for an exemption order under section 402 more than 5 business days before delivery of a preliminary prospectus, and the administrator by written notice to the applicant has not objected to the use of the preliminary prospectus, or a stop order, proceeding, or examination as described in this section is not in effect or pending.

451.801 Definitions. [M.S.A. 19.776(401)]

Sec. 401. When used in this act, unless the context otherwise requires:

(a) "Administrator" means the corporation and securities bureau of the department of commerce.

(b) "Agent" means any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities or commodity contracts. "Agent" does not include an individual who represents an issuer in (1) effecting transactions in a security exempted by section 402(a)(1), (2), (3), (4), (5), (9), or (10), (2) effecting transactions exempted by section 402(b), or (3) effecting transactions with existing employees, partners, officers, or directors of the issuer or any of its subsidiaries and if, in connection with all of these 3 cases, no commission is paid or given directly or indirectly for soliciting any person in this state. "Agent" does not include an officer or general partner of an issuer whose securities are registered under the provisions of this act, who represents the issuer in effecting transactions in such registered securities, if no commission is paid or given directly or indirectly for soliciting any person in this state. "Agent" does not include a person acting solely as a finder and registered pursuant to this act or acting as a finder under a transaction exempt pursuant to section 402(b)(19). A partner, officer, or director of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is an agent only if he otherwise comes within this definition. The administrator may by rule or order exclude other persons from the definition of the word "agent".

(c) "Broker-dealer" means any person engaged in the business of effecting transactions in securities or commodity contracts for the account of others or for

his own account. "Broker-dealer" does not include (1) an agent, (2) an issuer, (3) a bank, savings institution, or trust company, (4) a person who has no place of business in this state if (A) he effects transactions in this state exclusively with or through (i) the issuers of the securities or commodity contracts involved in the transactions, (ii) other broker-dealers, or (iii) banks, savings institutions, trust companies, insurance companies, investment companies as defined in the investment company act of 1940, pension or profit-sharing trusts, or other financial institutions or institutional buyers, whether acting for themselves or as trustees, or (B) during any period of 12 consecutive months he does not direct more than 15 offers to sell or buy into this state in any manner to persons other than those specified in clause (A), whether or not the offeror or any of the offerees is then present in this state, or (5) a person acting solely as a finder and registered pursuant to this act or acting as a finder under a transaction exempt pursuant to section 402(b)(19). The administrator may by rule or order exclude other persons from the definition of the word "broker-dealer".

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

(e) "Guaranteed" means guaranteed as to payment of principal, interest, or dividends.

(f) "Investment adviser" means any person who, for consideration, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or commodity contracts, or as to the advisability of investing in, purchasing, or selling securities or commodity contracts, who, for consideration and as a part of a regular business, issues or promulgates analyses or reports concerning securities or commodity contracts, or who acts as a finder in conjunction with the offer, sale, or purchase of a security or commodity. "Investment adviser" does not include (1) a bank, savings institution, or trust company; (2) a lawyer, accountant, engineer, geologist, geophysicist, or teacher whose performance of these services is solely incidental to the practice of his or her profession; (3) a broker-dealer or a registered agent acting on behalf of a broker-dealer whose performance of these services is solely incidental to the conduct of his or her business as a broker-dealer; (4) a publisher of any bona fide newspaper, news magazine, or business or financial publication of general, regular, and paid circulation; (5) a person who has no place of business in this state if (A) his only clients in this state are other investment advisers, broker-dealers, banks, savings institutions, trust companies, insurance companies, investment companies as defined in the investment company act of 1940, pension or profit-sharing trusts the assets of which are managed by a bank or trust company or other institutional manager, or other financial institutions or institutional buyers, whether acting for themselves or as trustees, or (B) during any period of 12 consecutive months he does not direct business communications into this state in any manner to more than 5 clients other than those specified in clause (A), whether or not he or any of the persons to whom the communications are directed is then present in this state; (6) such other persons not within the intent of this paragraph as the administrator may by rule or order designate; or (7) a trustee whose custody of assets is pursuant to judicial appointment, appointment under a trust indenture, or agreement and who does not hold himself out to the general public as giving advice to others with respect to securities and who maintains close contact with the personal financial affairs of his clients as a part of his fiduciary responsibilities, or a person who gives advice only to such a trustee.

(g) "Issuer" means any person who issues or proposes to issue any security or commodity contract, except that:

(1) With respect to certificates of deposit, voting-trust certificates or

collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors, or persons performing similar functions or of the fixed, restricted management or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which the security is issued.

(2) With respect to certificates of interest or participation in oil, gas, or mining titles or leases, or in payments out of production under such titles or leases, the term "issuer" means the owner of such oil, gas, or mining titles or leases or payments out of production or any fractional part thereof who creates and sells certificates of interest or participation therein.

(3) With respect to commodity contracts, issuer means a person engaged in the operation of a market on which commodities contracts are traded, and a person providing services or performing a function, including, but not limited to clearing, constituting a portion of such market. The administrator may by rule or order exempt any person from the definition of commodity issuer.

(h) "Nonissuer" means not directly or indirectly for the benefit of the issuer. A sale of securities shall be deemed to be indirectly for the benefit of the issuer if all of the following conditions are met:

(1) The sale is directly or indirectly made for the benefit of a director, or executive officer of the issuer, or a person occupying a similar status or performing similar functions, or a beneficial owner of 10% or more of any class of equity securities of the issuer.

(2) The sale, together with all sales made in this state by or for the benefit of the issuer during the 6-month period immediately before the date of the sale, otherwise than pursuant to a registration statement or exemption order under this act, exceeds 1% of the outstanding securities of the class of securities being sold.

(3) The securities are not of a class that has been designated by the administrator as eligible for trading in this state.

(i) "Person" means an individual, a corporation, a partnership, an association, a joint-stock company, a trust where the interests of the beneficiaries are evidenced by a security, an unincorporated organization, a government or a political subdivision of a government.

(j) (1) "Sale" or "sell' includes every contract of sale of, contract to sell, or disposition of, a security or commodity contract, or interest in a security or commodity contract for value.

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

(3) Any security or commodity contract given or delivered with, or as a bonus on account of, any purchase of securities, or commodity contracts, or any other thing is considered to constitute part of the subject of the purchase and to have been offered and sold for value.

(4) A purported gift of assessable stock is considered to involve an offer and sale.

(5) Every sale or offer of a warrant or right to purchase or subscribe to another security or commodity contract of the same or another issuer, as well as every sale or offer of a security or commodity contract which gives the holder a present or future right or privilege to convert into another security or commodity contract of the same or another issuer, is considered to include an offer of the other security or commodity contract.

(6) The terms defined in this subsection do not include:

(A) Any bona fide loan.

(B) Any 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 when each stockholder may elect to take the dividend in cash or property or in stock.

(C) Any act incident to a judicially approved reorganization in which a security is issued in exchange for 1 or more outstanding securities, claims, or property interests, or partly in such exchange and partly for cash.

(k) "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", "securities investor protection act of 1970", "commodity futures trading commission act of 1974", and "small business investment act of 1958", mean the federal statutes of those names as amended before or after the effective date of this act.

(*l*) "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease; or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "Security" includes any contractual or quasi contractual arrangement pursuant to which: (1) a person furnishes capital, other than services, to an issuer; (2) a portion of that capital is subjected to the risks of the issuer's enterprise; (3) the furnishing of that capital is induced by the representations of an issuer, promoter, or their affiliates which give rise to a reasonable understanding that a valuable tangible benefit will accrue to the person furnishing the capital as a result of the operation of the enterprise; (4) the person furnishing the capital does not intend to be actively involved in the management of the enterprise in a meaningful way; and (5) a promoter or its affiliates anticipate, at the time the capital is furnished, that financial gain may be realized as a result thereof. "Security" does not include an insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or some other specified period or a commodity contract. The administrator may exclude by rule or by order other transactions or agreements from the definition of the word "security".

(m) "State" means any state, territory, or possession of the United States, the District of Columbia, and Puerto Rico.

(n) "Commodity" means: (1) Those goods defined as commodities in the commodity futures trading commission act of 1974, (2) those goods commonly classified as commodities within the normal course of business dealings, (3) anything movable which is traded or for which contracts are executed or issued on any board of trade, or commodity exchange or market, or (4) precious metals. The administrator may by rule further define "commodity" or "commodity contract".

(o) "Commodity contract" means the transactions dealing in, resulting in, or relating to contracts of purchase or sale of a commodity: for (1) delivery in the future at a specified time or a time to be determined or where delivery is not

customarily made, including puts, calls, or any combinations thereof; (2) for present delivery where the value of the commodity is difficult to ascertain except by a person expert in the analysis of the commodity, and the commodity is offered for sale to the general public as an investment; (3) other options; (4) margin contracts; (5) or in general any interest in instrument commonly known as a commodity contract.

(p) "Principal" means a person associated with a broker-dealer who is actively engaged in the management of the broker-dealer's commodities, investment banking or securities business, including supervision, solicitation, conduct of business, or training of persons associated with a broker-dealer for any of these functions.

(q) "Promoter" means a person who, acting alone or in conjunction with 1 or more persons, directly or indirectly takes the initiative in founding and organizing the business or enterprise of an issuer; or a person who, in connection with the founding or organizing of the business or enterprise of an issuer, directly or indirectly receives in consideration of services or property, 10% or more of the proceeds from the sale of any class of securities or 10% or more of the equity interest in the issuer after the offering is complete. However, a person who receives such an amount of securities or proceeds either solely as underwriting commissions pursuant to an offering of securities registered under this act or solely in consideration of property or legal or accounting services shall not be deemed a promoter within the meaning of this subsection if the person does not otherwise take part in founding and organizing the enterprise.

(r) "Commission" means any payment in cash, securities, or goods for offering or selling, promise, or commitment to provide payment in the future for offering or selling, or any other similar payment. Commission does not include a real estate commission commensurate with fees paid in the area for similar services, paid to licensed real estate brokers solely for real estate services which have been rendered, or payment by a person to a lawyer or accountant in connection with advice or recommendations made by a lawyer or accountant to the client with whom the lawyer or accountant has an established professional relationship, if disclosure of the payment and the interest of the lawyer or accountant in the transaction or in the issuer or any affiliate of the issuer, is made in writing to the client before the sale. Officers, directors, and partners of an issuer or purchaser, or persons occupying a similar status shall not be considered a finder if their contact was purely incidental and their compensation was not directly or indirectly tied to or conditioned upon involvement in securities or commodities solicitation or purchase.

(s) "Direct or indirect compensation or remuneration" means any payment, receipt or use of proceeds of an offering for the benefit of the promoter, general partners, officers or directors, or persons occupying similar positions or their affiliates, any receipt, payment or use of securities or goods by those persons at less than the amount public investors paid for the securities or goods, or any markup charged on sale of property to the entity raising capital, any advantageous contractual relationships, any real estate commission, or other similar payments or arrangements to those persons.

(t) "Affiliate" means a person that directly or indirectly through 1 or more intermediaries controls, is controlled by, or is under common control with a specified person.

(u) "Finder" means a person who, for consideration, participates in the offer to sell, sale or purchase of securities or commodities by locating, introducing or referring potential purchasers or sellers. The finder does not include a person

whose actions are solely incidental to a transaction exempt pursuant to section 402(b)(19). The administrator may by rule or order exclude other persons from this definition.

451.802 Exempt securities and transactions; burden of proof; combining exempt offers or sales. [M.S.A. 19.776(402)]

Sec. 402. (a) The following securities are exempted from sections 301 and 403:

(1) Any security, including a revenue obligation, issued or guaranteed by the United States, any state, any political subdivision of a state, or any agency or corporate or other instrumentality of 1 or more of the foregoing; or any certificate of deposit for any of the foregoing, except that unless the issue is approved by the municipal finance commission, a revenue obligation of 1 of the foregoing payable from payments to be made in respect of property or money used under a lease, sale, or loan arrangement by or for a nongovernmental industrial or commercial enterprise or any guarantee or other obligation of such an enterprise made in connection therewith which may be considered to be a security is not exempt unless a notice in writing is filed at least 10 days before the issuance of the security with the administrator specifying the terms of the offer together with copies of any prospectus and sales material.

(2) Any security issued or guaranteed by Canada, any Canadian province, any political subdivision of any such province, any agency or corporate or other instrumentality of 1 or more of the foregoing, or any other foreign government with which the United States currently maintains diplomatic relations, if the security is recognized as a valid obligation by the issuer or guarantor.

(3) Any security issued by and representing an interest in or a debt of, or guaranteed by, any bank organized under the laws of the United States, or any bank, savings institution, or trust company organized and supervised under the laws of any state.

(4) Any security issued by and representing an interest in or a debt of, or guaranteed by, any federal savings and loan association, or any building and loan or similar association organized under the laws of any state and authorized to do business in this state.

(5) Any security issued or guaranteed by any federal credit union or any credit union, industrial loan association, or similar association organized and supervised under the laws of this state.

(6) Any security issued or guaranteed by any railroad, other common carrier, public utility, or public utility holding company which is:

(A) A registered holding company under the public utility holding company act of 1935 or a subsidiary of such a company within the meaning of that act; or

(B) Regulated in respect of the issuance or guarantee of the security by a governmental authority of the United States, any state, Canada or any Canadian province; also, any equipment trust certificate or equipment note or bond based on chattel mortgages, leases, or agreements for conditional sales of cars, motive power, or other rolling stock mortgages, leased or sold to or furnished for the use of or upon such railroads, other common carriers, public utilities, or holding companies supervised as above, or equipment, notes, or bonds where the ownership or title of such equipment is pledged or retained in accordance with the provisions of the laws of the United States, any state, Canada or any Canadian province, to secure the payment of such equipment trust certificates, bonds, or notes.

(7) Any security listed or approved for listing upon notice of issuance on the New York or American stock exchanges; any other security of the same issuer which is of senior or substantially equal rank; any security called for by subscription rights or warrants so listed or approved; or any warrant or right to purchase or subscribe to any of the foregoing. The administrator may by rule exempt securities listed on other exchanges or may establish criteria for designating other classifications of exempt securities.

(8) Any security issued by any person organized and operated not for private profit but exclusively for religious, educational, benevolent, charitable, fraternal, social, athletic, or reformatory purposes, or as a chamber of commerce or trade or professional association. However, unless the securities are part of an issue having an aggregate sales price of $50,000.00 or less and are sold only to bona fide members of the issuing organization and are sold without payment of a commission or consulting fee then the issuer shall do all of the following:

(i) Ten days before offer or sale of the security file with the administrator an offering circular in a form the administrator may by rule or order require together with a filing fee of $50.00, and the administrator does not disallow the exemption.

(ii) Not pay a commission or consulting fee to any person except a registered broker-dealer in connection with the offer or sale of the security.

(iii) Sell only through registered securities broker-dealers or through persons exempted from the definition of the term "agent" by the administrator. In connection with all of the foregoing, the administrator may by rule or order withdraw or further condition this exemption, or waive the conditions contained in subparagraphs (i) and (ii).

(9) Any prime quality negotiable commercial paper sold in an aggregate amount of not less than $25,000.00 to any 1 purchaser which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which evidences an obligation to pay cash at a fixed date within 9 months of the date of issuance, exclusive of days of grace, or any nonautomatic renewal of such commercial paper which is likewise limited, or any guarantee of such commercial paper or of any such renewal if the commercial paper is sold through a registered broker-dealer or an institution whose securities are exempted under subdivision (a)(3).

(10) Any investment contract or option issued in connection with an employees' stock purchase, option, savings, pension, profit sharing or similar benefit plan, if the administrator is notified in writing before the inception of the plan, or in the case of a stock option plan at least 10 days before the options granted thereunder have been exercised, except that notification shall not be required in the case of a plan which does not distribute to the participants securities of the employer or its affiliates establishing the plan.

(b) The following transactions are exempted from sections 301 and 403:

(1) Any isolated nonissuer transaction, and with respect to a certificate of interest or participation in an oil, gas or mining title or a lease or payment out of production under a title or lease, any isolated transaction not involving an offer or sale by a promoter, whether effected through a broker-dealer or not.

(2) Any nonissuer distribution of an outstanding security whose issuer and any predecessors have been in continuous operation for at least 5 years if:

(A) A recognized securities manual contains the names of the issuer's officers and directors, a balance sheet of the issuer as of a date within 18 months, and a profit and loss statement for either the fiscal year preceding that date or the most recent year of operations, or

(B) The security 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 3 preceding fiscal years, or during the existence of the issuer and any predecessors if less than 3 years, in the payment of principal, interest, or dividends on the security.

(3) Any nonissuer transaction effected by or through a registered broker-dealer pursuant to an unsolicited order or offer to buy; but the administrator may by rule require that the customer acknowledge upon a specified form that the sale was unsolicited, and that a signed copy of each such form be preserved by the broker-dealer for a specified period.

(4) Any transaction between the issuer or other person on whose behalf the offering is made and an underwriter, or among underwriters.

(5) Any transaction not part of a series of transactions in related or adjacent properties to individual investors, or any transaction involving an offer or sale to a financial institution as defined in subdivision (8), in a bond or other evidence of indebtedness secured by a real or chattel mortgage or deed of trust, or by an agreement for the sale of real estate or chattels, if 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.

(6) Any transaction by an executor, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian, or conservator.

(7) Any bona fide pledge or transaction in foreclosure of a pledge executed by a bona fide pledgee without any purpose of evading this act.

(8) Any offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the investment company act of 1940, pension or profit sharing trust the assets of which are managed by a bank or trust company or other institutional manager, or other financial institution or institutional manager, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity.

(9) Any transaction pursuant to an offering which satisfies in full each of the following requirements:

(A) The issuer and any person acting on its behalf shall exercise reasonable care to assure that purchasers in this state of the securities in the offering do not resell the securities without compliance with state and federal securities laws. For sales described in subparagraph (D)(2), (3), and (5) that reasonable care shall include, where appropriate, but not necessarily be limited to, all of the following:

(1) Making reasonable inquiry to determine if the purchaser is acquiring the securities for his own account or on behalf of other persons who may be considered as separate offerees or purchasers;

(2) Placing a legend on the certificate or other document evidencing the securities stating that the securities have not been registered under the act and setting forth or referring to the restrictions on transferability and sale of the securities;

(3) Issuing stop transfer instructions to the issuer's transfer agent, if any, with respect to the securities or, if the issuer transfers its own securities, making a notation in the appropriate records of the issuer;

(4) Obtaining from the purchaser a signed agreement that the securities will not be sold without registration under the act or exemption therefrom.

(B) The securities are not offered or sold in reliance upon this subdivision by means of any general advertising or general solicitation, except as approved by the administrator.

(C) A commission is not paid or given directly or indirectly for soliciting any prospective purchaser in this state, except to a broker-dealer registered pursuant to this act who is not affiliated with the issuer or its affiliates. Those payments shall be reflected on the books and records of the broker-dealer, and shall be fully disclosed in writing to each prospective purchaser. The broker-dealer or issuer shall file with the administrator on such forms as the administrator prescribes, a confidential report of offering within 30 days after initiation of the offering in this state and every 90 days thereafter until the final report of completion of the offering.

(D) Each sale in the offering made in reliance upon this subdivision meets all of the conditions of 1 of the following:

(1) Sales to any of the following classes of persons:

(i) Promoters or other persons actively engaged or reasonably expected to be actively engaged in the management of the issuer, or in a professional capacity as attorneys or accountants to the issuer, or directly related by blood or marriage to the promoter or person actively engaged or reasonably expected to be actively engaged in the management of the issuer, if such persons are purchasing with investment intent and the issuer relies upon this subparagraph for sales to not more than 10 persons in this state within a 12-month period;

(ii) Not more than 15 persons whose principal business is the line of business to which the offering relates, and who are qualified by previous experience to evaluate the risks of the investment.

The provisions of subsection (A) shall not apply to sales covered by subparagraphs (i) and (ii).

(2) Sales to not more than 15 persons in this state within any 12-month period, in reliance upon this subparagraph, and the issuer provides to all such offerees at least 48 hours before sale a document:

(i) Disclosing in reasonable detail the intended application of the proceeds to be received from the offering;

(ii) Disclosing in reasonable detail the current financial condition of the issuer and in the case of a limited partnership or oil and gas venture, the current financial condition of the general partner or oil and gas issuer; except that in the case of a limited partnership interest or interest in oil or gas, the document may merely state that the general partner or oil and gas issuer has a net worth, determined in accordance with generally accepted accounting principles, in excess of a stated sum, and that its net worth exceeds the obligations undertaken by the general partner or oil and gas issuer, and that the assets or operations of the general partner or oil and gas issuer will generate sufficient cash to meet these obligations as they come due;

(iii) Disclosing in all reasonable detail direct or indirect compensation or remuneration to be received by a promoter or affiliates of the promoter and fully identifying the persons who shall be recipients of that compensation;

(iv) Disclosing the form, date, and jurisdiction under which formed, and nature of business of the issuer;

(v) Disclosing the kind and amount of securities to be offered and the offering price or method by which the offering price is computed;

(vi) Stating, except in the case of a corporate issuer, that each investor or his designated representative may inspect the books and records of the issuer or the venture at any reasonable time for proper purposes;

(vii) Stating, except in the case of a corporate issuer, that the issuer shall

promptly call an informational meeting of all investors upon request by 25% in interest or more of the investors in any class of securities who are unaffiliated with a promoter or affiliate of the promoter;

(viii) Stating, except in the case of a corporate issuer, that the issuer shall agree to maintain at its offices a list of names and addresses of all investors in the entity available to any investor or the designated representative of any investor;

(ix) Stating that the issuer shall provide all investors with a detailed written statement of the application of the proceeds of the offering within 6 months after commencement of the offering or upon completion, whichever occurs first, and with annual current balance sheets and income statements to investors thereafter.

(3) Sales to not more than 35 persons in this state within any 12-month period in reliance upon this subparagraph, if all of the following conditions are met:

(i) The offeror files with the administrator an exemption application, an offering circular, and a $100.00 filing fee;

(ii) The administrator by order finds the offering consistent with the provisions of section 306 and declares this exemption effective;

(iii) The offering is made upon such conditions and with such information or provisions in the offering circular as the administrator may require;

(iv) The offering circular is delivered to each purchaser at least 48 hours before the sale to the purchaser.

(4) Sales made by a person other than an issuer to not more than 10 persons pursuant to offers to not more than 15 persons in this state within a 12-month period in reliance upon this subparagraph, if the offering is not part of a distribution of the issuer's securities.

(5) Sales made to a person who the seller has reasonable grounds to believe and does believe meets 1 of the following conditions:

(i) A business entity having either (i) net income from operations after taxes in excess of $100,000.00 in its last fiscal year or its latest 12-month period, or (ii) a net worth in excess of $1,000,000.00 at the time of purchase, and after the purchase has less than 10% of its total assets invested in the securities of the issuer.

(ii) An individual who after the purchase has an investment of more than $50,000.00 in the securities of the issuer, including installment payments to be made within 1 year after purchase by the investor; has either personal income before taxes in excess of $100,000.00 for his last fiscal year or latest 12-month period and is capable of bearing the economic risk, or net worth in excess of $1,000,000.00; and has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment or has obtained the advice of an attorney, certified public accountant, or investment adviser registered under the investment advisers act of 1940, or an investment adviser registered under this act, with respect to the merits and risks of the prospective investment.

(F) For purposes of this subparagraph:

(1) Each offer or sale made to a pension or profit sharing trust shall be deemed to have been made to each beneficiary as an individual offeree unless:

(i) The trust has an independent trustee;

(ii) The issuer makes inquiry and reasonably believes that the trust invests not more than 10% of its assets in the securities sold by the issuer; and

(iii) Within the 2-year period before the initial offer of the securities, the issuer was not directly or indirectly connected with the formation or subsequent operation of the trust or solicitation of its investors and the issuer makes inquiry

and reasonably believes that the trust was not formed to purchase the securities of the issuer.

(2) Each offer or sale made to a partnership or association shall be deemed to have been made to each partner or member as an individual unless all of the following occur:

(i) The issuer makes inquiry and reasonably believes that the partnership or association invests not more than 10% of its assets in the securities offered or sold by the issuer.

(ii) Within the 2-year period before the initial offer of the securities, the issuer was not directly or indirectly connected with the formation or subsequent operation of the partnership or association or solicitation of its investors and the issuer makes inquiry and reasonably believes that the partnership or association was not formed to purchase the securities of the issuer.

(3) Each offer or sale made to a corporation or business trust shall be deemed to have been made to each security holder of the corporation or business trust as an individual unless (i) a class of securities of the corporation or trust is registered pursuant to the securities exchange act of 1934, (ii) the decision of the corporation or trust to acquire the shares of the issuer is directly or indirectly related to the business of the corporation or trust and not for investment purposes, and its principal business is not investing in securities, or (iii) the issuer makes inquiry and reasonably believes that the corporation or trust invests not more than 10% of its assets in the securities offered or sold by the issuer, and as to each of the above, within the 2-year period before the initial offer of the securities the issuer was not directly or indirectly connected with the formation or subsequent operation of the corporation or trust or solicitation of its investors and the issuer makes inquiry and reasonably believes that the corporation or trust, or in the case of a wholly owned subsidiary, its parent, was not formed to purchase the securities of the issuer.

(4) An offer or sale to an investment company registered under the investment company act of 1940 shall constitute an offer or sale to an individual.

(5) Husband, wife, and children living as a family are considered to be 1 individual.

(6) Each client of an investment adviser, each customer of a broker-dealer, or a person with a similar relationship shall be considered an offeree or purchaser for purposes of this subdivision regardless of the amount of discretion given to the investment adviser, broker-dealer, or other person to act on behalf of the client, customer, or trust.

(G) The administrator may by rule or order as to any security or transaction, or any type of security or transaction, increase the number of offerees or purchasers, waive any conditions, and in conjunction with a request to exercise its discretion under these provisions, the administrator may further condition this exemption.

(10) Any offer or sale of a preorganization certificate or subscription in a corporation, and the issuance of securities pursuant thereto, if:

(A) No commission is paid or given directly or indirectly for soliciting any prospective subscriber;

(B) There are not more than 10 purchasers;

(C) Advertising is not published or circulated unless it has been reviewed and no objection thereto is made by the administrator in writing;

(D) The seller reasonably believes that all the buyers in this state, other than those designated in this subsection (b)(8), are purchasing for investment;

(E) The administrator may by rule or order waive the conditions in subparagraph (A) and require reports of sales under this exemption.

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

(A) A commission, other than a standby commission, is not paid or given directly or indirectly for soliciting any security holder in this state and the offer is made either to holders of the convertible securities or warrants and relates to the underlying security, or the securities are purchased by not more than 25 security holders in this state within a 12-month period.

(B) Twenty business days before any offer the issuer files with the administrator the offering circular or other materials proposed to be sent to security holders and other persons describing the terms of the offer together with a filing fee of $50.00 and the administrator does not by order disallow the exemption within the next 20 business days.

(12) Any offer, but not a sale, of a security for which a registration statement or exemption order request was filed under this act if a stop order is not in effect and a public proceeding or examination looking toward such an order is not pending and if made in compliance with section 307.

(13) Any offer, sale, or issuance of securities pursuant to an investment contract or option which is exempt under subsection (a)(10).

(14) Any offer or sale of a security as contemplated under the small business investment act of 1958 (1) to the federal small business administration, or (2) by a small business concern to a small business investment company or to a development company for equity capital provided or loans made, or (3) by a small business investment company to a small business concern as a condition to providing the latter with equity capital or loans.

(15) Any offer or sale of any security by a nonprofit development corporation, formed and existing under the laws of this state, if the primary purpose of the corporation is to promote and assist the growth and development of business enterprises in the area covered by its operations.

(16) The distribution by a cooperative corporation of its securities to its patrons as patronage refunds or returns distributed on a patronage basis.

(17) Any nonissuer transaction effected by or through a broker-dealer in any outstanding security of the same class as that which has been designated by order by the administrator as eligible for trading in this state, or that was registered for general public sale under this act or a predecessor act before January 1, 1978, if either the issuer has a class of securities registered under the securities exchange act of 1934 and has filed with the securities and exchange commission all reports required to be filed by it under that statute for the 12-month period preceding the date of sale, or the issuer has made publicly available such information as the administrator determines by rule or order as sufficient for the protection of investors and that information is on file with the administrator. The administrator, if it finds such action in the public interest, by order, may withdraw or condition this exemption as to any security or issuer. A person requesting a designation order shall pay a filing fee of $50.00.

(18) The sale of capital stock issued by a professional service corporation formed under Act No. 192 of the Public Acts of 1962, as amended, being sections 450.221 to 450.235 of the Michigan Compiled Laws.

(19) Any transaction incident to a class vote by shareholders pursuant to the certificate of incorporation or the applicable corporation statute, on a merger, consolidation, reclassification of securities, or sale of corporate assets in consideration of the issuance of securities of another corporation.

(20) Any transaction that the administrator by order exempts from the registration provisions of this act after a determination that registration is not necessary in the public interest and for the protection of investors. An order may be granted either before or after consummation of the transaction upon the petition of any interested party in the transaction.

(c) In any proceeding under this act, the burden of proving an exemption or an exception from a definition is upon the person claiming it.

(d) Offers or sales which are exempt under this section of the act may be combined with offers or sales exempt under any part of subsection (b) to exempt an entire transaction or series of transactions.

451.803 Sales literature or advertising communication; filing and acceptance; exemption. [M.S.A. 19.776(403)]

Sec. 403. The administrator may by rule or order require the filing and acceptance before use of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature or advertising communication addressed or intended for distribution to prospective investors, including clients or prospective clients of an investment adviser, unless the security, commodity contract, or transaction is exempted by section 402(a)(1) to (7).

451.805 Effect of registration, exemption, exception, or order; inconsistent representation prohibited. [M.S.A. 19.776(405)]

Sec. 405. (a) Neither the fact that an application for registration under sections 201 to 204 or a registration statement under sections 301 to 306 has been filed nor the fact that a person or security is effectively registered constitutes a finding by the administrator that any document filed under this act is true, complete, and not misleading. Neither any such fact nor the fact that an exemption or exception is available for a security or a transaction, or that an order has been issued by the administrator, means that the administrator has passed in any way upon the merits or qualifications of, or recommended or given approval to, any person, security, or transaction.

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

451.806 Administration of act; bureau as criminal justice agency; disclosures; privilege; joint investigations or inspections. [M.S.A. 19.776 (406)]

Sec. 406. (a) This act shall be administered by the corporation and securities bureau of the department of commerce which shall be a criminal justice agency as defined in 28 C.F.R. 20.3(c).

(b) The administrator or any of its officers or employees shall not disclose to the public or use for personal benefit any information which is filed with or obtained by the administrator and which is not made public pursuant to this act. This act does not authorize the administrator or any of its officers or employees to disclose any such information except among themselves or when necessary or appropriate in a proceeding or investigation under this act, or to federal, state, local, or foreign governmental agencies for their own official use. No provision of this act either creates or derogates from any privilege which exists at common law

or otherwise when documentary or other evidence is sought under a subpoena directed to the administrator or any of its officers or employees.

(c) The administrator may conduct joint investigations or inspections with the federal, state, or local agencies, or self-regulatory bodies as defined in the securities exchange act of 1934.

451.808 Cease and desist order; injunction, restraining order, order requiring accounting or disgorgement, or writ of mandamus; appointment of receiver or conservator; bond not required; hearing; decision; order denying or revoking exemption; remedies; commencement of action or proceeding. [M.S.A. 19.776(408)]

Sec. 408. (a) Whenever it appears to the administrator that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this act or any rule or order hereunder, it may in its discretion issue a cease and desist order or bring an action in a circuit court to enjoin the acts or practices and to enforce compliance with this act or any rule or order hereunder. Upon a proper showing a permanent or temporary injunction, restraining order, order requiring an accounting or disgorgement or writ of mandamus shall be granted and a receiver or conservator may be appointed for the defendant or the defendant's assets. The court may not require the administrator to post a bond.

(b) A person who has been ordered to cease and desist may file with the administrator within 15 days after service on him or her of the order a written request for a hearing. The administrator within 15 days after the filing shall issue a notice of hearing and set a date for the hearing. If a hearing is not requested by the person or is not ordered by the administrator within 15 days, the order will stand as entered. The administrator shall hold the hearing in accordance with Act No. 306 of the Public Acts of 1969, as amended, being sections 24.201 to 24.315 of the Michigan Compiled Laws, and shall have all the powers granted thereunder. The administrator shall issue a decision sustaining, modifying, or dismissing the original order.

(c) The administrator, if it finds such action to be in the public interest and that any person has violated or is about to violate any provision of this act or any rule or order hereunder, may by order deny or revoke any exemption specified in section 402(a)(1), (6), (7), (8), (9), or (10) or section 402(b) with respect to a specific security, issuer or transaction, or a person's right to sell exempt securities or engage in exempt transactions in the future without compliance with the registration provisions of this act. The order shall list the individual exemptions revoked and the rationale for the revocation. An order may not be entered without appropriate prior notice to all interested parties, opportunity for hearing, and written findings of fact and conclusions of law, except that the administrator may by order summarily deny or revoke any of the specific exemptions pending final determination of a proceeding under this subsection. Upon the entry of a summary order the administrator shall promptly notify all interested parties that the order has been entered and the reasons therefor and that within 15 days after receipt of a written request the matter will be set down for hearing. If a hearing is not requested within 15 days and none is ordered by the administrator, the order will remain in effect until it is modified or vacated by the administrator. If a hearing is requested or ordered, the administrator, after notice of an opportunity for hearing to all interested persons, may modify or vacate the order or extend it until final determination. An order under this subsection may operate retroactively. A person does not violate section 301 or 403 by reason of any offer or sale effected after the entry of an order under this subsection if that person sustains the

burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the order.

(d) None of the remedies provided for in this act are mutually exclusive and the administrator in its discretion may use as many remedies as it deems necessary. The administrator in seeking a remedy shall consider the present actions and the possibility of future violations by the parties against whom proceedings are contemplated, together with actions taken to mitigate harm to the public.

(e) The administrator shall not commence any action or proceeding under this act more than 6 years after the violation.

451.809 Violation; penalty; evidence; punishment for statutory or common law crime; filing criminal complaint or indictment. [M.S.A. 19.776(409)]

Sec. 409. (a) Any person who wilfully violates sections 101, 102, 103, 201, 203(h), 301, 402, 405(b), or 406(b), or who engages in conduct prohibited by section 204(a)(1)(J) to (S) and (V) to (Z), or who wilfully violates section 404 knowing the statement made to be false or misleading in any material respect, shall upon conviction be fined not more than $25,000.00, or imprisoned not more than 7 years, or both.

(b) The administrator may refer such evidence as is available concerning violations of this act or of any rule or order hereunder to the attorney general or the proper prosecuting attorney, who may, with or without such a reference, institute the appropriate criminal proceedings under this act.

(c) Nothing in this act limits the power of the state to punish any person for any conduct which constitutes a crime by statute or at common law.

(d) Any criminal complaint or indictment for violation of this act shall be filed within 6 years after the commission of the offense, but any period during which the party charged was not usually and publicly resident within this state shall not be included as part of the 6 years.

451.810 Offer or sale of security or commodity contract; liability; damages; contribution; tender; survival of action; limitations; rescission offer; disclosure; suit based on contract; rights and remedies cumulative. [M.S.A. 19.776(410)]

Sec. 410. (a) Any person who:

(1) Offers or sells a security or commodity contract in violation of section 201(a), 301, or 405(b), or of any rule or order under section 403 which requires the affirmative approval of sales literature before it is used, or of any condition imposed under section 304(d), 305(f), 305(g), or 412(g), or

(2) Offers or sells a security or commodity contract by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, the buyer not knowing of the untruth or omission, and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

(3) Is liable to the person buying the security or commodity contract from him, who may sue either at law or in equity to recover the consideration paid for the security or commodity contract, together with interest at 6% per year from the date of payment, costs and reasonable attorneys' fees, less the amount of any income received on the security or commodity contract, upon the tender of the security or commodity contract, or for damages if he no longers owns the security or commodity contract. Damages are the amount that would be recoverable upon

a tender less the value of the security or commodity contract when the buyer disposed of it and interest at 6% per year from the date of disposition.

(b) Every person who directly or indirectly controls a seller liable under subsection (a), every partner, officer, or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the nonseller who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

(c) Any tender specified in this section may be made at any time before entry of judgment.

(d) Every cause of action under this statute survives the death of any person who might have been a plaintiff or defendant.

(e) A person may not bring an action under this section more than 2 years after the contract of sale. A person may not bring an action under this section if the buyer received a written offer, before the action and at a time when he owned the security or commodity contract, to refund the consideration paid together with interest at 6% per year from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within 30 days of its receipt, or if the buyer received such an offer before the action and at a time when he did not own the security or commodity contract, unless he rejected the offer in writing within 30 days of its receipt. The documents making full written disclosure about the financial and business condition of the issuer and the financial and business risks associated with the retention of the securities or commodities shall be provided to the offeree concurrently with the written rescission offer. Such an offer shall not be made until 45 days after the date of sale of the securities and acceptance or rejection of the offer shall not be binding until 48 hours after receipt by the offeree. The rescission offer shall recite the provisions of this section. A rescission offer under this section shall not be valid unless the offeror substantiates that it has the ability to fund the offering and this information is set forth in the disclosure documents.

(f) A person who has not made or engaged in the performance of any contract in violation of any provision of this act or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract.

(g) Any condition, stipulation, or provision binding any person acquiring any security or commodity contract to waive compliance with any provision of this act or any rule or order hereunder is void.

(h) The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, but this act does not create any cause of action not specified in this section or section 202(e).

451.812 Rules, forms, and orders; making, amending, or rescinding; classification; financial statements; publication of rules and forms; applicability of provisions imposing liability; hearing; rules. [M.S.A. 19.776(412)]

Sec. 412. (a) The administrator may from time to time make, amend, and rescind rules, forms and orders as are necessary to carry out the provisions of this

act, including rules and forms governing registration statements, applications and reports, and defining any terms, whether or not used in this act, insofar as the definitions are not inconsistent with this act. For the purpose of rules and forms, the administrator may classify securities or commodity contracts, persons and matters within its jurisdiction, and prescribe different requirements for different classes.

(b) A rule, form, or order may not be made, amended, or rescinded unless the administrator finds that the action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes fairly intended by the policy and provisions of this act. In prescribing rules and forms the administrator may cooperate with the securities administrators of the other states and the securities and exchange commission with a view to effectuating the policy of this statute to achieve maximum uniformity in the form and content of registration statements, applications, and reports wherever practicable.

(c) The administrator may by rule or order prescribe (1) the form and content of financial statements required under this act, (2) the circumstances under which consolidated financial statements shall be filed, and (3) whether any required financial statements shall be certified by independent or certified public accountants. Financial statements shall be prepared in accordance with generally accepted accounting practices.

(d) Rules and forms of the administrator shall be published.

(e) A provision of this act imposing any liability applies to any act done or omitted in good faith in conformity with any rule, form, or order of the administrator, notwithstanding that the rule, form, or order may not later be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

(f) Every hearing in an administrative proceeding shall be public unless the administrator in its discretion grants a request joined in by all the respondents that the hearing be conducted privately.

(g) The administrator shall promulgate rules with respect to commodity issuers, broker-dealers, and agents as necessary or appropriate in the public interest or for the protection of investors. The rules may require, among other things, the promulgation and issuance of a disclosure statement by the broker-dealer or issuer of a commodity contract, the segregation of customer's funds and assets, maintenance of reserves for obligations, contingent or otherwise, to customers, the maintenance of a fidelity bond, hedging or covering obligations to customers, the signing and filing of a consent to service of process, and prior approval of advertising, limitation of the content of such advertising, and margin requirements.

(h) The rules promulgated and hearings held under this act shall be in accordance with Act No. 306 of the Public Acts of 1969, as amended, being sections 24.201 to 24.315 of the Michigan Compiled Laws.

451.813 Filing of documents; register; public inspection; availability of information to public; certified photostatic or other copies; charges; copy as evidence; certificate of nonexistence; interpretive opinions; rules. [M.S.A. 19.776(413)]

Sec. 413. (a) A document is filed when it is received by the administrator with the appropriate fee and all required forms.

(b) The administrator shall keep a register of all applications for registration and registration statements which are or have ever been effective under this act

and all denial, suspension, or revocation orders which have been entered under this act. The register shall be open for public inspection.

(c) The information contained in or filed with any registration statement, application, or report may be made available to the public under such rules as the administrator prescribes, except that the administrator may withhold from public inspection information, the disclosure of which is not necessary in the public interest and for the protection of investors.

(d) Upon request and at such reasonable charges as it prescribes, the administrator shall furnish to any person photostatic or other copies, certified under its seal of office, if requested, of any entry in the register or any document which is a matter of public record. The charges made shall constitute reimbursement to the administrator for the cost of reproduction. In any proceeding or prosecution under this act, any copy so certified is prima facie evidence of the contents of the entry or document certified.

(e) The administrator may certify the nonexistence of a filing for any documents which this act permits to be filed with the administrator, upon certification that the documents are of a type which, if filed, would be filed with the administrator and that a personal search of the records has been made by the person so certifying. A certificate of nonexistence shall be prima facie evidence that such a document has not been filed with the administrator.

(f) The administrator in its discretion may honor requests from interested persons for interpretative opinions and may promulgate rules setting forth procedures for requesting those opinions.

Approved October 23, 1978.

[No. 482]

AN ACT to amend Act No. 116 of the Public Acts of 1954, entitled "An act to reorganize, consolidate and add to the election laws; to provide for election officials and prescribe their powers and duties; to provide for the nomination and election of candidates for public office; to provide for the resignation, removal and recall of certain public officers; to provide for the filling of vacancies in public office; to provide for and regulate primaries and elections; to provide for the purity of elections; to guard against the abuse of the elective franchise; to define violations of this act; to prescribe the penalties therefor; and to repeal certain acts and all other acts inconsistent herewith," as amended, being sections 168.1 to 168.992 of the Compiled Laws of 1970, by adding section 486.

The People of the State of Michigan enact:

Section added; Michigan election law.

Section 1. Act No. 116 of the Public Acts of 1954, as amended, being sections 168.1 to 168.992 of the Compiled Laws of 1970, is amended by adding section 486 to read as follows:

168.486 Certifying and transmitting language of constitutional amendment or legislation initiated by petition. [M.S.A. 6.1486]

Sec. 486. If the qualified electors of this state approve a constitutional amendment or legislation initiated by petition, the board of state canvassers shall certify to the secretary of state the language of the amendment or legislation. The

Exhibit 9

Analysis of Substitute Senate Bill 834

STATE OF MICHIGAN

WILLIAM G. MILLIKEN, Governor

DEPARTMENT OF COMMERCE

P.O. BOX 30004, LAW BUILDING, LANSING, MICHIGAN 48909

KEITH MOLIN, Director

ANALYSIS OF SUBSTITUTE SENATE BILL 834 SPONSORED BY: Senator Anthony Derezinski

1. What is the purpose of the bill?

   The purpose of the bill is to amend the Michigan Uniform Securities Act, 1964 P.A. 265 (hereinafter the "Act"), through a general revision.

2. Was the bill introduced at the department's request?

   The bill was introduced at the request of the Department of Commerce.

3. Does the bill have the support of the department?

   The bill has the support of the Department of Commerce.

4. What are the arguments against the bill?

   The bill, by expanding the number and breadth of the exemptions from registration, will permit a larger number of securities offerings to be made in the state without the offering materials being subject to review by the Corporation and Securities Bureau before dissemination to offerees.

5. What are the arguments for the bill?

   (a) The Act, by expanding the number and breadth of the exemptions from registration, will permit entities, especially the small businessman seeking to raise small amounts of capital, to raise the capital at less expense. The Act also provides guidance as to the extent and nature of disclosure to be given.

   (b) Implemented, is a new concept of preliminary prospectus which should be of considerable benefit to securities issuers.

   (c) The Act continues the policy of detecting, investigating and acting on fraud in the sale of securities and commodity contracts in Michigan.

   (d) The bill amends the Act to account for recent changes in related federal regulation.

MICHIGAN THE GREAT LAKE STATE

6. Are there any revenue or budgetary implications in the bill (a) to the department; (b) to the State?

(a) Department

Yes. It is anticipated that registration fees to the state would be increased by approximately $150,000. Fees of between $50 to $100 are instituted for various types of exemption orders. Registration fees are increased from $250 to $500 for securities offerings; $10 to $15 for agent registration; and $100 to $250 for broker-dealer registration.

(b) State government

Yes. As discussed under (a) Department.

7. Are there any local governmental implications?

None.

8. What other principal departments might the bill affect?

None.

9. Any background information?

The Corporation and Securities Bureau proposed the bill over one year ago. A special subcommittee of approximately 25 attorneys from the Corporation, Finance and Business Law Sections of the Michigan Bar Association and a committee of the Detroit Chapter of the Securities Industry Association studied the bill in total and made recommendations. Other organizations have contributed to certain sections. The bill reflects agreement on needed changes in the Act. The bill was previously submitted as S.B. 1530 in 1976. The bill did pass out of Committee; however, the legislature adjourned prior to consideration and passing on the bill. The goals of the bill are:

1) to facilitate capital raising efforts by legitimate business entities.

2) to eliminate criminal and civil sanctions and to curtail regulation where the benefit to the public is not correlative to the punishment invoked and the cost of regulation.

3) to revise the current act to reflect changes in the Federal Securities Acts.

4) to include within the Act rules which have been promulgated under the Act to give the public better notice of the standards required.

5) to clarify ambiguities that have arisen under the current Act.

Approved by: _____
Keith Molin, Director

Date: 4/17/78

Governor William G. Milliken
Substitute Senate Bill No. 834

Proposed Uniform Securities Act Amendments
1964 P.A. 265

Section By Section Analysis

Part I

1. Subsection 102(a)(3)

This subsection is new. The amendment would provide that an investment adviser acting as principal for his own account may not knowingly sell any security or commodity contract to or purchase any security or commodity contract from an investment advisory client. The subsection also provides that a person acting as a broker for a third person may not knowingly sell or purchase for the account of such investment advisory client without written disclosure to the client and the consent of the client in writing. However, this prohibition would not apply to a transaction with a broker-dealer's customer if such broker-dealer is not acting as an adviser in such transaction. The purpose of the subsection is to require disclosure of potential conflicts of interest. This language is substantially the same as section 206(3) of the Federal Investment Advisers Act of 1940.

2. Subsection 102(b)(3)

This change strikes the last portion of this subsection which amplifies Subsection 1 prohibiting an investment advisory contract which does not provide that the investment adviser shall not be compensated on the basis of a share of capital gains. In lieu of the language stricken in Subsection 3, Subsection 102(d) is added which would state that Subsection 1 shall not be construed to prohibit a contract which provides for compensation based on the total value of the fund averaged over a definite period or as of definite dates or taken as of a definite date. Subsection 1 would not apply to an investment advisory contract with a registered mutual fund or a contract relating to the investment of assets in excess of $1 million under certain circumstances. This language comes from the last paragraph of Section 205 of the Federal Investment Advisers Act of 1940, and would provide for consistent interpretation between state and federal law.

It is also proposed to strike the definition of the word "assignment" which appears at the end of Subsection 3. Instead, Section 102(d) would provide that the definition of the term "assignment" and the other terms used in Section 102 shall be the same as the definition of such terms in the Investment Advisers Act of 1940, as amended.

3. Section 102(c)

This section is new. Section 102(c) would make it unlawful for an investment adviser acting as a finder to take possession of funds or securities in connection with the transaction for which payment is made for services as a

finder; to fail to make written disclosure to all involved persons that the adviser is acting as a finder along with the amount and method of payment as well as any personal beneficial interest he derives from his services; to participate in the offer, purchase or sale of a security or commodity in violation of Section 301 of the Act, or to participate in the offer, purchase or sale of a security or commodity without first obtaining information relative to the risks of the transaction, the direct or indirect compensation paid to the various parties, the financial condition of the issuer and the use of proceeds received from investors. The section does not require independent investigation or alteration of offering materials received by the finder.

A major concern of many persons viewing securities regulation is the absence of the recognition of the role of a finder in securing investors. Basically, a finder plays a passive role in transaction, serving to introduce the parties either through reference, personal introduction or providing information upon which the parties can act independently to consider entering into a purchase or sale of securities or commodities.

There has been substantial abuse by finders, leading the public to believe that they have no connection with the transaction or alternatively failing to reveal that the impetus for performing the introductory services is not a totally independent judgement, but rather is motivated in part or in whole by the presence of a finders fee.

Section 102(c) also makes it unlawful for an investment adviser acting as a finder to fail to inform or insure disclosure to the involved persons of any material information the finder knows or should know, in the exercise of reasonable care, that which is material in making an investment decision and to locate, introduce or refer persons that the finder knows or should know are not suitable investors for the transaction involved. The finder is not required to independently generate information.

Subject to Section 102(c)(5), he may furnish any information provided to him by the principal to the transaction to persons involved in the transaction as a result of his finding activities without liability under this act, except that this exclusion from liability shall not extend to his interpretations of this information or to any other information he furnishes.

A further concern is that the finder exercise some measure of discretion in the dealings he has with the potential investor. While he may transmit the offering materials prepared by the principal to the transaction, any other discussion puts him at risk. Obviously, a sales pitch is inappropriate and might result in the finder being classified as an agent, and the fee being characterized as a commission jeopardizing securities registration or exemption. Thus, it will behoove the offeror to recognize that careful instructions should be given to the finder to prevent excessive or fraudulent activity.

The finder is placed under an obligation not to recommend persons for whom an investment would be inappropriate. This provision parallels that imposed by the NASD on securities salesmen and proposed for adoption as Section 204(m) of these amendments.

Reference should be made to the proposed amendment of the definition of investment adviser in Section 401(f) of S.B. 834 and the proposed changes contained herein, infra.

4. Subsection 102(e)

This subsection was previously Section 102(c). It is renumbered. It presently provides that it is unlawful for an investment adviser to take custody of any securities or funds or commodity contracts of any client if the administrator prohibits custody or in the absence of rule the investment adviser fails to notify that he has or may have custody. Presently Rule 601.1 prohibits taking custody of funds or securities. By striking clauses one and two of this subsection and adding new language, it will provide that unless the administrator by rule or order permits custody it is unlawful for an investment adviser not also registered as a broker-dealer to have custody of securities, funds, or commodity contracts of any client. The new language would make it clear that an investment adviser also registered as a broker-dealer may have custody. It would also provide that in the absence of a rule or order an investment adviser not registered as a broker-dealer may not take custody.

5. Subsection 102(f)

This subsection is new. It would provide that an agent registered with a broker dealer may not also conduct advisory business except through the employer broker-dealer and with the written consent of the broker-dealer. Such written consent must be filed with the administrator. The potential for conflict of interest and abuse of a client is great when an agent is also registered as an investment adviser. The proposed subsection would give the employer broker-dealer notice of such activities and the ability and the responsibility for supervising the dual registrant.

The reference is not intended to apply to agents of issuers who are not registered with broker-dealers. Agents of issuers could register as investment advisers providing sufficient safeguards were instituted to prevent a conflict with their limited sales authority and their fiduciary obligations as investment advisers.

Part II

6. Section 201(c)

Section 201(c) is new. It would permit the administrator to require by rule or order that a broker-dealer designate a person to be registered as a principal of the broker-dealer in charge of management, financial matters, or compliance, unless the broker-dealer was a member of a national securities exchange. Principal registration for key officers of those firms is presently required by the exchanges and the N.A.S.D. It also establishes that the registration of a principal is only effective when he is associated with a particular registered broker-dealer.

The Bureau would be limited to mandating only one special principal per firm. The provision is designed to ensure that the firm has an individual knowledgeable in business, regulatory and financial matters as well as in the securities or commodities business.

Principal qualifications would be those imposed by the National Association of Securities Dealers, and the tests administered by that organization would be acceptable examinations.

7. Section 201(d)

Section 201(d) was Section 201(c). The amendment requires registration of investment advisers even if registered with the Securities & Exchange Commission. The Securities & Exchange Commission, at present, does not substantially regulate investment advisers and investment advisers have caused significant problems in Michigan through conversion of funds, churning, and aiding and abetting violations of the Uniform Securities Act.

8. Section 201(e)

Section 201(e) was formerly Section 201(d). The existing section provides for annual renewal of registration. The amendment would provide for continuing registration of broker-dealers, agents, principals, commodity issuers, and investment advisers until withdrawn or otherwise terminated. An annual report and an annual filing fee would still be required. The present system causes the registration of approximately 300 broker-dealers and approximately 7,000 agents to terminate on the same day at the end of the fiscal year. They cannot conduct business until their registration is renewed. Erroneous renewal applications, delay in the mails, or failure to pay the correct fee can cause a broker-dealer or an agent to suddenly become unregistered, causing inadvertent violations. This change would parallel the federal system of continuous registration until termination. If violations occur, they can be cured by administrative action.

9. Section 201(f)

Section 201(f) was Section 201(e). The section relates to the registration of commodity broker-dealers, agents, and issuers. The section provides an exemption from registration if a commodity is delivered to the buyer within 10 days after cash payment with certain conditions. The amendment adds the conditions that the commodity not be advertised except under a plan accepted by the administrator and that the seller of the commodity does not pay a commission, directly or indirectly, for soliciting any prospective buyer. These amendments are believed to be desirable to prevent commodities investment arrangements from being sold by unregistered issuers, broker-dealers, and agents which purport to deliver within 10 days after receiving payment, but which in fact may be operating bucket shops, utilizing false or misleading statements to sell, failing to make full disclosure, or making promises or guarantees which will probably be unfilfilled. The definition of commission is consistent with the new definition of commission contained in S.B. 834.

10. Section 201(g)

Section 201(g) was Section 201(f). The only change is the new number to accommodate renumbering of several other subsections.

11. Section 202(a)

The amendment adds principals to the types of registrants covered by the procedure set forth in this subsection. The amendment to Section 201(c) authorizes the administrator to require the registration of certain broker-dealer principals in certain circumstances. Section 202(a) establishes the procedure for such registration.

Another amendment to the section is the deletion of the words "or renewal" in relationship to registrations. The amendment to Section 201(e) establishes a procedure for continuous registration until termination.

The amendment to Section 202(a)(5) deletes the procedure whereby registration becomes effective on the thirtieth day after an application is filed. In practice an initial application for registration is rarely complete and error free. Accordingly, the administrator requests that items in the application be completed and corrected. The applicant is seldom able to do this within the 30 day period. Therefore, in most instances the administrator is compelled to issue an order deferring the registration because it is incomplete. This is a cumbersome procedure. Time spent preparing such deferral orders could be spent processing registration applications. The proposed amendment would make a registration effective upon order of the administrator.

This would not be a change in the way the law is administered in practice, but simply a reduction in unnecessary paperwork. The amendment would not lengthen the registration processing time; indeed, it might shorten it.

The other addition to Subsection 202(a)(5) appears in the last sentence. The proposal would allow the administrator to establish various classes of registrants. For example, some broker-dealers desire to specialize in one particular kind of security or offer one particular kind of service to their clients. To require registrants to comply with all of the requirements and meet all of the standards which are required of broker-dealers or other registrants who desire to do a general securities or commodities business and offer a variety of services to their customers unnecessarily discourages formation of new businesses. Specialized exams are currently administered by the National Association of Securities Dealers.

12. Section 202(b)

The amendment to Section 202(b) would make the language coincide with the procedure proposed in Section 201(3) whereby every registration shall be continuous until it is withdrawn and would increase the registration fees.

The deletion of language in the first sentence relating to "initial or renewal" registrations is intended to make this section coincide with proposed Section 201(e). The addition of language providing for an annual fee is intended to make it clear that continuous registration does not delete the requirement for an annual fee (which would otherwise have a serious adverse impact on revenues).

The increase in fees is intended to help defray rising costs resulting from inflation. Michigan has registration fees which are among the lowest in the nation.

13. Section 202(c)

Act 31 of the Public Acts of 1975 provides for the registration of certain persons transacting business in commodity contracts. The amendment to Subsection 202(c) would add commodity issuers as a type of registrant who may file an application for registration of a successor. Thus, a firm would not be required to halt business because of a change of name, organizational form or similar event. A filing of the information would suffice.

14. Section 202(d)

Section 202(d) authorizes the administrator to prescribe minimum capital for certain registrants as well as prescribing a ratio between net capital and aggregate indebtedness. The proposed additions to this subsection would make it clear that a registrant which finds itself not in compliance with the minimum requirements should cease business and notify the administrator. This addition is intended to protect investors from registrants whose net capital has fallen below the required standards but who continue to transact business, thus subjecting customers to the risk of loss or inconvenience if the firm fails. Notification and cessation of business is required federally.

15. Section 202(3)

The amendments to Subsection 202(e) would add commodity issuers and principals as types of registrants who are required to post surety bonds. Act 31 of the Public Acts of 1975 requires the registration of commodity issuers. Proposed Section 202(c), herein, would require the registration of certain principals of a broker-dealer. The proposed addition of these two classes of registrants in this subsection would protect customers who have a cause of action against commodity issuers or principals acting as sole proprietors if the registrant does not have sufficient assets to satisfy judgement. The maximum bond is $100,000 and no bond may be required of a registrant whose net capital exceeds $100,000. This is not a change in the amount of required bonds. Such bonds are not a significant problem for the industry.

The other proposed addition to the subsection would establish procedures whereby a court would try to ascertain that there were not additional prospective claimants. Under the present statute if a registrant fails financially under circumstances involving violations of law the first customer to sue may recoup the entire bond, leaving nothing for other investors.

16. Section 202(f)

Section 202(f) is new. It would permit the administrator to require broker-dealers and investment advisers to carry fidelity bonds covering general partners, officers, and employees. The administrator would be authorized to set the amount of the bonds by rule but in no case could the bonds be greater than $400,000 in the case of a broker-dealer or $100,000 in the case of investment advisers. This is similar to requirements of the Exchanges, the National Association of Securities Dealers, and the Securities and Exchange Commission.

17. Section 202(g)

This subsection is new. It would require fingerprinting of employees of a registrant who are regularly employed in the State of Michigan. Such fingerprints would be transmitted to the Federal Bureau of Investigation. This provision is designed to discover persons whose prior criminal records make it questionable whether they should be entrusted with handling negotiable securities, negotiable commodities contracts, investors' funds, or involved in giving advice to investors. Recent amendments to Section 17 of Federal Securities Exchange Act of 1934 mandated federal fingerprinting. This provision would permit the Bureau to participate in the system or defer to the Securities and Exchange Commission. The Bureau presently requires fingerprinting by rule for all sales personnel. Intrastate brokers would continue to be fingerprinted by the Bureau. Only those persons handling funds or securities, agents and supervisors would be subjected to this requirement.

18. Section 203(d)

The addition makes it clear that the administrator can exchange information with other securities and commodities regulatory authorities and other appropriate law enforcement agencies. The Bureau deals with a large number of federal, state and local agencies to form an enforcement network. The last sentence makes it clear that a registrant must keep its records open for reasonable periodic, special or other examinations. Failure to permit such inspection is grounds for summary suspension. This is a clarification of existing law.

19. Section 203(e)

Subsection 203(e)(1) is new. It is intended to provide an orderly procedure for satisfying all obligations when a registrant desires to terminate its registration. Accordingly, a registrant would be required to file a withdrawal form with the administrator, deliver all commodities and cash balances owing to customer, deliver all securities owing to other broker-dealers, meet any other conditions prescribed by the administrator by rule or order, and receive a withdrawal order from the administrator approving the withdrawal request. This procedure is similar to that established by Rule 15(b)(6)-1 under the Securities Exchange Act of 1934.

Subsection 203(e)(2) states that the procedure set forth above need not be followed if a registrant desires to temporarily cease business. Instead, such a registrant should notify the administrator in writing on or before the date of cessation of business of the fact of cessation, the reasons, and the date or basis for reopening of the business.

20. Section 203(f)

Subsection (f)(2) states that the withdrawal procedure set forth in Subsection 203(e)(1) need not be followed when a successor registrant will result from a merger or acquisition in which all obligations of the predecessor are acquired by the new broker-dealer, if the successor registrant will carry on the business in an uninterrupted fashion. In that event, the provisions of existing Section 202(c) having to do with registration of successors will apply instead.

21. Section 203(g)

This new section requires that a registered broker-dealer who has failed financially and become the subject of a trusteeship under the Federal Securities Investor Protection Act of 1970 notify the administrator and file a broker-dealer withdrawal form in accordance with Subsection 203(e). This subsection is designed to keep the administrator advised of brokerage firms which are being liquidated under the provisions of the aforementioned 1970 federal statute.

22. Section 203(h)

This subsection is new. It requires a registrant or an applicant for registration to notify the administrator of any enforcement proceedings or sanctions imposed by other regulatory agencies, so that the administrator can assess the potential impact on customers of the registrant, the seriousness of the allegations against the registrant, and the possibility that Michigan law has also been violated.

23. Section 203(i)

This subsection is a codification of our present rule. It requires broker-dealers and investment advisers to file advertising with the administrator contemporaneously with use, unless the administrator requires by rule or order that it be filed prior to use. The administrator has found that a substantial minority of broker-dealer and investment adviser advertising is misleading. Such advertising may not relate specifically to securities, but instead may relate to the services which the broker-dealer is able to offer to its customers, the financial health of the broker-dealer, the track record of investment advisers, and similar matters. To the extent that such advertising is distributed by registered investment advisers and registered broker-dealers it is incumbent upon the administrator to review the advertising in order to protect the registrant's customers from untruthful or misleading statements.

24. Section 204

The amendment would modify the internal numbering structure of this section in order to accommodate certain other proposed amendments. Thus, for example, the provision that the administrator must find an order to be in the public interest has been moved from Subsection 204(a)(1) to the first sentence of this section.

25. Section 204(a)

Subsection 204(a) presently provides that the administrator may deny, suspend, or revoke any registration under certain circumstances. Some violations are not sufficiently serious to warrant suspension of registration. Accordingly, the proposed amendment adds that the administrator may censure any registrant under certain circumstances.

26. Section 204(a)(1)

This subsection adds principal to the list of officials of a broker-dealer, commodity issuer, or investment adviser who may perform actions which cause Section 204 to be invoked by the administrator.

27. Subsection 204(a)(1)(F)

This subsection presently permits the administrator under certain circumstances to sanction a registrant whose registration has been denied or revoked by another regulatory authority. The amendment would add suspension of registration as a grounds for disciplinary action. The omission of suspension would appear to be an oversight in the original act.

The amendment to this subsection would also grant to the administrator the right to suspend, deny, or revoke registrations under certain circumstances if an individual has been subject to sanctions by another regulatory body. These changes parallel the existing grounds for proceedings against a registration under federal legislation. The purpose of the amendment is to make it clear that if such an individual is barred from association with a broker-dealer or investment adviser by federal agencies, an exchange or action of the National Association of Securities Dealers that the state could proceed against his registration. This is key to our cooperative enforcement regulatory program to avoid duplication of investigative effort or enforcement.

The amendment would grant the administrator power to deny, suspend or revoke registrations if the applicant or registrant had previously been associated with a broker-dealer which was liquidated under the provisions of the Federal Securities Investor Protection Act of 1970, or if one or more of the applicants or registrants, partners, officers, directors, or principals have been associated with such a broker-dealer, unless the association was terminated 12 months or more prior to the commencement of SIPC litigation, or unless the associated person can establish that he did not engage in dishonest or unethical business practices or violate or fail to comply with any provisions of this act or a predecessor act, or any rule or order thereunder, during his association with such a broker-dealer.

At the time that the original Michigan Uniform Securities Act was enacted, the Federal Securities Investor Protection Act of 1970 did not exist. The amendment would recognize that firms or persons which have failed financially or caused a failure in which the firm had to be liquidated with inconvenience and possible loss to their customers and with possible losses to the SIPC fund (and with ultimate possible losses to all federal taxpayers) may be poor risks to become registered. In addition, the amendment modifies substantially

the language pertaining to an associated person's establishment of compliance with the law. The language of amendments to the 1934 Act are not adequately clear thus leading the SEC to amend forms to express roughly this concept. The change is far better done by statute.

28. Subsection 204(a)(1)(J)

This is new. It states that unreasonable delay in delivering securities or commodities, to the extent that the registrant has control over delivery, is grounds for a proceeding against the registration. This is similar to existing Securities Rule 604.2(a); however, it is recommended that the provision should be moved from the rules to the statute.

29. Subsection 204(a)(1)(K)

This is new. It provides that a registrant may be sanctioned for representing the securities will be listed on an exchange without basis, in fact, for such representation. This is identical to existing Securities Rule 604(2)(b); however, it is recommended that the provision should be moved from the rule to the statute.

30. Subsection 204(a)(1)(L)

This is new. It provides that a registrant may be sanctioned for inducing excessive trading in a customer's account or inducing trading beyond the customer's known financial resources, if done for the benefit of the registrant in disregard of the customer's best interests as they reasonably appeared. This is similar to existing Securities Rule 604.2(c); however, it is recommended that it should be moved from the rules to the statute. This subsection is designed to combat churning. It is similar to NASD and SEC interpretations of the NASD Rules of Fair Practice, Article III, Section 2.

31. Subsection 204(a)(1)(M)

This is new. It provides that the administrator may institute proceedings against a registrant who recommends a securities or commodities transaction without reasonable grounds to believe that the recommendation is suitable for the customer on the basis of information furnished by the customer after reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and other information known by the person making the recommendation. This provision is similar to existing Securities Rule 604.2(d); however, it is recommended that it should be moved from the rules to the statute. The language is also very similar to the language of Article III, Section 2 of the NASD Rules of Fair Practice. The provision is designed to generally cope with registrants who recommend speculative low grade securities to unsophisticated investors or persons unable to bear the economic risk. This combats downgrading accounts, churning, and manipulations involving securities with weak markets.

32. Subsection 204(a)(1)(N)

This is new. It provides that the administrator may institute proceedings against a registration if the registrant as to promotional, new issue or secondary offerings recommends speculative low priced securities without knowledge of or attempt to obtain information concerning the customer's other security holdings, financial situation, investment objectives, and ability to bear the risk inherent in the purchase of such securities or if the registrant has recommended such securities in disregard of such information. This provision is similar to NASD interpretation of Article III, Section 2 of the NASD Rules of Fair Practice.

33. Subsection 204(a)(1)(O)

This is new. It provides that the administrator may institute proceedings against a registrant who has executed a transaction without authority to do so. The provision is identical to existing Securities Rule 604.2(3); however, it is recommended that it should be moved from the rules to the statute. It is similar to NASD interpretations of Article III, Section 18 of the NASD Rules of Fair Practice.

34. Subsection 204(a)(1)(P)

This is new. It provides that the administrator may institute proceedings against a registrant who has executed transactions pursuant to general discretionary authority without obtaining the general discretional authority in writing from the customer. Written authority is now required if the discretionary authority relates solely to the execution of an order and is limited in scope. This provision is identical to existing Securities Rule 604.2(f); however, it is recommended that it should be moved from the rules to the statute. It requires a registrant who proposes to "manage" a customer's account without receiving prior approval of the transactions with the customer to obtain a written power of attorney. It is similar to the provisions of Article III, Section 15(d) of the NASD Rules of Fair Practice.

35. Subsection 204(a)(1)(Q)

This is new. It provides that the administrator may institute proceedings against a registrant who has acted on an agency basis for both the buyer and the seller of a security or commodity contract without disclosing that fact to both on the confirmation. This provision is similar to Securities Rule 604.2(i); however, it is recommended that it should be moved from the rules to the statute. The provision is similar to Article III, Section 14 of the NASD Rules of Fair Practice. It requires disclosure of a possible conflict of interest situation and prevents secret profiteering.

36. Subsection 204(a)(1)(R)

This is new. The provision prohibits excessive markups or commissions. It is similar to Securities Rule 604.2(j). It is similar to Article III, Section 4 of the NASD Rules of Fair Practice. It protects unsophisticated investors

from unscrupulous firms or agents who would use high pressure or misleading sales techniques to induce investors to purchase overpriced securities or commodities available at significantly lower prices in the market.

37. Subsection 204(a)(1)(S)

This is new. It prohibits transactions not reasonably related to the market price. It is similar to existing Securities Rule 604.2(k). It is also similar to part of Article III, Section 4 of the NASD Rules of Fair Practice. Customers are frequently not aware of the exact market price of the securities or commodities which they order and in any case such prices may fluctuate rapidly after the customer is given a quote. Customers rely on registrants to execute orders at prices reasonably related to the market price. Often there is no way for the customer to verify the exact market price later. The onus should be on the registrant to insure that the price at which the transaction takes place is reasonably related to the market price, which the registrant is normally in the best position to ascertain.

38. Subsection 204(a)(1)(T)

This is new. It is similar to existing Securities Rule 604.2(m); however, it is recommended that it should be moved from the rules to the statute. It is similar to Article III, Section 20(a)(3) of the NASD Rules of Fair Practice. It provides that a registrant may not extend credit in violation of the Securities Exchange Act of 1934 or the regulations of the Federal Reserve Board. Improper credit extension can jeopardize the capital structure of the firm with resulting investor loss or inconvenience.

39. Subsection 204(a)(1)(U)

This is new. It prohibits manipulative or deceptive devices or contrivances in connection with the purchase or sale of securities or commodities by registrants. It is very similar to Article III, Section 18 of the NASD Rules of Fair Practice. Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934 contain similar provisions.

40. Subsection 204(a)(1)(V)

This is new. It prohibits a registrant from buying or selling a security without disclosing that the broker-dealer is acting as a market maker in this security or has a substantial position in the market. The purpose of the subsection is to require disclosure of potential conflicts of interest. The provision is generally similar to the disclosure requirements of Article III, Section 12 and Article III, Section 14 of the NASD Rules of Fair Practice.

41. Subsection 204(a)(1)(W)

This is new. It prohibits an agent or investment adviser from borrowing money from a customer. This prohibition presently appears in Securities Rule 604.2(1)(i); however, it is believed that it should be moved from the rules to the statute. It protects elderly investors from being victimized by agents.

42. Subsection 204(a)(1)(X)

This is new. It prohibits a registrant from making unauthorized use of the funds of a customer or hypothicating a customer's securities or commodities contract without having a lien thereon unless written consent of the customer was first obtained. The second part is similar to Securities Rule 604.2(h), but it is believed that it should be moved from the rules to the statute. The first part is similar to Article III, Section 19 of the NASD Rules of Fair Practice. Customers' funds and securities cannot be used to fund activities of the firm.

43. Subsection 204(a)(1)(Y)

This is new. It prohibits an agent from effecting transactions and not recording the transactions on the records of the agent's employer broker-dealer. It is similar to Securities Rule 604.2(1)(ii). Securities agents are only registered while employed by broker-dealers or issuers. Dual registration is not normally permitted. The employer broker-dealer has the responsibility to supervise the activities of the agent. There is no such thing as a "free-lance" agent. Accordingly, all transactions between agents and customers should be cleared through the employer broker-dealer and appear on the records of the broker-dealer. Otherwise, there is a great potential for fraud since customers normally associate agents with their employer broker-dealers and may not realize that in a given transaction the agent is not representing this broker-dealer. The Bureau has received numerous complaints from customers who feel that they were misled about the sponsorship of a particular investment opportunity by agents who utilized business cards with the employer broker-dealer's name, and received telephone calls relating to the proposed investment at the offices of the employer broker-dealer. Naturally, a broker-dealer which is unaware of an agent's transactions with a particular customer cannot supervise those transactions to insure that they meet the needs of the customer and that full disclosure has been made.

44. Subsection 204(a)(1)(Z)

This is new. It prohibits the operation of an account under a fictitious name. This prohibition is currently contained in Securities Rule 604.2(1)(iii). The potential for fraud is enormous when accounts are operated under a fictitious name.

45. Subsection 204(b)(5)

The amendment strikes the unnecessary words "initial or renewal" with respect to registration. This would make the subsection correspond with the amendment to Section 201 which establishes continuous registration.

46. Subsection 204(d)

This subsection presently provides that the administrator may cancel a registration if the registrant is no longer in business, has ceased to do business,

is subject to a determination of mental incompetence, is subject to control of a conservator or guardian, or cannot be located after reasonable search. Principals are added as classes of registrants subject to this subsection.

47. Subsection 204(e)

The 30 day withdrawal period is eliminated to insure that all accounts are settled. Reference is made to the amendment to Section 203(e). This is a departure from the Uniform Act standards.

Principals are added as one of the classes of registrants to whom this section applies, since certain principals will be registered pursuant to the amendments contained in Section 201(c).

48. Subsection 204(g)

This subsection provides that under certain circumstances the administrator may impose a civil penalty of $1,000 on a registrant who has violated certain portions of Section 204. In many cases, a registrant would find the payment of such a civil penalty less onerous than a suspension from doing business of even one day. This will give the administrator greater ability to fit the punishment to the violation. Where the harm has been cured, procedures imposed to prevent reoccurrence and the offender is of good repute, this sanction may be appropriate.

49. Subsection 204(h)

This subsection specifically provides that violations of Section 204 do not per se create civil liability to the customer. A customer would refer to Section 410 as to whether a course of action is available to him.

Part III

50. Section 303(c)(2)

The amendment would require that in registration by coordination the registration be filed with the administrator at least 20 days prior to effectiveness instead of 10 days and that all subsequent amendments except pricing amendments be on file at least 10 days. Experience has shown that 10 days is frequently not enough time to review a registration statement. The Bureau is unable to process within the present time limitation. The Uniform Act has a 10 day period. The filing time with the Securities and Exchange Commission is 30 days.

51. Section 303(e)

This subsection is new. It provides that a registrant may waive automatic effectiveness under registration by coordination thus avoiding a denial order. It further provides that such a waiver may subsequently be withdrawn. Under the present statutory procedure the applicant must either withdraw an inadequate registration statement in Michigan or the Bureau must enter a stop order.

Either of these alternatives may be unsatisfactory to an applicant because it must then notify other states and the SEC of the withdrawal in Michigan or of the stop order. By waiving automatic effectiveness, an applicant gives itself time to correct deficiencies in the registration statement.

52. Subsection 305(b)

The change would increase the maximum registration fee to $500 instead of $250. Michigan's present registration fees are among the lowest in the country. This change is designed to cope with increased costs brought about by inflation. The amendment would also provide that if review of the registration application has commenced prior to the time that the application is withdrawn the administrator would retain the total registration fee. Experience has shown that registrations are frequently withdrawn after the administrator has expended a large number of man hours in review. This will insure that the costs involved in the review are partially covered even if the registration is withdrawn. The amendment would also raise from $25 to $50 the amount of the fee which is obtained by the administrator if the application is withdrawn prior to the time that review has commenced. The receipt of the applicant and its docketing involve a number of clerical procedures which should be paid for even if an examiner has not commenced the review at the time the application is withdrawn.

53. Section 305(j)

Section 305(j) has been changed to provide that a registration statement may be amended after its effective date to increase the amount of the securities to be offered in Michigan. The amendment would permit retroactive registration of such additional securities upon payment, within six months after the sale, of a registration fee equal to the difference between the registration fee previously paid and the amount of the fee which would have otherwise been applicable to such additional securities, plus a late registration fee of $250. Experience has shown that issuers sometimes sell more securities than they have registered in Michigan (though not nationally). Such securities are unregistered and the transaction is voidable at the option of the buyer. This provision would permit the issuer to correct an inadvertent oversale but would impose a larger registration fee in order to discourage oversales. This is a significant change from the Uniform Securities Act, Section 305(k). The investor is not harmed by this change, and it eliminates an unnecessarily harsh requirement.

54. Section 307

The present statute does not permit the use of a preliminary prospectus (known as a red herring) prior to registration in the case of registration by notification or qualification, nor does it permit use of preliminary prospectus in situations where the issuer is seeking an exemption order from the administrator. The present statute does permit in Section 402(b)(12) the use of a preliminary prospectus in the case of registration by coordination. This provision would be retained in 307(a), which in addition, would allow the use of a preliminary prospectus under Section 302 (Registration by Notification).

307(b) would permit the use of preliminary prospectuses upon the written order of the administrator in filings under Section 304 or 402. This should be a substantial aid to securities issuers since it will permit receipt of indications of interest during completion of the registration or exemption process.

Part IV

55. Subsection 401(a)

This subsection would designate the Corporation and Securities Bureau of the Department of Commerce as the administrator of the act. This amendment together with the proposed amendment to Section 406(a) is designed to make it clear that the Bureau is eligible to receive law enforcement information from federal law enforcement agencies and also to make it clear that the Bureau is eligible to receive funding from the Federal Law Enforcement Assistance Administration or similar agencies.

56. Subsection 401(b)

This subsection defines the term "agent." It states that certain individuals selling exempt securities are excluded from the definition of the term. It is proposed to expand the list of exclusions by adding persons selling securities exempt under Section 402(a)(4) (savings and loan association securities), and 402(a)(5) (credit union securities).

The exclusions for persons selling securities exempt under Section 402(a)(9) (promissory notes) is deleted. Michigan has experienced a large amount of fraudulent activity in connection with the sale of promissory notes. Accordingly, it is believed that this exclusion should be deleted. Also, 402(a)(9) would require sale only through broker-dealers or financial institutions so no hardship is imposed. A recent Michigan Supreme Court opinion sharply curtailed this exemption as presently written. Such agents of brokers would be covered since they would receive commissions.

The words "in connection with all of these three cases" are added to make it clear that the prohibition against commissions applies to the whole sentence. The words "or other remuneration" are deleted. The term commission is defined later in this section. An exclusion is added for business finders registered pursuant to the act or acting as a finder in conjunction with most merger transactions. This change is mandated by the amendments relative to the definition of finder contained in S.B. 834.

57. Subsection 401(c)

This subsection defines the term "broker-dealer." It excludes certain persons from the definition, including a person who sells interests in oil and gas wells. The amendment would delete the oil and gas exclusion. Michigan has experienced a great deal of fraudulent activity in connection with oil and gas leases and, in any case, there does not appear to be any rationale in singling out the seller for this particular kind of security for exclusion from the definition of broker-dealer. The Uniform Securities Act did not exempt such persons so the definition is now consistent. An exclusion is added for business finders registered pursuant to the act or acting as a finder. Again, this change

is in keeping with the definition of finder in conjunction with most merger transactions.

58. Subsection 401(f)

This subsection defines the term "investment adviser" and the amendment excludes certain additional professionals from the term. The term "consideration" is added in lieu of "compensation" to make the section consistent with existing Section 102. In addition, the definition is modified to include those persons acting as finders in conjunction with the offer, sale or purchase of a security or commodity.

59. Subsection 401(f)(3)

Subsection 401(f)(3) exempts from the definition of investment adviser a broker-dealer whose services are solely incidental to the conduct of the business of a broker-dealer. It is proposed to delete the words "and who receives no special compensation for them." Recent federal requirements relating to "unbundling" of services mandate this change.

60. Subsection 401(f)(5) (Old)

This subsection deletes from the definition of investment adviser a person whose advice pertains only to securities exempt under Section 402(a)(1) (government and municipal securities). The potential for fraudulent activity in connection with municipal bonds has been amply demonstrated and in any case there does not appear to be any rationale for singling out an investment adviser who specializes in municipal bonds for exclusion from the definition. The statute presently requires the registration of municipal bond broker-dealers and agents. This is a change from the Uniform Securities Act.

61. Subsection 401(f)(5) (New)

This subsection is numbered 6 in the existing statute. It excludes from the definition of investment adviser persons located out of state whose investment advice is given to financial institutions or organizations more able to fend for themselves (banks, insurance companies, mutual funds, and so forth). The list of such persons includes pension or profit-sharing trusts. It is proposed to add the words "the assets of which are managed by a bank or trust company or other financial manager." Pension and profit-sharing trusts are often quite small both in terms of the number of participants and in terms of the dollar amount being managed. The manager is frequently one of the beneficiaries who devotes only a small percentage of his time to managing the trust and who has no special experience or expertise in finance. All of the other firms in the list are organizations which employ full-time financial professionals and who may not need the protection which may result from requiring the investment adviser who is rendering advice to them to be registered. There does not appear to be any rationale for not extending this protection, however, to small pension and profit-sharing trusts which cannot afford full-time professional management. Accordingly, the proposed language will require the registration of investment advisers who render

advice to pension and profit-sharing trusts unless the assets of the trust are managed by financial institutions. This is not believed to constitute a change in the intent of the existing law.

62. Subsection 401(g)(2)

Subsection 401(g) defines the term "issuer." It provides in Subsection 2 that there is no issuer of certificates of interest in oil and gas leases. This requirement has prevented oil and gas issuers from selling their own securities. There does not appear to be any rationale for saying that these securities do not have an issuer. Under certain circumstances officers can be held civilly liable for violations of the act. To say that a particular kind of security has no issuer is a fiction. No advantage results from this fiction. Accordingly, it is proposed that it be deleted. A new definition is inserted, defining the issuer as the person who fractionalizes the investment opportunity.

63. Subsection 401(h)

Subsection 401(h) defines the term "non-issuer." The additions to this subsection would treat sales by insiders and large shareholders as sales of the issuer to the extent that any such person sells during a six month period more than one percent of the outstanding securities of the class of securities being sold (other than securities sold pursuant to registration or an exemption order), and that the securities being sold are not of a class that has been designated by the administrator as eligible for trading in this state. This is designed to prevent profiteering by insiders at the expense of an unsophisticated or uninformed public while permitting sales of those securities for which adequate public information is available.

64. Subsection 401(i)(6)(A)

This subsection provides that although the term "offer" and the term "sale" does not include a bona fide loan, the term shall include pledges. The economic reality of certain pledges is that they do involve the transfer of securities. Accordingly, it is believed that pledges should be exempt from registration but included within the definition of offer and sale. An exemption from registration is provided by Section 402(b)(7). This exemption from registration would not prevent liability for misleading statements or penalties for violation.

The exclusion from the definition of offer and sale presently existing for bona fide loans was not deleted in response to apprehension that the statute could be interpreted too broadly as applied to ordinary business and commercial loan transactions.

65. Subsection 401(j)(6)(C)

This subsection presently provides that no offer or sale is involved in certain mergers and reorganizations. This provision was previously consistent with federal law as set forth in Rule 133 under the Securities Act of 1933. However, Rule 133 has been withdrawn and the SEC has promulgated Rule 145 which establishes that offers and sales of securities are involved in mergers and consolidations. In economic reality, when a shareholder is asked to vote on a merger in which he will acquire stock in another

corporation he is being offered stock in the other corporation. He should be entitled to full disclosure about the other corporation. Accordingly, existing Subsection 401(j)(6)(C) should be deleted. A new exemption replacing this exclusion is found in Section 402(b)(19).

66. Subsection 401(k)

This subsection refers to certain federal statutes used in the act and states that references in the act refer to these statutes as amended before or after the effective date of this act. Two new federal statutes are added to the list--the Securities Investors Protection Act of 1970 and the Commodity Futures Trading Commission Act of 1974.

67. Subsection 401(l)

This subsection defines the term "security." The amendment would add a definition of "risk capital" security. This concept is drawn from state and federal appellate decisions and recent publications by legal scholars. This amendment would clarify the existing Bureau position that such agreements constitute securities.

In essence, the amendment establishes a five part test under the risk capital test. An investor puts in money or other capital to an issuer who intends to develop a venture which subjects the investor's capital to risk of total or partial loss. The investor is induced to invest by representations of the issuer, promoter or their affiliates that some valuable benefit such as use of recreational facilities, participation in a buying club, or appreciation on resale of a membership will come to the investor because of the investment or membership purchase. Affiliates are included in light of the realities in the way such offerings are made. Promoters frequently set up corporations or other business entities to receive payments form which the promoter could benefit. Investors are misled without good disclosure, and their risk substantially increases. The final element is that the promoter must be anticipating a financial gain as a result of selling the membership, participatory interest or other symbol of financial commitment.

This amendment should be read in light of three cases:

Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906 (1961)
State Comm'r of Sec. v. Hawaii Market Center, Inc., 485 P.2d 105 (Hawaii 1971)
SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476 9th Cir.

In addition, the article by Professor Coffey at 18 Case W. Res. L. Rev. 367 is a prime basis behind the development of this modified risk capital theory.

68. Subsection 401(o)

This section defining commodity contracts has been revised to incorporate the existing rule into the statute. The proposal would include those contracts for present delivery where the value of the commodity is difficult to ascertain except by a person expert in the analysis of the commodity, and the commodity is offered for sale to the general public as an investment.

69. Subsection 401(p)

This subsection is new. It defines the term "principal." It is similar to the NASD definition. Principals are not required to register as agents unless they are acting as sales agents.

70. Subsection 401(q)

This subsection is new. It defines the term "promoter." The definition is derived from Regulation A and Rule 240 under the Federal Securities Act of 1933, and pertains to the risk capital definition in Section 401(l).

The definition excludes a person receiving an amount of securities or proceeds either as underwriting commissions or in consideration of property, legal or accounting fees.

Reasonable payments of securities in exchange for professional services are common practice, especially in start-up companies where there is no capital to pay such fees. Receipt of such securities should not per se constitute the professional as a promoter.

71. Subsection 401(r)

This subsection is new. It defines the term "commission." It will clarify, when read in conjunction with Section 401(s), limitations on exemptions found in Section 402(b)(9)-(11). The definition excludes real estate commissions or payment to lawyers or accountants for advice or recommendations recognizing the common practice of attorneys and accountants receiving fees in conjunction with placing their clients into a transaction which has been referred to them. The fiduciary duty of these professionals under the laws constituting their basis for practice, coupled with the general obligations of this Act requiring full disclosure, should provide adequate safeguards for these clients, each of whom should have a long-term relationship with the professional.

72. Subsection 401(s)

This subsection is new. It defines the term "direct or indirect compensation or remuneration."

73. Subsection 401(t)

This subsection is new. The term is defined to mean a person that directly or indirectly through one or more intermediaries, controls, is controlled by, or is under the common control with a specified person. The definition is a commonly used term both in the statute and securities law generally and is derived from Rule 405 under the Securities Act of 1933.

74. Subsection 401(u)

This subsection is new. It defines the term finder and completes the recognition of the concept of a finder tying back to Sections 102(c) and 401(f). A finder means any person who, for consideration, participates in the offer to sell, sale or purchase of securities or commodities by locating, introducing or referring potential purchasers or sellers.

75. Subsection 402(a)(1)

This subsection exempts from registration government securities. It is proposed to add language to provide that revenue obligations which are payable not from taxes but from lease, sale, or loan arrangements by or for a nongovernmental industrial or commercial enterprise are exempt only if a notice is filed with the administrator ten days prior to the issuance of the security. However, this condition would not apply to offerings which have been approved by the Municipal Finance Commission. Substantial non-disclosure relating to these securities endangers investors and government bond ratings. Presently, guarantees of these obligations are considered separate securities, except when made by a governmental entity. This distinction would be removed by this amendment.

76. Subsection 402(a)(6)

This subsection exempts from registration securities of common carriers and public utilities. The words "public utility" are added before the words "holding company" to make it clear that not all holding companies are exempted by this subsection. This is not a change in meaning but simply a clarification of existing language.

77. Subsection 402(a)(7)

This subsection exempts from registration securities listed on the New York Stock Exchange. The American Stock Exchange is added to the exemption. Securities listed on the American Stock Exchange are required to meet listing requirements and to make public disclosure which adequately protect investors. In addition, it is proposed to add language which would permit the administrator by rule to exempt securities listed on other exchanges or to establish criteria for designating other classifications of exempt securities. This will make it possible for the administrator to include in the exemption an exchange whose listing requirements have been raised to the point that registration no longer appears to offer additional protection to the investor and to exempt by rule categories of high quality securities which are not listed on an exchange even though they meet the listing requirements. These exemptions will permit the administrator to place more time reviewing issues not subject to extensive regulation presently.

78. Subsection 402(a)(8)

This subsection provides an exemption from registration for the securities of certain nonprofit organizations. Examples are churches, private colleges and retirement homes. The securities are often sold with minimal disclosure

to persons who cannot afford to lose their money. False promises are made about high yields and safety. Millions of dollars of such securities are sold annually. In recent years several Michigan nonprofit organizations have gone into bankruptcy or gone out of business costing their security holders millions of dollars. Examples are Mackinac College on Mackinac Island and Calvin Christian Retirement Home in Grand Rapids. Burcham Hills, a retirement home in East Lansing, is currently in federal bankruptcy court under Chapter 11. John Wesley College in Owosso, Michigan, has been unable to pay principal or interest on $12 million worth of promissory notes for several months and likewise is in Chapter 11 proceedings. Investors in such organizations often lose their life savings in a bankruptcy. Accordingly, the exemption would only be available if an acceptable offering circular is filed with the administrator 10 days prior to the offering, if no commissions are paid in connection with the offering except to a broker-dealer, and if the securities are sold only through persons exempted from the definition of the "agent" by the administrator or through registered broker-dealers. These provisions would not apply to a securities offering having an aggregate sales price of $50,000 or less which are sold only to bona fide members of the issuing organization. The administrator would have the authority by rule or order to withdraw or further condition the exemption or waive restrictions. One of the worst rip-offs in the securities business has been the so-called "religious consultants" who go to churches, persuade them to enter into a bonding program for expansion, promise training and expert assistance during the bond program, then disappear after one lecture to the sales force, delivery of some forms, and taking the first 10 percent of the proceeds themselves. The bond issue then fails or badly lags, with both the investors and the congregation the losers. Broker-dealer registration would be required for these consultants.

79. Subsection 402(a)(9)

This subsection provides an exemption for short term commercial paper. It is similar to and derived from a federal exemption in the Securities Act of 1933. The original purpose of the exemption was to permit transactions involving high quality commercial paper without registration. The exemption has been misread and badly abused by individuals and companies which have sought to sell short term promissory notes to public investers utilizing fraudulent representations. In recent years millions of dollars of losses have resulted from such abuses in Michigan. There have been several successful criminal prosecutions in Michigan relating to such sales. One company is currently in receivership. That company relied heavily on sales of short term promissory notes ostensibly exempt to finance its operations. It is imperative that the language of the exemption be clarified to make it clear that it applies only to certain prime quality commercial paper. The $25,000 denomination is the usual minimum for sales of this paper. Prime quality would be determined by reference to the standards of the trade, pertinent legal decisions and in light of interpretations by the Securities and Exchange Commission. Nine months is the Federal standard for these securities. The restriction on marketing recognizes the existing procedure for selling

only through broker-dealers or financial institutions. Most large companies will rely on exemptions provided by Section 402(a)(7) or (b)(8) in selling their securities. The need for this change is illustrated by People v. Dempster, 396 Mich 700 (1976).

80. Subsection 402(a)(10)

This subsection provides an exemption from registration for employee stock option, pension, profit-sharing, or other plans. It requires that the administrator be notified in writing 10 days before the issuance of investment contracts or options in connection with such plans. The present language is apparently confusing to companies and attorneys attempting to rely on the exemption and there are many inadvertent violations. Accordingly, the exemption is amended to provide that, in the case of stock option plans, the notification is not required until 10 days before the exercise of the options. This is consistent with federal law and is likely to result in fewer inadvertent harmless violations. In the case of plans not involving stock options the requirement would be that the administrator be notified 10 days before the inception of the plan, which is a much more certain date than the date of issuance of a contract or option which may be indefinite and may vary between employees. No notification at all would be required in the case of plans which do not distribute to the participants securities of the issuer or its affiliates. Additional protections are enforced through the Federal Employee Retirement Income Security Act of 1974.

81. Subsection 402(b)(1)

Securities of the type discussed in the amendment in this subsection did not have a clearly identifiable issuer pursuant to the definitional language in present Section 401(g)(2). The availability of an exemption under 402(b)(1) on a transaction involving these securities was therefore unclear since a condition to the exemption was that the person be a nonissuer. Proposed amendment to 401(g)(2) now defines an issuer in these securities. The 402 (b)(1) amendment is intended to make the exemption available to sales by holders including sales deemed to be indirectly for the benefit of the issuer except for sales by the issuer or promoter. The amendment is intended to permit individuals and companies engaged in the oil and gas business who have purchased such a security from an issuer to dispose of the security to other similar persons.

82. Subsection 402(b)(5)

This subsection provides an exemption from registration for mortgages and notes sold as a unit. It has been the subject of abuse by promoters fraudulently selling undeveloped lots in swamps, deserts and jungles. Millions of dollars in losses have occurred in Michigan. Accordingly, language is added restricting the exemption to transactions which are not part of a series of transactions in related or adjacent properties to individual investors. Language is added also making it clear that any offer or sale of a mortgage and mortgage note to a financial institution as defined continues to be exempt.

83. Subsection 402(b)(7)

This subsection provides an exemption from registration for pledges of securities in conjunction with obtaining commercial or similar loans. The proposed amendments are designed to clarify the exemption. No change in meaning is intended. Any distribution of securities to public investors would not be exempt under this section.

84. Subsection 402(b)(8)

This subsection exempts offers or sales to certain financial institutions. Such financial institutions (such as banks, insurance companies and mutual funds) are in financial businesses, employ full time professional financial persons, and are deemed to be able to fend for themselves without the protection of a registration statement. However, included in the list of financial institutions is the term "pension or profit-sharing trusts." Many such trusts are small, both in terms of assets and in terms of total beneficiaries and are managed on a part time basis by one of the beneficiaries who is not a financial professional. Such trusts should be entitled to the protection of a registration statement covering the securities which are sold to them. The Bureau believes that present law does not exempt such offers or sales, but clarifying language qualifying the exemptions, unless the trust is managed by a bank or trust company or other institutional manager, is necessary, to reduce confusion and eliminate a vehicle for improper avoidance of the law.

85. Subsection 402(b)(9)

This subsection is one of the most commonly relied upon. It provides an exemption for small offerings. It has proven inadequate and insufficiently flexible to serve the legitimate needs of many businesses for capital derived from offerings of limited scope. Accordingly, the existing subsection is deleted and a new provision added for five different kinds of offerings under Subsection 402(b)(9)(D). The condition which would be imposed upon persons relying on the subsection would vary according to which of the five types of offerings was involved. In any instance, however, all set forth conditions must be met in full.

There are three general standards for such offerings. The offering must be made to persons who are purchasing for investment, the offering cannot be part of a scheme to avoid compliance with the securities laws, the securities cannot be sold through general advertising or solicitation, and no commission can be paid except to a broker-dealer registered under the Act. The provisions are consistent with existing interpretation of the law.

86. Subsection 402(b)(9)(A)

This subsection is new. It would require that the issuer and any person acting on its behalf exercise a reasonable standard of care to assure that persons in this state do not resell securities without complying with both the state and federal laws. "Reasonable care" is meant to include

making reasonable inquiry to determine whether the purchaser is investing for his own account or for others (who may be considered separate offerees or purchasers); placing a legend on security documents evidencing that such has not been registered under the Act and referring to the transfer and sale restrictions; issuing stop transfer instructions to the issuer's transfer agent; and obtaining a signed agreement from a purchaser that the securities will not be sold without registration under or exemption from this Act.

87. Subsection 402(b)(9)(B)

Provides that securities offered or sold in reliance on Subsection 402(b)(9) must not be offered or sold by means of any general advertising or general solicitation, except as approved by the administrator.

88. Subsection 402(b)(9)(C)

Provides that no commission is to be paid or given directly or indirectly for soliciting any prospective purchaser in Michigan except to a broker-dealer registered under the Act. Commissions to broker-dealers shall be reflected on the books and records of the broker-dealer and shall be fully disclosed in writing to each prospective purchaser. The broker-dealer or issuer shall file with the administrator on such forms as the administrator prescribes, a confidential report of offering within 30 days of initiation of the offering in Michigan and every 90 days thereafter until completion of the offering.

89. Section 402(b)(9)(D)(1)

The first type of offering is set forth in Subsection 402(b)(9)(D)(1). It provides an exemption for sales to promoters or other persons who are, or are reasonably expected to be, actively engaged in the business of the issuer, or in a professional capacity as attorneys or accountants to the issuer, or to persons directly related by blood or marriage to such persons engaged in the management of the issuer. Sales may not be made to more than 10 persons in any 12 month period in reliance on this subsection. An exemption is also provided for sales to not more than 15 persons operating professionally in the same line of business. The first exemption recognizes that persons involved with the business or who are acting as professional advisers in conjunction with the offering are in a position to obtain all information necessary to make an informed investment decision and will usually make proper inquiries to protect their investments. The 15 person limitation in the second exemption is a modification intended to prevent unlimited offerings which might create substantial enforcement problems through misinterpretation. Further, the situation when more professionals would be involved is extremely rare and the provisions for petition to the Bureau for exemption order are still available.

90. Section 402(b)(9)(D)(2)

The second type of offering is set forth in Subsection (D)(2). It exempts sales to not more than 15 persons within any 12 month period. All offerees

must be provided at least 48 hours prior to sale a document which discloses in reasonable detail the intended application of the proceeds of the offering and discloses in reasonable detail the current financial condition of the issuer, and in the case of a limited partnership, the current financial condition or net worth of the general partner. The document must also disclose in reasonable detail all commissions and direct or indirect compensation or remuneration to be received by any promoter or affiliates and fully identify the persons who shall be recipients of such compensation. The document must disclose the form, date and jurisdiction of organization; the nature of the issuer's business; and the kind and amount of securities to be offered and the offering price or the method by which the offering price is computed. The document must state, except in the case of a corporate issuer, where corporate law provides this protection already, that each investor or his designated representative may inspect the books and records of the issuer at any reasonable time for proper purposes, that the issuer shall promptly call an informational meeting of all investors upon request by 25 percent in interest or more of the investors in any class of securities who are unaffiliated with any promoter or any affiliate of the promoter, and that the issuer shall agree to maintain at its offices a list of names and addresses of all investors in the entity available to any investor or the designated representative of any investor. The document must also state that the issuer, corporate or noncorporate, shall provide all investors with a detailed written statement of the application of the proceeds of the offering within six months after commencement of the offering or upon completion, whichever occurs first, and with annual current balance sheets and income statements to investors thereafter.

91. Section 402(b)(9)(D)(3)

The third type of offering is set forth in Subsection (D)(3). It exempts sales to not more than 35 persons in this state within any 12 month period if the offeror files with the administrator an exemption application, an offering circular and $100 filing fee; the administrator by order finds the offering consistent with the provisions of Section 306 and declares the exemption effective; the offering is made upon such conditions and with such information or provisions in the offering circular as the administrator may require; and the offering circular is delivered to each purchaser at least 48 hours prior to the sale to such purchaser. Most persons filing under this exemption would rely on Bureau guidelines for preparation of their offering circular.

92. Section 402(b)(9)(D)(4)

The fourth type of offering is set forth in Subsection (D)(4). This provision exempts sales made by a person other than an issuer to not more than 10 persons pursuant to offers to not more than 15 persons in Michigan within a 12 month period provided the offering is not part of a distribution of issuer's securities. This permits officials and insiders to make limited placements after the holding period has expired. It should be read in conjunction with proposed section 401(h).

93. Section 402(b)(9)(D)(5)

The fifth type of offering is set forth in Subsection (D)(5). It exempts sales made to persons who the seller has reasonable grounds to believe meet certain high financial standards. It encompasses some of the concepts of the Federal Securities Act of 1933, Rule 146.

The exemptions provided by this subsection are cumulative and can be used in isolation or combination.

94. Subsection 402(b)(9)(F)

Sets forth under what circumstances an offer or sale to a trust, partnership or association, and corporation or business trust will be regarded as one offer or sale rather than an offer or sale to each trust beneficiary, partner, or security holder, for purposes of Subsection 402(b)(9). The subsection sets forth that the issuer cannot be directly or indirectly connected with the formation of subsequent operation of the trust, partnership or association for a period of two years prior to the initial offer of securities. This provides a sufficient "cooling off" to reduce the probability of enforcement problems. The subsection also provides that an offer or sale to a registered investment company constitutes one offer or sale and that husband, wife and children living as a family are considered to be one individual for purposes of the subsection. Clients of an investment adviser, customers of a broker-dealer, and persons with similar relationships are considered the offerees or purchasers for purposes of the subsection regardless of the amount of discretion given the investment adviser, broker-dealer, or other person.

95. Subsection 402(b)(9)(G)

Provides that the administrator may by rule or order as to any security or transaction, or any type of security or transaction increase the number of offerees or purchasers or waive any conditions. In conjunction with a request to exercise its discretion under these provisions, the administrator may further condition this exemption. The subsection ensures that broad-based changes in the exemption provisions are made only by statute and not by administrative role.

96. Subsection 402(b)(10)

This subsection exempts the sale of preorganization certificates or subscriptions under certain circumstances. The words "in a corporation" are added under the word "subscription" to clarify that the exemption is only available for corporations. This is not a change in meaning. The requirement that each of the subscribers sign the articles of incorporation in person is deleted. This requirement is cumbersome and obsolete. No purpose is presently served by such a requirement, since such signatures are not required under the new Business Corporation Act. The exemption would require that the administrator review any advertising pertaining to the

securities and that the seller reasonably believe that all buyers in Michigan (other than financial institutions) were purchasing for investment and not for redistribution. The present subsection limits the number of subscribers to ten. The present subsection prohibits commissions or other remuneration for soliciting any prospective subscriber. The amendment states that the administrator may by rule or order waive this condition and require reports of sales under the exemption. The exemption may be used in combination with other exemptions.

97. Subsection 402(b)(11)

This subsection provides for exemption from registration for offers and sales to existing security holders under certain circumstances. The subsection is modified to provide an exemption if no direct or indirect commission is paid for soliciting any security holder in this state and such offers are made to the holders of convertible securities or warrants related to the underlying security or the securities are purchased by not more than 25 security holders in this state within a 12 month period. The subsection provides a third exemption if 20 days prior to any offer the issuer files an offering circular and other materials proposed to be sent to security holders describing the terms of the offer together with a filing fee of $50 and the administrator does not disallow the exemption within the next 20 business days.

98. Subsection 402(b)(12)

This subsection provides an exemption for the use of preliminary prospectuses in the case of registration by coordination. The exemption is expanded to make it also applicable by order to registration by qualification or notification and to exemption requests. The exemption would be available as it presently is if a registration statement has been filed for registration by coordination. Otherwise, it would be available by order of the administrator. This modification is intended to make this exemption consistent with proposed Section 307. The purpose of the modification is to expand the ability to use a preliminary prospectus and should be a significant benefit to Michigan business.

99. Subsection 402(b)(17)

This subsection presently provides the exemption from registration for the sale by shareholders (but not by issuers) of securities that have previously been registered. The subsection restricts the exemption situations in which the seller offers less than 5 percent of the particular class of securities during any period of 12 consecutive months. The amendment would authorize the administrator to designate by order securities which were eligible for trading in Michigan. The exemption for previously registered securities would continue for securities registered prior to January 1, 1978, if either (1) the issuer has a class of securities registered under the Federal Securities Exchange Act of 1934 and has filed all required reports or (2) the issuer has made publicly available such information as the administrator determines by rule or order as sufficient and such information is on file with the administrator. The restriction of the exemption to 5 percent or less of the class of securities would be stricken. The filing fee for a designation order would be $50.

100. Subsection 402(b)(18)

This subsection provides an exemption from registration for professional service corporations. It is proposed to change the word "securities" to the words "capital stock" to make it clear that although a professional service corporation may sell its capital stock without registration to the professionals who are members of or joining the firm, it is not free to issue debentures or other securities to the general public. Act 192 of the Public Acts of 1962 restricts the sale of professional service corporation capital stock to members of the profession.

101. Subsection 402(b)(19)

This subsection is new. It creates an exemption from registration for any transaction incident to a class vote by shareholders, pursuant to the certificate of incorporation or the applicable corporation statute, on a merger, consolidation, reclassification of securities, or sale of corporate assets in consideration of the issuance of securities of another corporation.

Under the existing statute, mergers and consolidations are not offers or sales as defined by Section 401(j). Section 401(j)(6)(C) has been deleted in this bill thereby providing that such transactions do involve offers and sales of securities (which is in accordance with the economic reality of the situation and with current federal law). The language from Section 401(j)(6)(C) has been moved to the exemption section, thus providing the protection of the anti-fraud provisions of the Act without significantly upsetting the procedures followed in such transactions presently. It parallels the present federal system in providing the anti-fraud protection.

102. Subsection 402(b)(20)

This subsection is new. It provides that the administrator may by order exempt from registration any transaction after a determination that registration is not necessary in the public interest and for the protection of investors. Such order may be granted prior to or after consummation of the transaction upon petition of any interested party. From time to time the administrator encounters securities transactions where no public interest exists in imposing a requirement of the law. This provision should not be used generally to abrogate rights of persons with a bona fide claim, but rather to cure innocent, inadvertent violations where no public harm has occurred.

103. Subsection 402(c)

Existing Subsection 402(c) is moved to Subsection 408(c).

104. Subsection 402(d)

This subsection is new. It would provide that offers or sales which are exempt under this section of the Act may be combined with offers or sales exempt under any part of Section 402(b) to exempt an entire transaction or series of transactions. This makes clear the concept that different subsections can be combined into a single offering without the loss of the exemptions provided by the specific subsections.

105. Section 403

Section 403 requires the filing and approval prior to use of any advertising or sales literature unless the security is exempt by Section 402. Substitute the word "acceptance" for the word "approval" to avoid the implication that statements contained in an advertisement are certified by the administrator. The amendment would restrict advertising in exempt transactions to Subsection 402(a)(1) through (7), except as provided by rule.

106. Subsection 405(a)

This subsection provides that registration does not constitute a finding by the administrator that any document filed is true, complete and not misleading and that the administrator has not passed on the merits or recommended or given approval to any person, security, or transaction. The words "or that an order has been issued by the administrator" are added to this subsection to make it clear that the issuance of an exemption order, exclusion order, or any other order does not imply recommendation or approval.

107. Subsection 406(a)

This subsection states that the act shall be administered by the Department of Commerce. It is proposed to add the words "Corporation and Securities Bureau which shall be a 'criminal justice agency' as defined by 28 C.F.R. s 20.3(c)(1975)." The purpose of this addition is to make it clear that the Bureau is entitled to receive information from federal law enforcement agencies and to make the Bureau eligible to receive federal funding from the Law Enforcement Assistance Administration.

108. Subsection 406(b)

This subsection provides that the administrator or its officers or employees may not use for personal benefit any information which is filed and not made public. It is proposed to add the words "disclose to the public or to" prior to the words "use for personal benefit" to make it clear that when an employee of the Bureau obtains nonpublic information in the course of an investigation or otherwise and that information is not made public by the administrator under the provisions of the act that the employee cannot disclose such information to the public. This provision is desirable to protect the privacy of persons who are under investigation, the privacy of persons who have been interviewed by the Bureau, and the information which has been provided to the Bureau in confidence. It is also proposed to amend the subsection to make it clear that the Bureau can disclose information to federal, state, local, or foreign governmental law enforcement agencies for their official use. This does not constitute a change from existing law but merely a clarification. The Bureau conducts a large number of investigations leading to enforcement actions. During the course of these investigations, it exchanges information with various law enforcement agencies. The amendment is intended to make it clear that the administrator is authorized to exchange investigatory or other nonpublic information with law enforcement agencies.

109. Subsection 408(a)

This subsection provides that the administrator may issue a cease and desist order or bring action in the circuit court for Ingham County for an injunction. The subsection is amended to provide that the action may be brought in any circuit court. In some circumstances it may not make sense to require all the witnesses and all of the defendants to travel great distances to try a case in Ingham County.

The section also allows the granting of an order requiring an accounting or disgorgement in addition to permanent or temporary injunction or restraining orders. This clarifies the power of the court to take steps to ascertain the use of investor funds or require repayment incident to an action by the Bureau.

110. Subsection 408(b)

This subsection is new. It establishes procedure relating to hearings on cease and desist orders. It codifies existing practice. The subsection also provides that a knowing violation of a final cease and desist order or a knowing authorization, direction, or aiding in such violation or a knowing failure to comply with the terms of such an order is grounds for conviction of a misdemeanor and a fine of not more than $5,000, imprisonment for not more than 6 months, or both. Each violation constitutes a separate offense.

111. Subsection 408(c)

This subsection has been moved from 402(c) and modified. It provides that the Bureau may revoke certain exemptions. The amendment would provide that the administrator must find such action in the public interest and must find that a violation has been committed or is about to be committed. The order would add the exemptions under Section 402(a)(1), (6), (7) and (9) to the list of exemptions that can be revoked. The order would also state that a person's right to sell exempt securities or engage in exempt transactions in the future without registration may be revoked under the aforementioned circumstances. The order would also list the individual exemptions revoked and the rationale for such action. The present act establishes a right to a hearing with respect to the revocation of an exemption. The proposed amendment would provide that the hearing must be requested within 15 days. Experience has shown that securities violators are often repeaters. This provision would clearly establish the administrator's responsibility to revoke exemptions pertaining to future sales with respect to such a person. A person who is the subject of such action would then know that all of his securities offerings would require registration in the future. Most violators select an exemption upon which they purport to rely, even though the circumstances are such that the exemption is not available or even through the offering is fraudulent. It is believed that this amendment may to some extent reduce the problem of recidivism in securities violations.

112. Subsection 408(d)

This subsection is new. It provides that the remedies provided in the act are not mutually exclusive and the administrator may use remedies as it

deems necessary. From time to time, the administrator has encountered the argument that it must elect remedies. This amendment would make it clear that the administrator upon obtaining evidence of a violation may immediately issue a cease and desist order designed in part to put the public on notice of the violation and then seek an injunction and/or a receivership or take any other action provided for in the statute.

The subsection would also allow the administrator, where it reasonably appears that the persons who have in the past committed offenses are unlikely to engage in violations of the law in the future and that they have taken steps to rectify harm done to investors, to take such factors into consideration in the determination of whether to issue an administrative order or seek an injunction.

113. Subsection 408(e)

This subsection is new. It provides a 6 year statute of limitation on the remedies available to the administrator under the act.

114. Subsection 409(a)

This subsection presently provides that any person who violates any provision of the act or any rule or order shall upon conviction be fined or imprisoned or both. The amendment would delete these criminal penalties for violations of a rule or order. Further, it would clearly specify which of the provisions of the act are covered by this section. The maximum fine is increased from $5,000 to $25,000. Securities violations are frequently extremely lucrative. A corporation which has committed a criminal violation of the Act cannot be imprisoned and therefore can only be fined under this subsection. A fine of $5,000 is inadequate for a corporation or person who has sold a million dollars worth of illegal securities. The maximum sentence is raised from 3 years to 7 years. Securities violators also do enormous harm, completely ruining the lives of some of their victims, taking the life savings, defrauding hundreds or thousands of people, and raising millions of dollars of money illegally. It is believed that a 3 year maximum sentence is not adequately severe. Experience has shown that prosecutors are sometimes reluctant to prosecute securities cases because the possible punishment is not sufficiently great.

115. Subsection 409(d)

This subsection is new. It provides a six year statute of limitations from criminal prosecutions under the Act. However, any period during which the party charged was not usually and publicly resident with the state shall not be included as part of the six years.

116. Subsection 410(e)

This subsection provides that a person who has purchased a security which was sold illegally may not sue if before suit the buyer received a recision offer meeting the requirements of the subsection. A requirement is added that the recision offer documents making full disclosure about the financial and business condition of the issuer and the financial and business risks associated with the retention of the securities or commodities be provided to the offeree concurrently with the written recision offer. No recision offer could be made until 45 days after the date of sale and that no acceptance or rejection of the offer shall be binding until 48 hours after receipt of the offer by the offeree. The recision offer must recite the provisions of Section 410 of the Act and the recision offer is not valid unless the offeror can substantiate that it has the ability to fund the offering and this information is set forth in the disclosure documents. A person who receives a recision offer is being asked to make a new investment decision. Very frequently, the first investment decision was made without adequate disclosure. The problem is then compounded if the offeree must decide whether or not to rescind without adequate disclosure. Even if there initially was adequate disclosure the relevant material information may change prior to the recision offer. For these reasons, it is desirable that full disclosure be provided to the offeree concurrently with the written recision offer. The Bureau has found that on occasion offerors will deliberately sell securities illegally and at the same time require the buyer to sign a rejection of a recision offer. This procedure is designed to place the buyer of an illegal security in a position where he cannot sue. Accordingly, it is believed that the amendment should state that recision offers cannot be made until 45 days after the sale and that acceptance or rejection is not binding until 48 hours after receipt of the offer. The recipient of a recision offer will be in a better position to understand the nature of the decision that he is being asked to make if he has read the civil liability section. The Bureau has found that sometimes issuers and other persons make recision offers in order to eliminate their civil liability without any financial means to honor a request for recision. Such sham recision offers are fraudulent and should be invalid. Accordingly, the offeror should be required to substantiate in the offering documents that he has the ability to fund the offering.

117. Subsection 412(g)

This subsection is new. It would provide that the rules promulgated and hearings held by the Bureau under the Act be in accordance with the Administrative Procedures Act of 1969.

118. Subsection 413(c)

This subsection presently provides that the information contained in or filed with any registration, application, or report may be made available to the public under such rules as the administrator prescribes. The amendment provides that the administrator may withhold for public inspection

information, the disclosure of which is not necessary in the public interest and for the protection of investors. In connection with registration applications information is occasionally given to the administrator in confidence. There may be no public benefit from the disclosure of such information and disclosure of the information may cause harm to individuals or constitute an unwarranted invasion of privacy. An example might be disclosure of the names of investors required to be filed in a report for an exempt offering under Section 402(b)(9). No public benefit or investor protection may result from disclosing the names of investors in "private placements." However, without this protection, the investors may then be subjected to numerous and inconvenient offers for other securities and other investments. This will likewise protect confidential negotiation or financial information, trade secrets and pricing information prior to public offer.

Exhibit 10

The Economic Realities of a Security Is There a More Meaningful Formula

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The Economic Realities of a "Security" Is There a More Meaningful Formula

Ronald J. Coffey

The Economic Realities of a "Security": Is There a More Meaningful Formula?

Ronald J. Coffey

The existence of a "security" is of vital importance in determining whether the federal and state securities laws will apply to certain transactions. The continually widening scope of such laws has prompted Professor Coffey first to discuss briefly the definition sections of the federal statute and then to examine the basic formula propounded by the Supreme Court for determining the existence of a security. After submitting that the twenty-year-old formula might be lacking in some areas, the author proposes and then thoroughly discusses his own theory which is based upon the essential economic considerations underlying the "security" concept. Professor Coffey concludes with a discussion of statutory construction in light of the formulas proposed by the courts and the definition sections of the statutes.

I. INTRODUCTION

A. The Problem and Its Importance

RECENT YEARS have witnessed a substantial increase in the number of statutory roads to redress available to the disenchanted purchaser of a "security." On the frontiers of this expansion of remedies is the increased use of SEC Rule 10b-5[1] as the basis of fraud-type actions brought by securities buyers. Despite persuasive arguments to the contrary,[2] buyers have been rather successful in circumventing the restrictions[3] imposed on actions under section 12(2) of the Securities Act of 1933[4]

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[1] 17 C.F.R. § 240.10b-5 (1964), promulgated under the Securities Exchange Act of 1934, § 10(b), 48 Stat. 891, 15 U.S.C. § 78j(b) (1964) [hereinafter cited as Exchange Act].

[2] 3 LOSS, SECURITIES REGULATION 1778-97 (2d ed. 1961, Supp. 1962).

[3] *Id.* at 1779-80. Such restrictions include a short statute of limitations, relief limited to rescission while the plaintiff is still in possession of the purchased securities, and the possibility that security for costs and reasonable attorneys' fees may be required.

[4] 48 Stat. 84, as amended, 15 U.S.C. § 77*l*(2) (1964) [hereinafter cited as Securities Act].

simply by pursuing a cause of action under Rule 10b-5[5] or even under section 17(a) of the Securities Act.[6]

While adding to the number of remedial arrows in the quiver of the securities purchaser, the courts and administrative agencies have also increased the range of those arrows by evolving what has been termed the "Expanding 'Securities' Concept."[7] While the proposition that the "security" concept itself is expanding may be debated, it is unquestionably true that the last half decade has seen many devices and transactions brought within the pale of the state and federal securities laws,[8] all to the great chagrin of many practicing attorneys. The inclusion of an ever-widening variety of transactions within the definition of "security," coupled with the tendency of the courts to give buyers a wider choice of statutory remedies, has substantially magnified the impact of the securities laws on the business community.[9] At the very least, the prospect that these statutes might continue to grow "at both ends" (in remedy as well as in definitional coverage)[10] should be reason for a thoughtful second look at some of the basic propositions and considerations underlying the securities laws.[11]

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[5] *E.g.*, Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965); Rustic v. Werblin, CCH FED. SEC. L. REP. ¶ 91637 (S.D.N.Y. Feb. 28, 1966) (recognizing fraud-type actions by buyer based on SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1964), the Securities Act, *and state law* under pendent jurisdiction).

[6] *E.g.*, Pfeffer v. Cressaty, 223 F. Supp. 756 (S.D.N.Y. 1963) (Securities Act § 17(a), 48 Stat. 84 (1933), as amended, 15 U.S.C. § 77q(a) (1964); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1964)), wherein the plaintiff was permitted to pursue an action for damages while still in possession of the purchased securities. The reason given for finding an independent cause of action under § 17(a) was that in such an action, "plaintiff would not have the advantage of the unusual rule as to burden of proof [defendant has the burden of proving defense of innocence] created by Section 12." Pfeffer v. Cressaty, *supra* at 758; *cf.* Belhumeur v. Dawson, 229 F. Supp. 78 (D. Mont. 1964).

[7] See Pasquesi, *The Expanding "Securities" Concept*, 49 ILL. B.J. 728 (1961).

[8] See generally 1 LOSS, *op. cit. supra* note 2, at 455-512. The question of which devices and transactions come within the purview of the state and federal definitions of "security" has been actively litigated, and there have been many reported decisions in this area since the 1962 Supplement to Professor Loss' treatise.

[9] Indeed, perhaps the day is not far hence when it will be said of the securities laws — as it has been similarly said of heaven, the Internal Revenue Code, and the antitrust statutes — that "not a sparrow falls without the securities laws nodding their assent."

[10] The jurisdictional requirements of the federal securities laws are also being relaxed. See, *e.g.*, Lennerth v. Mendenhall, 234 F. Supp. 59 (N.D. Ohio 1964) (intrastate telephone call sufficient jurisdictional basis for applying Securities Act § 5, 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1964)). Perhaps the federal securities laws should be described as growing at both ends *and in the middle*.

[11] While the task of determining whether a particular device or agreement is a security seems a humble one, one blue sky law administrator has recently said that, of all the securities conundrums, "ascertaining whether a security is involved in a particular transaction can be the most difficult problem an attorney faces." Newton, *A Look at*

Having noted charily that the widening vistas of remedy tend to broaden the effects of extending the definitional coverage of the securities laws, this discussion now focuses on the latter problem, *i.e.*, the issues and analysis involved in determining what transactions should come within the definition of a "security."

B. *Framework and Structure of Analysis*

The starting points for an examination of the "security" concept are the definition sections of the federal statutes[12] and of the state blue sky laws.[13] These definition statutes typically include a list of fairly specific and readily identifiable types of devices and arrangements,[14] along with a group of more general classifications which tend to be less susceptible of any single meaning.[15] The courts, counsel, and administrative agencies have long wrestled with both the specific and the general elements of the definition, struggling to explicate the essential characteristics of the "security" concept. It is within the framework of the more recent cases which

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the Montana Securities Act and Its Relation to the Federal Securities Act, 26 MONT. L. REV. 31, 35 (1964).

[12] Securities Act § 2(1), 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b(2) (1964); Exchange Act § 3(a)(10), 48 Stat. 882 (1934), as amended, 15 U.S.C. § 78c(a)(10) (1964); Public Utility Holding Company Act of 1935, § 2(a)(16), 49 Stat. 803, as amended, 15 U.S.C. § 79b(a)(16) (1964); Investment Company Act of 1940, § 2(a)(35), 54 Stat. 789, as amended, 15 U.S.C. § 80a-2(a)(35) (1964); Investment Advisers Act of 1940, § 202(a)(17), 54 Stat. 847, as amended, 15 U.S.C. § 80b-2(a)(17) (1964). The Trust Indenture Act of 1939, § 303(1), 53 Stat. 1151, as amended, 15 U.S.C. § 77ccc(1) (1964), adopts the definition of Securities Act § 2(1), 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b(2) (1964). There are some minor and some major differences in these definitions, and the discrepancies will be noted as they become critical to the analysis in the text. Recently promulgated SEC Rule 3a11-1, 17 C.F.R. § 240.3a11-1 (Supp. 1966), defining "equity security," will have some impact on our subsequent analysis, as will the exemptions found in Securities Act §§ 3-4, 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77c-d (1964).

[13] As Professor Loss has indicated, some care must be exercised to note differences in the specific wording of the various state and federal statutes. 1 LOSS, *op. cit. supra* note 2, at 456. However, the state courts especially have exhibited a remarkable elasticity in following the decisions under the federal acts and the laws of other states. They appear favorably disposed to discount the significance of the categories listed in the statutory definition in favor of a more pervasive, and perhaps more meaningful, concept. This problem will be explored at greater length later in the article.

The definition contained in the UNIFORM SECURITIES ACT § 401 *l*, 1 BLUE SKY L. REP. ¶ 4931 (1958), is very similar to that in the Federal Securities Act. The Uniform Act has been adopted substantially or in modified form in twenty-one states, the District of Columbia, and Puerto Rico. 1 BLUE SKY L. REP. ¶ 4901 (1965).

[14] *E.g.*, "any note, stock . . . bond, [or] debenture." Securities Act § 2(1), 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b(1) (1964).

[15] *E.g.*, "certificate of interest or participation in any profit-sharing agreement . . . transferable shares, investment contract . . . or, in general, any interest or instrument commonly known as a 'security' . . . ." *Ibid.*

have construed and applied the definitional provisions of the state and federal securities laws — in their general[16] and specific aspects — that this article will conduct its analysis.[17] The primary goal of this article is thus to formulate, from a consideration of a number of recent opinions involving a variety of devices and arrangements,[18] a set of analytical tests and guidelines which might be used to determine whether particular transactions involve securities and are hence the proper subjects of the special regulatory features of the state and federal securities laws.

First, the basic structure and protections of the securities laws will be examined in an effort to state, in the most general terms, the fundamental considerations which should underlie any examination of the distinguishing features of a security.[19] This is followed by a discussion of a revered formula which traditionally has been thought of as accurately setting forth the specific indicia of a security.[20] Then, with some trepidation, there is suggested a more complete and reliable shorthand description of the essential economic realities underlying the "security" concept.[21] Each element of the proposed definition is discussed at some length,[22] and particular attention is paid to the problems created when courts and administrative agencies become too enamored of neat formulas handed down from prior opinions and fail to focus on the essential economic considerations relevant to identifying a security. Also explored are

[16] Perhaps the most enlightening attempts to enunciate the true nature of a security are found in cases applying the general provisions of the definition sections, which must be invoked whenever novel devices or transactions are the subjects of litigation. Certainly the broad provisions should stimulate the deepest thought on the part of practitioners. "The definition [of 'security'] expressly includes many of the more orthodox types of securities, and, though patent, even these are sometimes inadvertently 'missed' (for example, preorganization subscriptions). The definition contains several categories, however, which can be extremely troublesome, and understandably 'missed.'" Newton, *supra* note 11, at 35.

[17] It will be necessary, however, to consider certain of the older cases whose holdings (but not necessarily whose reasoning) will serve as the bedrock of this discussion.

[18] Of primary concern will be such devices as: promissory notes, cooperative apartments, organization memberships, franchises, coin investment agreements, preincorporation arrangements, interests in developmental property, interests in productive property accompanied by management agreements, limited partnership interests, retail marketing and financing techniques, and a variety of other novel but thought-provoking transactions. Some notable *lacunae* in this article are the areas of commingled trusts, equity-insurance arrangements, managing agency accounts, and mineral interests, although now and then one may catch the scent of crude as the landmark case on oil leases, SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943), is referred to.

[19] See text accompanying notes 25-32 *infra*.

[20] See text accompanying notes 33-46 *infra*.

[21] See text accompanying note 47 *infra*.

[22] See text accompanying notes 48-159 *infra*.

the distortions introduced by a rigidly literal approach to statutory interpretation or by an excessive concern for deceptive rules of construction.[23] Finally, the issues peculiar to isolated and private transactions are discussed, and possible solutions to some rather difficult problems of policy and statutory construction are indicated.[24]

II. Essential Characteristics of a "Security": Statutes, Formulas, and Decisions

A. *General Conclusions Derived From Statutory Structure*

The state and federal securities laws contain two basic levels of protection. First, they provide for the full disclosure[25] of registration or state administrative approval[26] whenever the security involved is not covered by certain exemptive provisions.[27] Second, even if the exemptive provisions apply so that registration or state approval are not required, distribution and trading ordinarily remain subject to several anti-fraud and anti-half-truth provisions.[28] Generally speaking, the anti-fraud statutes relax the procedural and substantive conditions of relief which are characteristic of the common law and equitable fraud actions.[29] Moreover, they usually carry criminal penalties for their violation.[30] From these simple observations two important sets of conclusions can be drawn:

(1) The considerations involved in determining whether a particular device or transaction is a security are not coextensive with the considerations used to determine whether full disclosure (by way

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[23] See text accompanying notes 160-83 *infra*.

[24] See text accompanying notes 184-204 *infra*.

[25] Securities Act §§ 5-7, 8, 10, 48 Stat. 77, 79, 81 (1933), as amended, 15 U.S.C. §§77e-g, 77h, 77j (1964).

[26] See, *e.g.*, in the area of state securities regulation, Uniform Securities Act § 304(c), 1 Blue Sky L. Rep. ¶ 4924 (1958).

[27] Securities Act §§ 3-4, 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77c-d (1964); Uniform Securities Act § 402, 1 Blue Sky L. Rep. ¶ 4932 (1958).

[28] See Securities Act §§ 12(2), 17(a), 48 Stat. 84 (1933), as amended, 15 U.S.C. §§ 77*l*(2), 77q(a) (1964); Exchange Act §§ 15(c)(1)-(2), 48 Stat. 895 (1934), as amended, 15 U.S.C. §§ 78*o*(c)(1)-(2) (1964); Uniform Securities Act §§ 101, 410(a)(2), 1 Blue Sky L. Rep. ¶¶ 4902, 4940 (1958); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (1964). It is also probably true that the anti-fraud provisions apply to those transactions which the SEC has exempted in one way or another from registration. See, *e.g.*, regarding employee benefit plans, Mundheim & Henderson, *Applicability of the Federal Securities Laws to Pension and Profit-Sharing Plans*, 29 Law & Contemp. Prob. 795, 808 n.42, 813-14 (1964). See also SEC Rule 133, 17 C.F.R. § 230.133 (1964), extending a kind of exemption to certain financial reorganizations.

[29] See 3 Loss, *op. cit. supra* note 2, at 1421-44, 1763-97.

[30] Securities Act § 24, 48 Stat. 87 (1933), 15 U.S.C. § 77x (1964); Exchange Act § 32, 48 Stat. 904 (1934), as amended, 15 U.S.C. § 77ff (1964).

of registration) or administrative approval should be required. This is evident because the statutes are written so that the residual but substantial protection of the anti-fraud provisions persists notwithstanding the applicability of an exemption from registration or state approval. It is improper to equate the question of whether an arrangement constitutes a security with the question of whether the registration or approval philosophies should be invoked. To do so automatically excludes from the definition of "security" those transactions which possess enough troublesome characteristics to require liberal anti-fraud protection but which also involve enough balancing safeguards (or few enough additional worrisome characteristics) to eliminate the need for registration and state approval. For example, it cannot be said that an arrangement is not a security just because it is offered to only a few fully informed and sophisticated buyers so as to be exempt from registration or state approval.[31] By their structure, the securities laws clearly imply that the features of a transaction which dictate the requirement for registration or state approval are distinct from, and in addition to, the criteria employed in deciding the prior and more basic question of security *vel non*.[32]

(2) Although the securities laws are intended to cover more situations than those in which registration and state administrative approval are required, they cannot have been meant to embrace all

[31] See Securities Act § 4(2), 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77d (1964). The desirability of transferring some of the standards now used to determine the availability of exemptions (in particular, the number and character of the offerees) to the definition sections of the securities statutes will be discussed later in the article. Such standards would then be used in resolving the first and more basic question of whether a transaction is a security. See text accompanying notes 184-204 *infra*.

[32] There is a tendency on the part of courts and commentators, when discussing the criteria for determining whether an arrangement is a security, to state a test which is improperly couched in terms of whether the arrangement is one in which full disclosure (by way of registration) or state administrative approval should be required. For example, in Pasquesi, *supra* note 7, at 728, the writer begins his article on the definition of security by discussing the disclosure philosophy of the registration provisions of the Securities Act. See also Polikoff v. Levy, 55 Ill. App. 2d 229, 204 N.E.2d 807, *cert. denied*, 382 U.S. 903 (1965), in which the court held that no security was involved within the meaning of the Federal Securities Act and the Illinois Blue Sky Law because, *inter alia*, "the protection of the full disclosure afforded by registration is not needed." *Id.* at 234, 204 N.E.2d at 809.

The proclivity to phrase the question of whether a particular transaction is a security in terms of whether the full disclosure of registration should be required has spawned some interesting comments on the security aspects of limited partnership interests. It seems to be the position of some that limited partnership interests should not be deemed securities at all when they are non-transferable and offered to a cozy little group of fully informed, though passive investors. See 1 LOSS, *op. cit. supra* note 2, at 504-06. Under the present statutory scheme, however, the number and knowledge of the offerees seem relevant only to the question of whether the sale is a private one and therefore exempt under Securities Act § 4(2), 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77d (1964).

transactions involving fraud or half-truths. The special prohibitions against misstatements and material omissions, together with specific procedures and remedies, constitute a general liberalization of common law fraud relief and are obviously meant to apply only when there are special policy justifications for invoking their protection.

Combining the preceding conclusions, the following proposition may be legitimately derived from an examination of statutory structure: A "security" is a transaction whose characteristics distinguish it from the generality of transactions so as to create a need for the special fraud procedures, protections, and remedies provided by the securities laws. This proposition may be rephrased in the form of a "master question" regarding the nature of a security: What characteristics or features of a transaction necessitate its being subject to the rather specialized anti-fraud protection afforded by the securities laws? The air has now been cleared by demonstrating that the inquiry made herein cannot be identified with the question of whether registration and state administrative approval should be required. Recognizing, therefore, that the characteristics sought constitute a certain minimum group of elements which are not necessarily sufficient to give rise to a requirement for full disclosure and approval, an examination of the specific characteristics contained in the judicially approved formula for identifying a security is in order.

B. *The Howey Formula*

In response to the "master question" posed in the preceding discussion, the Supreme Court of the United States, in *SEC v. W. J. Howey Co.*,[33] propounded the following formula: "A security[34] is a transaction . . . whereby [1] a person invests his money [2] in a common enterprise and [3] is led to expect profits [4] solely from the efforts of the promoter or a third party."[35] This formula has

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[33] 328 U.S. 293 (1946).

[34] The *Howey* case involved the interpretation of the phrase "investment contract" in Securities Act § 2(1), 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b(2) (1964). For now, it will be assumed that the Court's enumeration of the essential characteristics of an investment contract applies to all the specific and general classifications contained in the definition sections of the various laws. See statutes cited notes 12-13 *supra*. The wisdom of applying an overriding "economic realities" test to all transactions which are claimed to be securities — even those which come within the literal meaning of words such as "notes," "stocks," and "bonds"—will be examined later. See text accompanying notes 160-83 *infra*.

[35] 328 U.S. at 298-99. Hereinafter, the formula quoted in the text shall be referred to as the "*Howey* formula" or the "*Howey* test."

been quoted and purportedly applied in a myriad of federal and state cases and administrative opinions.[36] It is true that a formula is an extremely helpful tool when used as a checklist or guideline for adjudication. However, the formula must be, in the first instance, the product of an accurate and complete analysis which will lead to its intelligent application in subsequent, but often differing, fact patterns.

Although the *Howey* opinion contains much enlightening discussion, it seems incomplete or misleading with respect to certain essential qualities of a security. These shortcomings are, not surprisingly, reflected in the *Howey* test itself. As a prelude to later analysis, attention is called to the following points which seem to render the *Howey* formula (to use the Court's own adjective) "unrealistic:"[37]

(1) The *Howey* test attenuates (or ignores) the risk of loss of the original value furnished by the purchaser.[38] This deficiency is aggravated by the summary and misleading treatment given to the reasoning of the two lower courts,[39] which stressed the fact that the buyer had received, in exchange for his initial value, tangible property with an intrinsic value not dependent on the success of any enterprise — a circumstance which bears directly on the buyer's risk of losing the value which he originally furnished.[40]

(2) The words "common enterprise" are particularly ambiguous, having a wide range of possible meanings,[41] and tend to fog

[36] United States v. Herr, 338 F.2d 607, 609-10 (7th Cir. 1964), *cert. denied*, 382 U.S. 999 (1966); Roe v. United States, 287 F.2d 435, 438 (5th Cir.), *cert. denied*, 368 U.S. 824 (1961); Blackwell v. Bentsen, 203 F.2d 690, 693 (5th Cir. 1953), *cert. denied*, 347 U.S. 925 (1954); SEC v. Orange Grove Tracts, 210 F. Supp. 81, 82 (E.D. Mass. 1962); Emery v. So-Soft, Inc., 199 N.E.2d 120, 123 (Ohio Ct. App. 1964).

[37] "The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae." 328 U.S. at 301.

[38] Throughout this article, the phrase "original value furnished by the purchaser" will often be referred to simply as "original value," "initial value," or "initial investment." These terms relate to the money, property, or services furnished by the alleged "buyer" to the alleged "seller" in the first step of the purported "security" transaction. The term "buyer" will be used to refer to the would-be purchaser of the purported security — the one who furnishes the initial value. "Seller" relates to the one who receives the initial value.

[39] SEC v. W. J. Howey Co., 60 F. Supp. 440, 442 (S.D. Fla.), *aff'd*, 151 F.2d 714, 717 (5th Cir. 1945), *rev'd*, 328 U.S. 293 (1946).

[40] "We reject the suggestion of the Circuit Court . . . that [a security] . . . is *necessarily* missing where . . . the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole." 328 U.S. at 301. (Emphasis added.) This subject is worthy of closer scrutiny; the qualifying adverb "necessarily" probably saves the statement from being harmful dictum. See text accompanying notes 92-94 *infra*.

[41] Some possible "common enterprise" situations are those in which each of the par-

rather than to clarify the central issues involved in identifying a "security."

(3) Emphasis is placed on the inducement of future "profits." The criticism here is twofold. First, attention is focused on the promise of future profits and drawn away from the risk of immediate loss of initial investment. Second, the word "profits" presents some troublesome problems of interpretation.[42]

It is a major contention of this article that risk to initial investment, though not determinative, is the single most important economic characteristic which distinguishes a security from the universe of other transactions. It is further submitted that the courts and administrative bodies have placed too little emphasis on the danger of loss of original value, while placing too much emphasis on the inducement of future profits.[43] The numerous manifestations of risk to initial investment[44] have not been adequately recog-

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ticipants owns: (1) a percentage interest in the assets or entity of an enterprise, it being understood that he will receive a share of profits and that his original value shall bear a share of enterprise losses; (2) a claim against the enterprise, calling for return of his original value plus interest in scheduled payments, fixed or variable, related or unrelated to profits; (3) specific property employed or used by an enterprise, with each owner receiving a percentage share of the profits derived from the use of all such property — the percentage share being based on the ratio of the value of each owner's property to the total value of all such property; (4) the same facts as were listed in the third situation but with each owner receiving the net profits derived from his specific property; and (5) property not described in (1)-(4), the present value of which has been determined by taking into account the anticipated but unrealized success of the enterprise.

The foregoing are simply various ways in which money or property can be subjected to the risks of an enterprise. On the one extreme, the words "common enterprise" could be taken to convey the notion that the values furnished by investors must be subject to all the risks of an enterprise, pro rata, *e.g.*, by means of percentage shares in the enterprise assets or entity, where there is a pro rata division of the pooled gains and losses of all operations, giving some of the flavor of "common" stock. On the other hand, these words might simply be meant to describe situations in which the values furnished by investors are in some way subject to the risks of the *same enterprise*.

The adjective "common" also connotes plurality and poses the problem of whether there must be a minimum number of investors in the enterprise. The issues generated by the phrase are certainly fraught with fine distinctions which perhaps need not be drawn after more material but less complicated questions have been resolved.

[42] The initial inquiry is whether the reference point of profitability is the buyer's initial investment or the overall operations of the risk enterprise. This question becomes critical when the buyer is led to expect a return over and above his initial investment, whether or not the enterprise has profits. A further question is whether a fixed rate or amount of return comes within the notion of "profits." Finally, do "profits" include unrealized appreciation or nonpecuniary benefits?

[43] While the bulk of the decisions are probably correct on their facts, it is felt that their reasoning has been inaccurate or misleading, creating the danger of improper adjudication in the future.

[44] See note 41 *supra*. However, the essential element of risk of loss of original value may be coming abruptly into its own. See Note, 50 CALIF. L. REV. 156 (1962); Note, 14 HASTINGS L.J. 181 (1962). Californians seem to have been jolted a bit by the

nized, and the much discussed element of expected "profits" has itself been misunderstood. In short, it is felt that the answer to the "master question" has not been fully and accurately answered by the *Howey* test or its underlying analysis.

The principal teaching of *Howey* is that, in the process of identifying a security, "form [is] . . . disregarded for substance and emphasis [is] . . . placed upon economic reality."[45] This short mandate yields two important lessons, one regarding statutory interpretation and the other concerning the kind of qualities which distinguish a security from the generality of transactions. Taking these topics in reverse order, the discussion now proceeds to a tentative statement of this author's own formula or checklist describing the *economic realities* underlying the "security" concept.[46]

C. *Statement of the Economic Realities of a "Security"*

The master question of this inquiry has been previously posited: What characteristics or features of a transaction necessitate its being subject to the rather specialized anti-fraud protection afforded by the securities laws? The *Howey* test has enjoyed the acceptance and approval of courts and agencies for twenty years. The function of this article is not to swim against the stream of past analysis, but rather to widen it here, narrow it there, and perhaps shift its course in various places. It is submitted that the following test states the essential economic characteristics which distinguish a security from the generality of transactions so as to create a need for the liberal procedures, protections, and remedies provided by the securities laws against fraud and half-truths.

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court's heavy emphasis on risk to initial investment in Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961).

[45] 328 U.S. at 298.

[46] In text accompanying note 47 *infra*, a formula will be offered stating the "economic realities" which are, it is contended, the essential characteristics of a "security." In text accompanying notes 48-159 *infra*, the proposed formula will be discussed in the context of a number of recent opinions in order to test the validity of its underlying analysis. The opinions occasionally manifest wayward reasoning, some of which seems to have been induced by the ambiguities of the *Howey* test; however, it will also appear that the adjudicators themselves have not been found wanting in their ability to introduce a variety of red herring. Text accompanying notes 160-83 *infra* will treat of the necessity of making the "economic realities" test a pervasive one, *i.e.*, one which would be controlling even when certain transactions come within the literal meaning of the readily identifiable classifications listed in the definitional statutes. Finally, text accompanying notes 184-204 *infra* focuses on some of the special problems created by isolated and private transactions and suggests some ways in which such transactions should be treated in the light of present statutory language and its implications.

A "security" is:

(1) A transaction[47] in which
(2) a person ("buyer") furnishes value ("initial value") to another ("seller"); and
(3) a portion of initial value is subjected to the risks of an enterprise, it being sufficient if —
  (a) part of initial value is furnished for a proprietary interest in, or debt-holder claim against, the enterprise, or
  (b) any property received by the buyer is committed to use by the enterprise, even though the buyer retains specific ownership of such property, or
  (c) part of initial value is furnished for property whose present value is determined by taking into account the anticipated but unrealized success of the enterprise, even though the buyer has no legal relationship with the enterprise; and
(4) at the time of the transaction, the buyer is not familiar with the operations of the enterprise or does not receive the right to participate in the management of the enterprise; and
(5) the furnishing of initial value is induced by the seller's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above initial value, will accrue to the buyer as a result of the operation of the enterprise.

The foregoing statement reiterates the *Howey* test in some respects, but the essence of the "new look" is found particularly in the third and fourth paragraphs which highlight the troublesome prospect that the buyer's original value could dwindle because of the failure of an enterprise over which he exercises no control.

The phrase "common enterprise" has been abandoned because it implies that the buyer must receive a proprietary share in the enterprise with the understanding that his initial investment will bear its share of overall enterprise losses. As will be demonstrated, risk to initial investment can take several other forms. Moreover, there seems to be no requirement that there be any minimum number of buyers (or offerees), as the word "common" tends to imply.

Another general departure from the *Howey* formula is the wording "benefits of some kind, over and above initial value" instead of the term "profits." It will be seen that the expectation of fixed amounts or rates of return (related or unrelated to the profits reflected on the income statement of the enterprise), appreciation

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[47] At text accompanying notes 184-204 *infra*, there is a discussion of the advisability of adding the following limitation after the word "transaction": "except an isolated transaction not involving an offering to the public."

in value, or even non-pecuniary benefits in excess of initial value should be sufficient to satisfy the profit inducement requirement.

The following discussion is an attempt to demonstrate the analytical approach by which the proposed "economic realities" test for identifying a security can be applied to the recent cases.

D. *Analysis of the "Economic Realities" Test in the Context of Recent Decisions*

(1) A Transaction.—As used in the test for identifying a security, the term "transaction" has a broad meaning indeed. It describes a concatenation of separate but related events, such as transfers of money and property, written promises, oral promises and representations, and even surrounding circumstances. All occurrences and events which can, in a broad sense, be properly considered as part of one bargain are welded together into one legally significant event for securities law purposes.

The ordinary transaction involves the transfer of money or property by the buyer in exchange for a written promise of some kind from the seller. However, a "transaction" may also consist of the transfer of initial value by the buyer, the buyer's receipt of an interest in specific real property, and the seller's representation that a developmental project nearby might cause an increase in the value of the buyer's interest.[48] A transfer of value by the buyer, the receipt of specific property in return, and the execution of an agreement giving the seller[49] or a third party[50] management control over the property may also comprise a single transaction.

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[48] SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943). The Court noted that "security" transactions are generally in documentary form but sometimes include surrounding circumstances. See Roe v. United States, 287 F.2d 435 (5th Cir.), *cert. denied*, 368 U.S. 824 (1961): "By its very nature, it is the *peculiar facts of the setting* which turn the offer from a mere sale of property into a sale of a security." *Id.* at 440. (Emphasis added.)

[49] SEC v. W. J. Howey Co., 328 U.S. 293 (1946); Blackwell v. Bentsen, 203 F.2d 690 (5th Cir. 1953), *petition for cert. dismissed per curiam*, 347 U.S. 925 (1954); SEC v. Great W. Land & Dev., Inc., CCH FED. SEC. L. REP. ¶ 91537 (D. Ariz. 1965) (Transfer Binder 1964-1966), *rev'd on other grounds*, 355 F.2d 918 (9th Cir. 1966) (buyer purchased an undivided beneficial interest in a specific parcel of land and agreed that the seller should have power to list and sell the real estate); Sarmento v. Arbax Packing Co., 231 Cal. App. 2d 421, 41 Cal. Rptr. 869 (Dist. Ct. App. 1964), involving the sale of a growing grape crop together with an agreement that the seller would care for and market the grapes. The court considered the sale of the grapes together with the marketing and care agreement but held the combination did not constitute a "security." Op. Fla. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70653 (Dec. 14, 1964).

[50] SEC v. Orange Grove Tracts, 210 F. Supp. 81 (D. Mass. 1962). "The fact that . . . [the] third party [who takes management control of the property received by the buyer] may be legally distinct from the [seller of the property] . . . does not bring the activity outside the coverage of [the Securities Act] . . . ." *Id.* at 83.

The buyer's transfer of initial value has also been viewed in combination with: the seller's oral promises;[51] written and oral promises and representations by the seller;[52] the transfer of a franchise to the buyer, accompanied by the oral representations of the seller;[53] negotiable instruments plus the seller's oral representations and promises;[54] the transfer of a distributorship franchise to the buyer, followed by the buyer's purchase of tangible property for resale, coupled with an arrangement to have the seller do the reselling on a commission basis;[55] written "receipts" plus representations of the seller;[56] sales of consumer goods to the buyer for more than fair market value, accompanied by the oral and written representations and promises of the seller;[57] transfers of intangible property to the buyer together with oral and written agreements and representations regarding the seller's management of the intangibles;[58] or written

[51] Op. Nev. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70691 (Nov. 12, 1965) (oral partnership interests).

[52] SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961) (promissory notes and vague representations regarding buyer's future share in the success of the enterprise); People v. Smith, 180 Cal. App. 2d 420, 4 Cal. Rptr. 282 (Dist. Ct. App. 1960) (promissory notes and understandings that stock would be issued to replace notes). The notes would have been exempt under California law, but the court found that the whole transaction was an offer of stock. *Id.* at 425, 4 Cal. Rptr. at 285.

[53] Drug Management, Inc. v. Dart Drug Corp., CCH FED. SEC. L. REP. ¶ 91293 (D.D.C. 1963). The court, in holding that no "security" was involved, viewed a franchise agreement and the seller's representations as one transaction.

[54] United States v. Attaway, 211 F. Supp. 682 (W.D. La. 1962) (loans by plaintiff in exchange for checks, accompanied by defendant's oral promises and representations regarding payment of interest).

[55] United States v. Herr, 338 F.2d 607 (7th Cir. 1964), *cert. denied*, 382 U.S. 999 (1965). The plaintiff purchased the right to distribute the defendant's products. The plaintiff subsequently purchased goods from the defendant for resale; however, since the plaintiff was not in the position to do the reselling himself, he commissioned the defendant to resell the products for him.

[56] Polikoff v. Levy, 55 Ill. App. 2d 229, 204 N.E.2d 807, *cert. denied*, 382 U.S. 903 (1965). The seller disseminated letters describing a motel venture and gave "tentative receipts" for the initial value furnished by the buyer.

[57] Pennsylvania Sec. Comm'n v. Consumers Research Consultants, Inc., 3 BLUE SKY L. REP. ¶ 70631 (Pa. C.P. 1963), *aff'd*, 414 Pa. 253, 199 A.2d 428 (1964), wherein a vacuum cleaner was sold to the plaintiff for an inflated price and the seller promised the plaintiff a certain sum for every cleaner sold to persons recommended by the plaintiff. Considering all the circumstances, it was held that there was no "security." *Ibid.* Emery v. So-Soft, Inc., 199 N.E.2d 120 (Ohio Ct. App. 1964) (overcharge for water softener with referral agreement; *held*, no "security"); Yoder v. So-Soft, Inc., 202 N.E.2d 329 (Ohio C.P. 1963) (overcharge for water softener with referral agreement; *held*, a "security"). *Cf.* Fidelity Credit Co. v. Bradford, 177 So. 2d 635 (La. Ct. App.), *appeal denied*, 248 La. 430, 179 So. 2d 273 (1965) (vacuum cleaner plus referral agreement; overcharge not clear).

[58] Farrell v. United States, 321 F.2d 409 (9th Cir. 1963), *cert. denied*, 375 U.S. 992 (1964). *Farrell* involved the sale of trust deed and mortgage notes (or interests therein) to buyers, together with management and service contracts. For details of facts, see the related opinion in Los Angeles Trust Deed & Mortgage Exch. v. SEC, 264 F.2d

promises of the seller plus the written promises of a third party.[59] Oral unilateral offers of payment for services have also been found to be transactions eligible for security classification.[60]

It is abundantly clear, then, that the term "transaction," as used in the suggested test for identifying a security, is a collective one. Prior to analyzing a transaction for its security characteristics, the courts and agencies determine the dimensions of the transaction by integrating separate but related transfers, agreements, representations, and surrounding circumstances.[61] The significance of this practice lies in its effect on subsequent steps of the analytical process. As the content of a transaction is expanded to include more events and circumstances, there is a correspondingly greater chance of finding that the transaction possesses all of the essential characteristics of a security. In other words, by conglomerating a number of events into a composite transaction, the courts and agencies have often facilitated the task of finding that the transaction is endowed with all the distinguishing features of a security. Those qualities will now be considered seriatim as they appear in the proposed formula.

(2) *Furnishing of Initial Value.*—Of course, value can be furnished in the form of money, property,[62] or services.[63] Once value has been furnished by the buyer, a number of events may follow, including the transfer of tangible property from the seller to the buyer. At first blush it might appear as though the buyer, having received specific tangible value in return, can no longer claim that any part of his initial value is still invested. The fact that the buyer receives tangible property in return for his value may signal the need for unusually careful analysis, but it by no means precludes the

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199, 202-03 n.3 (9th Cir. 1959). See also SEC Securities Act Release No. 3892, CCH FED. SEC. L. REP. ¶ 76559 (Jan. 31, 1958); Op. Cal. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70383 (May 23, 1958).

[59] Bellerue v. Business Files Institute, Inc., 61 Cal. 2d 488, 393 P.2d 401, 39 Cal. Rptr. 201 (1964). Corporation *A* agreed to sell stock in corporation *B* to the buyer in exchange for the buyer's loans to corporation *B*. Corporation *B* executed its notes payable to the buyer in the amount of the loans. The notes would have been exempt, but the combination of steps was an investment contract.

[60] SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961).

[61] Some recounts of relevant surrounding circumstances read very much like travelogues. See Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965); Nicewarner v. Bleavins, 244 F. Supp. 261 (D. Colo. 1965).

[62] Jackson v. Robertson, 90 Ariz. 405, 368 P.2d 645 (1962); State v. Davis, 131 N.W.2d 730 (N.D. 1964) (buyer exchanged stock for notes).

[63] SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961).

possibility that the whole transaction[64] constitutes a security. Even if the buyer receives tangible property in exchange for his original value, the question is still whether the transaction exhibits the "economic realities" of a security. In the proposed test, one of the most important economic characteristics of a security is the fact that the buyer's initial investment is somehow, considering the effects of the entire transaction, subjected to the risks of an enterprise. The discussion now passes to an analysis of the risk issue.

(3) Risk of Loss of Initial Value.—Risk of loss of initial value is an essential attribute of a security. This proposition can be traced to the most prestigious of sources. Although not often cited, the following language constitutes the core of Mr. Justice Jackson's rationale in *SEC v. C. M. Joiner Leasing Corp.*:[65]

> It is clear that an economic interest in this [enterprise] . . . was what *brought into being* the instruments [evidencing real property interests] that defendants were selling and gave to the instruments *most of their value* and all of their lure. The trading in these [interests] . . . had all the evils inherent in the securities transactions which it was the aim of the Securities Act to end.[66]

Without the enterprise, there would be *no value* to anyone's real property interest.

The Court's concern is clearly focused on the relationship between the success of the enterprise and the *preservation or deterioration of the value* which the buyer *originally furnished* in the alleged security transaction. The fact that the buyer would have been left without "any value" if the enterprise had failed made it crystal clear that the initial value furnished by the buyer was subject to the risks of the enterprise. The fate of the buyer's initial investment was tied to the success of the venture, a circumstance which the Court considered critically relevant to the need for securities law protection.

Joiner isolated the element of *risk to initial value* as one of the essential features of a "security." While it has been said that *Howey* was a clarification of *Joiner*,[67] one wonders whether the

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[64] All the constituent elements of the transaction must be considered. See text accompanying notes 48-61 *supra*.

[65] 320 U.S. 344 (1943). The following passage is more frequently cited: Novel, uncommon, or irregular devices, whatever they appear to be, are also reached [by the federal securities laws] if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as . . . "any interest or instrument commonly known as a 'security.'" *Id.* at 351.

[66] *Id.* at 349. (Emphasis added.)

[67] Pasquesi, *The Expanding "Securities" Concept*, 49 ILL. B.J. 728 (1961).

Howey formula's shift in emphasis — from risk of initial value to the expectation of future profits — is faithful to Mr. Justice Jackson's penetrating analysis in *Joiner*.[68] Many state and federal opinions have cited both Supreme Court cases,[69] but the risk of loss notion articulated in *Joiner* has not been stressed nearly as much as the *Howey* formula with its heavy emphasis on the expectation of future profits.

Perhaps a renaissance of the risk factor is developing, however. A recent federal decision, *SEC v. Latta*,[70] and a state decision, *Silver Hills Country Club v. Sobieski*,[71] contain explicit language recognizing risk to initial investment as an essential characteristic of a security. In the *Latta* case, the court observed: "Unless the defendant is successful in [her enterprise] . . . the contracts [sold to the buyers] will remain *scraps of worthless paper*."[72] In deciding the "crucial question" of whether the transaction at bar came within the "regulatory purpose" of the securities laws, the *Silver Hills* court isolated the risk to the buyer's initial investment as the most important aspect of the transaction.[73]

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[68] Mr. Justice Jackson did not take part in the *Howey* decisions.

[69] *E.g.*, Roe v. United States, 287 F.2d 435 (5th Cir.), *cert. denied*, 368 U.S. 824 (1961); Blackwell v. Bentsen, 203 F.2d 690 (5th Cir. 1953), *petition for cert. dismissed per curiam*, 347 U.S. 925 (1954); SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961); Polikoff v. Levy, 55 Ill. App. 2d 229, 204 N.E.2d 809 (1965), *cert. denied*, 382 U.S. 903 (1965).

[70] 250 F. Supp. 170 (N.D. Cal.), *aff'd per curiam*, 356 F.2d 103 (9th Cir. 1965), *cert. denied*, 384 U.S. 940 (1966). Estelle Latta, undaunted by the passage of time and the policies of the law disfavoring endless litigation, continues her campaign to cause a redistribution of the estate of Mark Hopkins, who shuffled off this mortal coil more than eighty years ago. To finance her endeavor, she sold, for one hundred dollars each, assignments of 1/21,000 of any redistribution that she might obtain. It is not clear from the opinion how much gain was expected to accrue to the purchasers of these fractional interest assignments, but one thing was certain: Unless Estelle Latta was at least partially successful, the money paid for these unlikely instruments would, as far as the hapless buyers were concerned, join Mr. Hopkins in the great beyond.

[71] 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961). The promotor of a country club sold initial memberships for substantial sums. The proceeds were used to finance completion of club facilities and other organizational expenditures. Purchasers of memberships received no interest in the assets or profits of the club but were granted only the right to use the facilities of the club when it was completed. Thus, while the profits expected by the buyers were difficult to identify and assess, it was clearly possible that, if the seller failed to complete the club, a substantial part of the buyers' purchase value would dissipate forthwith in the manner so vividly portrayed by those fleeting little money bags with wings which appear in the cartoons.

[72] 250 F. Supp. at 173. (Emphasis added.) The risk that has been discussed at this point in the article is simply the risk that the buyer's original investment will become *worthless or worth less*. "This is a situation in which the economic welfare of investors is 'inextricably woven' with the ability of the promoter to carry out [the enterprise] . . . ." *Id.* at 173.

[73] 55 Cal. 2d at 815, 361 P.2d at 908, 13 Cal. Rptr. at 188.

These cases represent no shockingly new analytical approach to identifying a security, as some would seem to think.[74] They are true to highly respectable judicial attitudes, such as those in *Joiner*. There could be a deceptively obvious reason why many opinions (including *Howey*[75]) have taken the different tack of placing principal emphasis on the fact that the buyer was led to expect future profits. First, risk to initial value is generally accompanied by promises or representations which cause the buyer to expect a rather clearly identifiable sort of pecuniary profits in the future.[76] Second, it seems true that the buyer's reasonable expectation of future profits is often somewhat easier to detect than the element of risk to initial investment, as will be seen. The combination of these two phenomena may account for the bias of the decisions in favor of adopting the expectation of future profits as the most significant factor in identifying a security.[77]

In any event, while it may be generally harmless, and often more convenient, to gloss over the risk characteristic, there are at least two situations in which this sort of imperfect analysis will lead to improper results:

(1) In some cases, the profits expected by the buyer may be difficult to identify and assess; this would be especially true if the term "profits" were construed narrowly to mean only a share of the internal net profits shown on the income statement of an enterprise.[78] At the same time, there may be a serious risk of loss of initial investment. If the pivotal issue is whether there is a reasonable expectation of future profits, the transaction may be excluded from security classification because the adjudicator is uneasy about the precise nature of the profits expected. It is submitted that such a resolution would be erroneous and inconsistent with the purposes of the securities laws. Substantial determinative weight should be attached to the factor of risk to initial investment. Where the evidence to support a reasonable expectation of future profits is tenuous or difficult to interpret, the presence of risk to original value should be examined carefully and employed as a complementary factor to determine the result.[79]

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[74] See, *e.g.*, Note, 14 HASTINGS L.J. 181-82 (1962).

[75] SEC v. W. J. Howey Co., 328 U.S. 293 (1946).

[76] See Note, 50 CALIF. L. REV. 156, 159 (1962).

[77] See SEC v. W. J. Howey Co., 328 U.S. 293 (1946).

[78] This is the issue previewed in note 42 *supra*. It will be discussed later at greater length. See text accompanying notes 146-59 *infra*.

[79] The California authorities seem ready to adopt this view. See Sobieski, *Securities Regulation in California: Recent Developments*, 11 U.C.L.A.L. REV. 1, 7-8 (1963).

(2) On the contrary, however, a transaction may be replete with promises and representations which amply support the buyer's reasonable expectation of future profits, but the effect of the transaction may not be to subject any of the buyer's initial value to the risks of an enterprise.

The foregoing observations lead naturally into the next item of discussion, which is an investigation of the various ways in which the buyer's initial investment can be subjected to the risks of an enterprise.

(a) Manifestations of Risk.—Subparagraphs (3)(a), (b), and (c) of the proposed formula[80] are shorthand and highly generalized descriptions of the basic ways in which the buyer's initial investment can be subjected to the risks of an enterprise. In testing for the net effect of a transaction on the buyer's initial value, the economic significance of each constituent event of the whole transaction must be carefully assessed. In some transactions, the element of risk is easily isolated; in others, the risk is more subtle and more difficult to identify with precision.[81] Most adjudicators, sensing the presence of a sufficiently troublesome degree of risk to original value, either fail to analyze the danger of loss further or merely advert to it in the most general terms. While the decisions usually reach a correct result without close and accurate scrutiny of the risk factor, they are, by reason of their deficiencies in this respect, considerably less valuable as precedent.[82]

In the interest of explicating the various forms in which risk is manifested, there follows a detailed analysis of a number of the specific mechanics by which the buyer's initial value can be subjected to the risks of an enterprise. Each subheading will indicate the kind of property which the buyer receives in exchange for his initial investment, and the relationship, if any, created between the buyer and the risk enterprise.

(i) Intangible Proprietary Interest in the Enterprise: Repayment Upon Termination Plus Share of Profits and Losses.—

[80] These subparagraphs appear at the text following note 47 *supra*.

[81] Some mention was made of these problems in note 41 *supra*.

[82] "It has been said that there should be no hard and fast rule by which to determine whether that which is offered to a purchaser is [a security] . . . since such a determination would act as a guide post in the aid of the unscrupulous in circumventing the law." Commonwealth *ex rel.* Pa. Sec. Comm'n v. Consumers Research Consultants, Inc., 414 Pa. 253, 255, 199 A.2d 428, 429 (1964), *affirming* 3 BLUE SKY L. REP. ¶ 70631 (Pa. C.P. 1963). While the quoted passage is undoubtedly correct in its statement regarding the desirability of rigid rules, no concern for keeping offerors guessing should stultify the development of a rational analytical approach (together with some shorthand guidelines) for appraising the "security" aspects of a transaction.

These are the transactions in which the purchaser receives a proprietary interest in the enterprise. He has a percentage share of the enterprise assets or entity, but he also understands that his initial investment will bear a percentage share of enterprise losses.[83] Hereafter, such arrangements will be referred to as "percentage-share" or "proprietary-interest" transactions. Under such arrangements, the buyer's initial value is placed at the risk of the business enterprise in the most unequivocal way, in that he places his initial value at the disposal of the enterprise in exchange for a proprietary interest.[84] The initial investment flows into the stream of general enterprise capital and becomes fully exposed pro rata to all of the failures of operations, often serving more or less (depending on the particular agreement) as a shield or cushion for creditors. Upon termination of the enterprise, the buyer has no claim if his original value has been wiped out by deficits.

Thus, whenever the buyer receives, in exchange for his initial value, a proprietary interest in the enterprise, the presence of risk to his original investment is rather easy to detect.

(ii) Intangible Claim Against the Enterprise: Creditor's Right To Receive Repayment and Interest.—Here the buyer relinquishes specific ownership of his initial investment and takes in return a creditor's intangible claim against the enterprise.[85] The initial investment merges into the general enterprise capital, just as it does in the proprietary interest arrangement. Unlike the buyer of a percentage share, however, the purchaser does not agree to bear the losses of the enterprise pro rata, and his value is usually to be

[83] *Stock; preorganization certificates and subscriptions*: Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965); Lennerth v. Mendenhall, 234 F. Supp. 59 (N.D. Ohio 1964); Jackson v. Robertson, 90 Ariz. 405, 368 P.2d 645 (1962); People v. Smith, 180 Cal. App. 2d 420, 4 Cal. Rptr. 282 (Dist. Ct. App. 1960). See also Bellerue v. Business Files Institute, Inc., 61 Cal. 2d 488, 393 P.2d 401, 39 Cal. Rptr. 201 (1964); Donovan v. Dixon, 261 Minn. 455, 113 N.W.2d 432 (1962) (guaranty fund certificates).

Partnership interests; investment units: Smith v. Sherman, 206 Cal. App. 2d 93, 23 Cal. Rptr. 487 (Dist. Ct. App. 1962); Rivlin v. Levine, 195 Cal. App. 2d 13, 15 Cal. Rptr. 587 (Dist. Ct. App. 1961); Conroy v. Schultz, 194 A.2d 20 (N.J. Super. Ct. 1963); Op. Nev. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70691 (Nov. 12, 1965).

[84] Under the partnership and corporate forms, the buyer's ownership in specific property is severed, and he takes an interest in the factitious business entity. In joint adventures or other informal enterprise organizations, the buyer may furnish specific property in which he retains an ownership interest. However, vis-a-vis outsiders dealing with the venture, the property is considered a capital contribution and bears its share of enterprise losses, without the buyer's being able to assert his ownership interest against such outsiders.

[85] United States v. Attaway, 211 F. Supp. 682 (W.D. La. 1962) (checks with seller's agreement to pay interest if not cashed); State v. Davis, 131 N.W.2d 730 (N.D. 1964) (6 year notes). See also SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961) (loan notes).

returned according to a schedule, whether or not the enterprise has suffered losses.

In some cases, there is sufficient junior percentage-share-type investment to absorb losses before they erode the enterprise assets to a point where the creditor's original investment is jeopardized. Holders of debt may not always be so fortunate, however, since not all enterprises are financially structured to include percentage-share junior investment,[86] and those which are may provide only a thin cushion for creditors.

In short, the original value furnished in a debt transaction may be somewhat more protected from the ravages of enterprise failure than is the value furnished for a proprietary interest. A secured debt is merely farther removed from the front lines of risk, for failure of the enterprise is as likely to take its toll of the property securing the debt as it is the rest of the assets.

It seems safe to say, then, that there is a significant degree of risk to initial value furnished in exchange for debt obligations.

(iii) Tangible or Intangible Property: Buyer Retains Specific Ownership but Recommits Property to Use or Employment by the Enterprise.—In such a transaction, the buyer receives an interest in specific property. Such interest may have a present fair market value, independent of the future success of an enterprise,[87] equal to the original value furnished by the buyer.[88] The critical component of the transaction is the fact that the buyer, while retaining ownership of the specific property, immediately recommits it for use or employment by an enterprise. The vehicle by which the property is recommitted to the enterprise is often a management or service agreement. The property received and recommitted by the buyer may be tangible[89] or intangible.[90] The enterprise to which the

[86] Individuals may operate the enterprise with capital derived solely from the issuance of debt. See Llanos v. United States, 206 F.2d 852 (9th Cir. 1953), *cert. denied*, 346 U.S. 923 (1954); United States v. Monjar, 47 F. Supp. 421 (D. Del. 1942), *aff'd*, 147 F.2d 916 (3d Cir.), *cert. denied*, 325 U.S. 859 (1944). See also SEC v. Addison, *supra* note 85.

[87] Payment of initial value in recognition of the yet unrealized success of an enterprise is discussed in text accompanying notes 102-10 *infra*.

[88] The transaction may differ in this respect from the "overcharge" situations discussed in text accompanying notes 111-18 *infra*.

[89] SEC v. W. J. Howey Co., 328 U.S. 293 (1946); United States v. Herr, 338 F.2d 607 (7th Cir. 1964), *cert. denied*, 382 U.S. 999 (1966) (buyer purchased goods at wholesale and commissioned seller to resell at retail); SEC v. Great W. Land & Dev., Inc., CCH FED. SEC. L. REP. ¶ 91537 (D. Ariz. 1965) (Transfer Binder 1964-1966), *rev'd on other grounds and remanded*, 355 F.2d 918 (9th Cir. 1966) (buyer received interest in real property but agreed to let seller list and sell it); SEC v. Willoughby Coin Exch., CCH FED. SEC. L. REP. ¶ 91355 (S.D. Cal. 1964) (coin collection man-

property is recommitted need not be that of the seller of the property.[91]

The principal objection to classifying such transactions as securities seems to stem from the fact that the buyer may receive property with an independent present market value equal to the original value furnished. If the buyer takes a full *quid pro quo*, how can he be said to have placed any value at the risk of an enterprise? This is the question which was raised by the two lower courts in *SEC v. W. J. Howey Co.*,[92] and to which the Supreme Court responded tersely: "We reject the suggestion . . . that [a security] . . . is *necessarily* missing where the . . . tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole."[93] The word "necessarily" is critical, for it is doubtful whether the Court would have applied its holding to some simple variants of the *Howey* facts. For example, *B* purchases crop-producing property from *S*, who has vigorously expounded the profits to be made from working the land. *B* then shops around for someone to manage his land and later signs a land service contract with a third party. The theory of *Howey* would not seem to be apposite. *B*'s original value was not subjected to the risks of an enter-

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agement); SEC v. Comstock Coin Co., CCH FED. SEC. L. REP. ¶ 91414 (D. Nev. 1964) (Transfer Binder 1964-1966) (coin collection management); SEC v. Orange Grove Tracts, 210 F. Supp. 81 (D. Mass. 1962) (sale of land with development and management contract); Op. Fla. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70653 (Dec. 14, 1964) (land with management contract).

[90] United States v. Herr, *supra* note 89 (franchise entrusted to another for exploitation); Farrell v. United States, 321 F.2d 409 (9th Cir. 1963), *cert. denied*, 375 U.S. 992 (1964) (sale of mortgage notes with management contract); Los Angeles Trust Deed & Mortgage Exch. v. SEC, 285 F.2d 162 (9th Cir. 1960), *cert. denied*, 366 U.S. 919 (1961) (another stage of the *Farrell* litigation); SEC Securities Act Release No. 3892, CCH FED. SEC. L. REP. ¶ 76559 (Jan. 31, 1958) (mortgage note servicing); Op. Cal. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70383 (May 23, 1958).

Of course, the intangible which is sold to the buyer may itself constitute a security without being recommitted to an enterprise. In Farrell v. United States, *supra*, the defendant purchased individual makers' notes and resold them to the public with service contracts. The first question is whether the notes were securities, either at the time of the making or as redistributed by the defendant. The second question is whether the transaction, consisting of the sale of the notes together with the management contract, was a security. See Op. Cal. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70250 (Dec. 29, 1954). The question of whether an isolated and private promissory note is a security at the time of making will be discussed later. See text accompanying notes 184-204 *infra*.

[91] SEC v. Orange Grove Tracts, 210 F. Supp. 81 (D. Mass. 1962).

[92] 60 F. Supp. 440, 442 (S.D. Fla.), *aff'd*, 151 F.2d 714, 717 (5th Cir. 1945), *rev'd*, 328 U.S. 293 (1946). See also SEC v. Bailey, 41 F. Supp. 647 (S.D. Fla. 1941), wherein the court noted that "contracts for the sale and purchase of a tangible and identifiable commodity, title to and possession of which passes to the purchaser, are not ordinarily regarded as [securities]." *Id.* at 650.

[93] SEC v. W. J. Howey Co., 328 U.S. 293, 301 (1946). (Emphasis added.)

prise in a series of steps which can reasonably be treated as a single integrated transaction. In other words, the troublesome risk to *B*'s original investment must arise from the fact that, even though he receives property of equal value, he *immediately recommits* it to the risks of an enterprise *as part of the same transaction.* The net effect is similar to that of the one-step transaction, in which the initial value itself becomes part of the capital of an enterprise and in which the buyer, instead of receiving an interest in specific property distinct from the enterprise, takes a proprietary interest or debt-holder's claim.[94]

The similarity is not complete, however, for the species of risk is distinctly different from that in transactions where the initial investment flows into the general capital of the enterprise. Here, although his assets are in some sense "employed in the enterprise,"[95] the buyer retains ownership of specific property which is not subject directly to the internal operating losses of the enterprise. Nevertheless, the buyer's property is subject to various other operational hazards of the enterprise. For instance, if the buyer's property were productive crop land and the enterprise managing it became defunct while the crops were growing, the damage might be so serious that both the crop and a part of the intrinsic value of the land (representing initial investment) would be lost.[96] It might be argued that the person who has owned land for some time undertakes the same risk when he turns the land over to a management enterprise.[97] The answer to this contention seems to be that, in the latter case,

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[94] In United States v. Herr, 338 F.2d 607 (7th Cir. 1964), *cert. denied*, 382 U.S. 999 (1966), the buyer furnished initial value to the seller for a distributorship franchise. He then furnished additional value to the seller for goods at wholesale. As part of the transaction, he agreed to have the seller resell the goods through the seller's facilities. Thus, the buyer purchased and recommitted both intangible and tangible property. In assessing the net effect of the entire transaction, the court stated: "[R]egardless of the statement in the agreement . . . that the relationship created . . . was that of vendor and purchaser, we construe it to be . . . [a security]." *Id.* at 610.

[95] SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946). One way of describing the difference in risk would be to distinguish between the cases where the initial value is used *in* the enterprise (see text accompanying notes 83-86 *supra*) and cases where property is received in exchange for initial value and is then recommitted for use *by* an enterprise.

[96] The risk is greater where the management enterprise may sell the property. *E.g.*, SEC v. Comstock Coin Co., CCH FED. SEC. L. REP. ¶ 91414 (D. Nev. 1964) (Transfer Binder 1964-1966).

[97] As long as the landowner did not pay more than fair market value for the management services and did not contribute his land as capital in a joint venture with the management enterprise, it is doubtful that such a transaction would be considered a security, no matter what kind of lavish promises of fabulous profits were made by the management enterprise.

the owner of the land has not, as part of the same transaction, made a new investment by parting with cash or one kind of property in exchange for a new kind of property. The securities laws are concerned mainly with protecting the buyer when he exchanges what he already has for something new.

The risk arising where property is received and immediately recommitted to an enterprise does not depend on the size or quantity of the property. The small size or quantity of property may tend to explain why it was recommitted, for the property may be so small that it cannot be economically exploited except in conjunction with other similar property. Once the property is placed under the control of an enterprise, however, the risk is the same whether the property could have been productively employed or managed by the buyer or not. The *Howey* opinion, by stressing the small size of the tracts of crop-growing land sold to the buyer in that case, seemed to indicate that small size is a *sine qua non* of risk to initial value.[98] Indeed, some courts have interpreted *Howey* as holding that small size is a necessary condition for a security finding.[99] However, other cases, involving larger quantities of property, have found that a security was involved,[100] apparently on the theory that once the

[98] SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946). "Indeed, individual development of the plots of land . . . would seldom be economically feasible due to their small size. Such tracts gain utility . . . only when cultivated and developed as component parts of a larger area." *Id.* at 300.

[99] *E.g.*, Sarmento v. Arbax Packing Co., 231 Cal. App. 2d 421, 41 Cal. Rptr. 869 (Dist. Ct. App. 1964), wherein the buyer purchased eighty acres of growing grapes. The buyer agreed to bear the risk of loss while the crops were growing and to take responsibility for harvesting. The seller agreed to care for the crop while it was growing and to arrange for shipping. One branch of the court's rationale was based on the fact that the buyer retained control over the crops — the so-called "joint venture" theory. See text accompanying notes 123-31 *infra*. However, the court also stated:

> Plaintiffs did not buy property synthetically divided into *small units* in order to mask *intangible interests* in the total business enterprise. . . . Plaintiff's profit, if any, would be determined by the difference between cost and selling price of this particular 80 acres of grapes, not by fractional participation in the profits *or losses* of the seller's business operations. *Id.* at 425, 41 Cal. Rptr. at 871. (Emphasis added.)

[100] United States v. Herr, 338 F.2d 607 (7th Cir. 1964), *cert. denied*, 382 U.S. 999 (1966) (quantity of goods for resale not so small that they could not be sold by purchaser); Blackwell v. Bentsen, 203 F.2d 690 (5th Cir. 1953), *petition for cert. dismissed per curiam*, 347 U.S. 925 (1954) (twenty acres); SEC v. Bailey, 41 F. Supp. 647 (S.D. Fla. 1941) (twenty acres). Sarmento v. Arbax Packing Co., *supra* note 99, gives a rendering of *Howey* which is curious in more than one respect. The California court seems to indicate that the buyers in *Howey* received "fractional interests in the total business enterprise" so as to have a "fractional participation in the profits or losses of the [management enterprise's] business operations." *Id.* at 871, 41 Cal. Rptr. at 425. The buyers in *Howey* would certainly have been astounded if they had been told that their plots of land were subject to internal operating losses of the management corporation, and the seller would have been equally surprised to discover that the buyers had a

property is recommitted to the enterprise, the same risks ensue no matter what the property's size.[101]

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right to share in the operating profits of the management corporation or a right to share in the proceeds of liquidation. In committing their property to the control of the management corporation, the buyers did not acquire an enterprise interest similar to that of the corporation's stockholders; the buyers did not agree that their land would bear a share of the internal operating losses shown on the income statement of the management enterprise.

A separate problem is the manner in which a number of buyers are to share in the proceeds derived from the several separately owned pieces of property under the supervision of the management enterprise. This matter will be treated later, but at this point it would be well to point out that a careful reading of the lower court *Howey* opinions indicates that, although the management enterprise pooled the fruit from all plots for purposes of marketing, each owner received net proceeds based on the amount of fruit harvested from his land, not a proportionate share of the proceeds based on the ratio which the quantity of his land bore to the total quantity of land under the control of the management enterprise. Each purchaser "looked to the fruitage of his own grove and not to the fruitage of the groves as a whole." SEC v. W. J. Howey Co., 151 F.2d 714, 717 (5th Cir. 1945), *rev'd*, 328 U.S. 293 (1946).

Thus, the future profits of each purchaser's land were not diminished pro rata by the lack of profits on other land. This was clear in Blackwell v. Bentsen, *supra*, and appears to have been the case in SEC v. Orange Grove Tracts, 210 F. Supp. 81 (D. Mass. 1962) and SEC v. Bailey, *supra*.

In any event, the method of distributing proceeds from managed property relates to *future profit experience* and not to risk to the buyer's original value. Even if each landowner takes a share of overall proceeds based on the size of his land, so that some owners' profits are reduced by inferior production on other land, no owner's land itself (representing his initial investment) would be subject to losses resulting from lack of production from another's property.

[101] A somewhat more difficult problem is presented by the following set of facts. *B* purchases property from *S*. At the time of purchase, it is virtually certain that *B* will be forced to relinquish the property to the supervision (and the attendant risks) of a management enterprise, not just to generate income, but to preserve the value of the property at the level of his initial investment. At the time the transaction is attacked as a "security," neither *B* nor other buyers have recommitted their property to a management enterprise.

In such a case, since *B* does not concurrently recommit his property for use or employment by an enterprise, it is difficult to say that *B*'s original value was subjected to the risks of an enterprise as part of a transaction connected with *S*. If it were clear that the market value of the property could not be preserved without its being relinquished to supervisory control, perhaps it could be said that part of the original value was paid in recognition of the future success of the management enterprise to which *B* would ultimately have to recommit his property. This would place the result on a rationale applicable to the fact pattern discussed under the next heading, in which the buyer furnishes his initial value in recognition of the yet unrealized success of an enterprise with which the buyer may have no legal relationship. In such a case, part of the present value of the property purchased is clearly attributable to the anticipated but unaccomplished success of an enterprise.

It might also be reasoned that, since *S* could have reasonably foreseen that *B* would be forced to recommit the property to the risks of an enterprise, the sale by *S* and any subsequent management arrangement entered into by *B* should be integrated into one transaction.

The size of the property would be relevant to the element of risk to initial value if it tended to prove the virtual certainty that the property received by the buyer would have to be recommitted to a management enterprise *to maintain its fair market value at the level of initial investment*. Small size would not be relevant to the issue of risk if it proved only that the property would have to be recommitted *to generate income*.

(iv) Tangible or Intangible Property: Original Value Paid in Recognition of the Yet-Unrealized Success of an Enterprise; No Legal Relationship With Enterprise Necessary.—Sometimes the buyer receives property other than that described in the preceding three subsections.[102] The amount of initial value which the buyer pays for the property is arrived at by taking into account the yet-unrealized success of an enterprise. If the expected success of the enterprise is not forthcoming, the value of the property purchased is deflated pro tanto to a level below the initial investment. The enterprise may[103] or may not[104] be that of the seller of the property. It is not necessary that the buyer have any continuing legal relationship with the enterprise.[105]

Unlike the situations already canvassed, the buyer does not receive a proprietary interest or a creditor's claim for repayment; nor does he receive property that is recommitted for use by an enterprise. Instead, the transaction is such that some portion of the *present value* of the property received by the buyer can only be explained in terms of the *future successful operations* of an enterprise. Of course, the foregoing characterization may apply to the percentage-share, debt, and "recommitted property" transactions already examined, but such arrangements involve other more discernible risks which emanate from the very nature of the legal relationships created between the buyer and the risk enterprise.[106] A subsisting legal relationship

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[102] This assumption is made only for the purposes of analysis. Note, however, that transactions often possess more than one of the types of risk discussed in text accompanying notes 83-101 *supra* and 103-18 *infra*.

[103] SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943); United States v. Schaefer, 299 F.2d 625 (7th Cir.), *cert. denied*, 370 U.S. 917 (1962); Nicewarner v. Bleavins, 244 F. Supp. 261 (D. Colo. 1965); SEC v. Latta, 250 F. Supp. 170 (N.D. Cal.), *aff'd per curiam*, 356 F.2d 103 (9th Cir. 1965), *cert. denied*, 384 U.S. 940 (1966); Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961); People v. Woolson, 181 Cal. App. 2d 657, 5 Cal. Rptr. 766 (Dist. Ct. App. 1960) (a mélange of ill-drawn agreements involved in a bizarre scheme to sell gold to the Mexican government).

[104] Roe v. United States, 287 F.2d 435 (5th Cir.), *cert. denied*, 368 U.S. 824 (1961).

[105] SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943); Roe v. United States, 287 F.2d 435 (5th Cir.), *cert. denied*, 368 U.S. 824 (1961).

[106] In Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961), the buyer received, in consideration of his initial value, a "membership" in a country club that was not yet completed. The "membership" gave him the right to use all club facilities. However, he did not receive any interest in the country club enterprise or its future profits, and he was required to pay monthly dues if and when the club was completed. Thus, it cannot be said that the risk to the buyer's original value arose by virtue of his having a percentage-share interest or a creditor's claim. The risk stemmed from the fact that his initial value was paid in recognition of the future completion and operation of the club by the seller's enterprise; that is, part, if not all, of

need not be the basis of risk, however. The failure of an enterprise may, by force of circumstances,[107] depress the value of property received by the buyer. If part of the present value of such property is attributable to the anticipated accomplishments of an enterprise, a portion of the buyer's initial investment may vanish if success is not achieved.

This type of risk is frequently manifested in situations where the buyer purchases property for capital appreciation on the strength of representations that gains will be forthcoming upon successful completion of various developmental projects.[108] The purchase price has two components: the inherent value of the property, aside from the expected effect of the developmental enterprise, plus an increment which represents the discounted value of ultimate enterprise success. Thus, if the developmental enterprise fails, the buyer not only misses his capital gains but also suffers a loss of his initial investment.

The same type of risk to initial value may attend the purchase of an intangible right to future payments, *e.g.*, a percentage interest in royalties[109] or a share in the future distribution of an estate which is presently in litigation.[110]

(v) Property With Fair Market Value Less Than Initial Value: Conditional Right To Receive Payments.—The hybrid transactions to be discussed under this heading have caused a great deal of consternation in the courts, and understandably so. The basic factual pattern underlying the problem can be stated quite simply. *B* purchases property (hereafter referred to as the "purchased property") from *S* at more than its current fair market value. For pur-

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the value of the membership was attributable to the successful materialization of club benefits.

[107] In SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943) and Roe v. United States, 287 F.2d 435 (5th Cir.), *cert. denied*, 368 U.S. 824 (1961), this force of circumstances lay in the fact that the oil content of the buyer's property would be taken to be more or less similar to that of nearby property on which drilling tests were being conducted. In Silver Hills Country Club v. Sobieski, *supra* note 106, the membership would not have been worth very much without the accompanying golf course, bar, and swimming pool.

[108] Some of this type of risk seems to have been present in several of the productive crop land cases already analyzed. See, *e.g.*, SEC v. Orange Grove Tracts, 210 F. Supp. 81 (D. Mass. 1962), in which part of the initial value seems to have been paid in recognition of the future success of cultivation operations being conducted on surrounding land.

[109] United States v. Schaefer, 299 F.2d 625 (7th Cir.), *cert. denied*, 370 U.S. 917 (1962); Nicewarner v. Bleavins, 244 F. Supp. 261 (D. Colo. 1965).

[110] SEC v. Latta, 250 F. Supp. 170 (N.D. Cal.), *aff'd per curiam*, 356 F.2d 103 (9th Cir. 1965), *cert. denied*, 384 U.S. 940 (1966).

poses of focusing on the issues, it will be assumed that the purchased property is not a proprietary interest or debt-holder's claim; that it is not recommitted to use by an enterprise;[111] and that no part of its present fair market value is attributable to the anticipated but unrealized success of an enterprise.[112] *S* promises to pay *B* a certain amount upon the occurrence of a specified event, *e.g.*, *S*'s making sales to persons whose names were furnished by *B* (customarily called "referral sales").[113]

The confusion probably springs from two seemingly applicable propositions which tend to militate against holding that such a transaction is a security. First, since the buyer receives the purchased

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[111] We have already dealt with the situation in which as part of the transaction, the property received is recommitted to employment by an enterprise. See text accompanying notes 87-101 *supra*.

[112] Sometimes the initial value furnished by the buyer is paid in recognition of the future success of an enterprise (particularly a developmental enterprise) with which the buyer may have no legal relationship. This problem was dealt with in text accompanying notes 102-10 *supra*.

[113] Pennsylvania Sec. Comm'n v. Consumers Research Consultants, Inc., 3 BLUE SKY L. REP. ¶ 70631 (Pa. C.P. 1963), *aff'd*, 414 Pa. 253, 199 A.2d 428 (1964) (vacuum cleaners); Fidelity Credit Co. v. Bradford, 177 So. 2d 635 (La. Ct. App.), *appeal denied*, 248 La. 430, 179 So. 2d 273 (1965) (vacuum cleaners; overcharge not clear); Emery v. So-Soft, Inc., 199 N.E.2d 120 (Ohio Ct. App. 1964) (water softener); Yoder v. So-Soft, Inc., 202 N.E.2d 329 (Ohio C.P. 1963) (water softener).

In Pennsylvania Sec. Comm'n v. Consumers Research Consultants, Inc., *supra*, the court held that no security was involved because the buyer was to secure the additional payments through "his own efforts." Thus, the decision rested partially on the "joint venture" theory, which will be considered later. See text accompanying notes 123-31 *infra*. The second leg of the opinion was based upon the court's interpretation of the word "profits" in the *Howey* formula. The court arrived at the highly questionable conclusion that the "profits" which the buyer is led to expect must be payable only if the risk enterprise makes a profit. Thus, the court impliedly excluded from security classification a transaction wherein the buyer furnishes initial value in consideration for a right to receive a sum certain, contingent upon the happening of a specific event, but unrelated to the operating profits of the enterprise. See text accompanying notes 146-59 *infra*.

Emery v. So-Soft, Inc., *supra*, was decided on the same two grounds announced in Pennsylvania Sec. Comm'n v. Consumers Research Consultants, Inc., *supra*. In both cases the courts intimated that the payments for referral sales were simply compensation to the buyers for furnishing sales leads and introducing the seller's product to their friends. If it be assumed that the buyers were receiving no more than fair market value for their so-called services, then the overcharge remains unexplained. Certainly the buyers did not pay the overcharge for the right to receive the fair market value of their services.

Yoder v. So-Soft, Inc., *supra*, involved facts very similar to those in Emery v. So-Soft, Inc., *supra*, but the court seemed to have a better insight into the financial realities. In holding that the transaction constituted a security, the court noted that "the sale of the [water] softener was nothing more than a 'gimmick' used by the defendant to make the sale of a money making scheme to gullible purchasers." Yoder v. So-Soft, Inc., *supra* at 330. This is in contrast to Fidelity Credit Co. v. Bradford, 177 So. 2d 635, 640 (La. Ct. App.), *appeal denied*, 248 La. 430, 179 So. 2d 273 (1965), wherein the court, without any analysis, concluded that the payments promised to the buyer were "advertising gimmicks" used to sell vacuum cleaners.

property, one is tempted to say that the buyer has completed a simple purchase, has gone his way with property in hand, and should not be heard to say that his initial value has been subjected to the risks of an enterprise. This approach overlooks the spread between the original value furnished and the current fair market value of the purchased property. Second, a problem is raised by the general principle that a "bad bargain" is of no concern to the law. This principle does not seem applicable to the situation in which the buyer receives a conditional right to future payments and where he has reason to believe not only that the value differential will be recouped but also that he may receive benefits over and above the amount of the overcharge.

It is submitted that the court, in *Yoder v. So-Soft, Inc.*,[114] correctly characterized the overcharge-sale-conditional-payment transaction as a novel method of financing, whereby the *overcharge spread* is subjected to the risks of an enterprise in the manner described under the previous subheading. For his overcharge, the buyer has received an intangible right to receive payments upon the happening of a certain event. This right to future payments has no present value except in terms of the future success of the enterprise. It seems that *Pennsylvania Sec. Comm'n v. Consumers Research Consultants, Inc.*[115] and *Emery v. So-Soft, Inc.*[116] might have been decided differently if the specified amounts had been payable only out of profits made by the seller on each referral sale or out of the overall operating profits of the seller's enterprise.[117] The benefits expected by the buyer might then have been more speculative, but the fact that the buyer was entitled to a guaranteed amount on each referral sale, whether or not the risk enterprise had profits,[118] should not be controlling.

It seems safe to say that any improper analysis in the foregoing cases resulted from a failure to recognize the rather disguised form of risk to initial investment and from a narrow interpretation of the

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[114] 202 N.E.2d 329 (Ohio C.P. 1963).

[115] 3 BLUE SKY L. REP. ¶ 70631 (Pa. C.P. 1963), *aff'd*, 414 Pa. 253, 199 A.2d 428 (1964).

[116] 199 N.E.2d 120 (Ohio Ct. App. 1964).

[117] The attitude of the Pennsylvania Supreme Court in the *Consumers Research* case can be gleaned from the following statement: "[T]he [buyer] . . . is not promised a share in the profits, but is given a *specific fee, regardless of profits* . . . ." Commonwealth *ex rel.* Pa. Sec. Comm'n v. Consumers Research Consultants, Inc., 414 Pa. 253, 256, 199 A.2d 428, 429 (1964). The court should have considered what would have happened if the enterprise had become insolvent.

[118] See text accompanying notes 146-59 *infra*.

word "profits" (in the *Howey* formula) to mean only payments made out of profits earned by the risk enterprise.

(b) Summary.—The foregoing exegesis of risk was meant to convey some notion of the multifarious character of *risk to initial investment*. It has been noted that the element of risk may be disguised so as to escape notice,[119] especially if the focal point of analysis is the *expectation of profits*. Moreover, if the term "profits" is construed narrowly and the risk factor is not properly identified, it is possible that certain transactions involving genuine risk to the buyer's initial value might escape security classification.[120]

Since there are a number of diverse forms of risk to initial investment, it would be very difficult to ascribe any definite meaning to the words "common enterprise" in the *Howey* formula. On balance, this phrase seems to be of little aid in the process of identifying a security.

Attention has also been called to a circumstance which tends to negate the existence of risk, *viz.*, the buyer's receipt of property, other than a proprietary interest in, or debt-holder's claim against, the seller's enterprise. The discussion so far has focused on situations in which there is risk to initial value despite the receipt of property.[121] Later, cases will be examined in which the receipt of property or services should be taken to exclude the presence of risk.[122]

By training the spotlight on risk to initial investment, it is not suggested that the other elements of the traditional *Howey* formula — lack of control over the enterprise and the expectation of profits — are not essential qualities of a "security." Recall that the basic objective of this inquiry is to isolate the characteristics of a transaction which create a need for the special fraud protection of the securities laws. It is clear that Congress and the state legislatures did not intend the securities laws to provide relief against fraud in all transactions. However, the special anti-fraud procedures, pro-

[119] *Cf.* Sarmento v. Arbax Packing Co., 231 Cal. App. 2d 421, 41 Cal. Rptr. 869 (Dist. Ct. App. 1964); Fidelity Credit Co. v. Bradford, 177 So. 2d 635 (La. Ct. App.), *appeal denied*, 248 La. 430, 179 So. 2d 273 (1965); Emery v. So-Soft, Inc., 199 N.E.2d 120 (Ohio Ct. App. 1964); Commonwealth *ex rel.* Pa. Sec. Comm'n v. Consumers Research Consultants, Inc., 414 Pa. 253, 199 A.2d 428 (1964), *affirming* 3 BLUE SKY L. REP. ¶ 70631 (Pa. C.P. 1963).

[120] Emery v. So-Soft, Inc., *supra* note 119; Commonwealth *ex rel.* Pa. Sec. Comm'n v. Consumers Research Consultants, Inc., *supra* note 119.

[121] See text accompanying notes 87-118 *supra*.

[122] See text accompanying notes 138-44 *infra*. See also text accompanying notes 92-95 *supra*.

tections, and remedies do seem pre-eminently appropriate where a buyer puts up initial value that will be subject to the perils of enterprise failure even when there is no fraud.

(4) Lack of Buyer's Familiarity With, or Control Over, the Enterprise.—The last statement is subject to one important qualification. The danger of fraud being practiced upon the buyer is considerably reduced when his initial investment is subjected to the risks of an enterprise with which he is familiar at the time of the transaction and over which he exercises management control. Under such circumstances, the buyer is hardly in a position to claim that he was induced to furnish value by means of misstatements or half-truths about the character of the venture. Moreover, if the buyer exercises his control prerogatives, he is in a better position to protect his original value from the hazards of enterprise operation. Thus, the so-called "joint venture" theory has been developed. Its effect is to exclude from the "security" category those transactions involving the subjection of the buyer's initial investment to the risks of an enterprise with which he is familiar and in which he plays an active management role.[123]

The use of the phrase "joint venture" to describe this judicial doctrine is rather anomalous. The principle should apply only when the buyer is intimately familiar with the enterprise and actively participates in its affairs. These are the special factors which protect the buyer against the dangers of fraud and risk.[124] However, it is perfectly possible to have a "joint venture" (in a more

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[123] Drug Management, Inc. v. Dart Drug Corp., CCH FED. SEC. L. REP. ¶ 91293 (D.D.C. 1963) (buyer purchased drugstore franchise); Weinstock v. L. A. Carpet, Inc., 234 Cal. App. 2d 809, 44 Cal. Rptr. 852 (Dist. Ct. App. 1965); Sarmento v. Arbax Packing Co., 231 Cal. App. 2d 421, 41 Cal. Rptr. 869 (Dist. Ct. App. 1964) (one branch of opinion); Hargiss v. Royal Air Properties, Inc., 206 Cal. App. 2d 406, 23 Cal. Rptr. 678 (Dist. Ct. App. 1962); Polikoff v. Levy, 55 Ill. App. 2d 229, 204 N.E.2d 807, *cert. denied*, 382 U.S. 903 (1965); Emery v. So-Soft, Inc., 199 N.E.2d 120 (Ohio Ct. App. 1964) (one branch of opinion); Commonwealth *ex rel.* Pa. Sec. Comm'n v. Consumers Research Consultants, Inc., 414 Pa. 253, 199 A.2d 428 (1964), *affirming* 3 BLUE SKY L. REP. ¶ 70631 (Pa. C.P. 1963) (one branch of opinion). *Contra*, Jackson v. Robertson, 90 Ariz. 405, 368 P.2d 645 (1962).

Under California law there is a specific exemption for "any bona fide joint venture interest, except such interests when offered to the public." CAL. CORP. CODE § 25100(m). Nonetheless, the cases applying the statute involve most of the same issues pertinent to the judicial doctrine. Note, however, that a side effect of including the "joint venture" theory in the statutory exemptive structure is to make a joint venture interest prima facie a security.

[124] Polikoff v. Levy, 55 Ill. App. 2d 229, 204 N.E.2d 807 (1965), *cert. denied*, 382 U.S. 903 (1965): The buyer "has an equal right of control . . . and [the] . . . right to know what is going on." *Id.* at 234, 204 N.E.2d at 809.

traditional sense) with passive members.[125] Presumably, such joint-venture interests would constitute securities.[126] It seems that "joint control" is the critical element; the buyer must play "no mere passive role."[127] It is therefore suggested that this doctrine be referred to as the "joint control" exception.

Some courts have liberally applied the theory to certain factual patterns. In one case, the court based its decision on the buyer's "equal *right* of control" and his "equal *right* to know what [was] ... going on."[128] In another case, the court found that the buyer was taking part in a sales enterprise when his only chore was to write letters to his friends introducing the enterprise's product.[129]

Although the joint control concept has been rejected in some quarters,[130] it seems sound in principle and has been included as a component of the author's proposed formula for identifying a se-

[125] It seems that the essentials of a joint venture are simply "a community of interest . . . [and] an expectation of profit." *Id.* at 235, 204 N.E.2d at 810.

[126] SEC Rule 3a11-1, 17 C.F.R. § 240.3a11-1 (Supp. 1966) defines "equity security" to include an "interest in a joint venture."

[127] Weinstock v. L. A. Carpet, Inc., 234 Cal. App. 2d 809, 44 Cal. Rptr. 852 (Dist. Ct. App. 1965). "The parties are equal owners and stand on equal footing as entrepreneurs." *Id.* at 813, 44 Cal. Rptr. at 854.

[128] Polikoff v. Levy, 55 Ill. App. 2d 229, 204 N.E.2d 807, *cert. denied*, 382 U.S. 903 (1965). (Emphasis added.) The defendant wrote letters to a number of friends and relatives, offering investment units in a motel enterprise. It was anything but clear that the buyers actually knew "what was going on" at the time of purchase or that they would thereafter take an active part in management. It may be that the decision was influenced more by the private and isolated nature of the transaction than by the element of "joint control."

[129] The prosecution failed to introduce evidence that the buyer had been told that he would "not be permitted to try his hand or abilities as a salesman." Pennsylvania Sec. Comm'n v. Consumers Research Consultants, Inc., 3 BLUE SKY L. REP. ¶ 70631 (Pa. C.P. 1963), *aff'd*, 414 Pa. 253, 199 A.2d 428 (1964). The buyer was to receive certain payments if the seller's enterprise were successful in selling goods to the buyer's friends. The buyer wrote letters to his friends, telling them about the product and giving them advance notice that the seller would be in touch with them.

This "studied attempt to fleece purchasers of a 'Built-In-Vacuum System' by securing an unconscionable overcharge" also had its chain letter aspects. Commonwealth *ex rel.* Pa. Sec. Comm'n v. Consumers Research Consultants, Inc., 414 Pa. 253, 254, 199 A.2d 428 (1964). The buyer was to receive payments if the seller completed sales with persons whose names were furnished *by the buyer's friends*. The court seemed to overlook the fact that the buyer had no control whatever over the latter sales.

The *Consumers Research* rationale was adopted in another case in which the buyer did not even write to his friends. Emery v. So-Soft, Inc., 199 N.E.2d 120 (Ohio Ct. App. 1964).

[130] *E.g.*, Jackson v. Robertson, 90 Ariz. 405, 368 P.2d 645 (1962). "[T]he Securities Act was not enacted to protect any of the parties to this law suit. Nevertheless, the contract herein called for issuance of corporate securities which might very well have been foisted upon the investing public by any of the five men involved." *Id.* at 409, 368 P.2d at 648. The reasoning is specious, for the application of the joint control rule among active managers does not prevent a court from finding that a later transaction with outsiders constitutes a security.

curity. However, the exception should be applied only when the buyer's position truly reduces the possibility of fraud and gives him the power to affect the risk to his initial investment. At the time of the transaction, the buyer should possess both knowledge of the risk enterprise and the power to influence the course of its future operations. It seems highly questionable whether the joint-control theory should govern where the buyer assumes a management role *after* the purported security transaction but has had no knowledge of the risk enterprise prior thereto.[131]

(5) Reasonable Expectation of Benefits in Excess of Initial Value.—Thus far, two major characteristics of a security transaction have been examined: (1) risk to the buyer's initial value, and (2) the buyer's lack of familiarity with, or control over, the risk enterprise. At this juncture, it may well be asked whether these qualities alone are sufficient to distinguish a security from the universe of transactions.

(a) In General.—The question actually becomes: should the special fraud protection of the securities laws be applied to all transactions in which the buyer's initial value is subjected to the risks of an enterprise with which he is not familiar and over which he has no control? *Howey*[132] has answered this question in the negative. The seller must have induced the buyer to furnish initial value by means of promises or representations which give rise to a reasonable expectation of "profits." Thus, even though risk to initial investment may be the most economically troublesome quality of a security transaction (as has been earnestly contended), the Su-

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[131] In Drug Management, Inc. v. Dart Drug Corp., CCH FED. SEC. L. REP. ¶ 91293 (D.D.C. 1963), the buyer purchased a franchise for the operation of a specially constructed drugstore. The buyer was to operate the drugstore and thus would control the exploitation of the franchise *after* the alleged "security" transaction. There were no facts to indicate that the buyer had any knowledge of other enterprises in which such franchises had been employed. *Held*, no security. The franchising business seems to be booming from coast to coast. See The Wall Street Journal, April 6, 1966, p. 1, col. 6.

The buyer is in control of his business after he pays for his franchise (which is often tied to some kind of gadget or other tangible property). To some extent, therefore, he can directly defend his investment against operational risks. However, since the buyer is generally ill-informed about the mechanics of the franchised business, he is as susceptible as anyone to fraud in the franchising transaction. These considerations seem to have been at work in Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965), where the buyer was to be one of three stockholders of a corporation franchised for the operation of automatic archery lanes. The court did not apply the joint control theory, even though it appears that the buyer might well have exercised management control over the enterprise thereafter.

[132] SEC v. W. J. Howey Co., 328 U.S. 293 (1946).

preme Court seems to require some additional element to establish seller responsibility for the transaction.

The requirement seems sound; securities regulation does not appear to be necessarily appropriate for all types of transactions in which the buyer's initial value is subjected to the risks of an enterprise. For example, the SEC has indicated that it would not *ordinarily* consider the term "security" to embrace trading stamps, streetcar tokens, meal tickets, Christmas gift certificates, box tops, or theater tickets.[133] Technically speaking, the initial value furnished by the buyer of such items is subjected to the risks of the seller's enterprise in much the same way as that of a creditor.[134] It is difficult to find any expectation of "profit" in these situations,[135] and perhaps this is why, under the teaching of *Howey*, they should not be classified as securities. Unfortunately, the analysis cannot be so simplistic. The SEC has indicated a willingness to take a second look at these transactions if they are "used as a method of corporate financing."[136] The reason for closer scrutiny would seem to be the increased degree of risk, since the expectation of "profits" would still be missing. This raises the question of whether a sufficiently high degree of risk will call the securities laws into operation, even in the absence of a reasonable expectation of profits.[137]

The same issue arises in the context of the so-called cooperative apartment arrangements, some of which have been excluded from the "security" category because of the lack of "profit" motive.[138] However, one may also ask whether there is any manifestation of risk to the buyer's initial investment. The buyer in these transactions often receives full rental value (usually a lease) in return for his initial investment.[139] If he occupies the leasehold, it cannot be

133 SEC Securities Act Release No. 3890, 1 CCH FED. SEC. L. REP. ¶ 1041 (Jan. 25, 1958).

134 See discussion of the creditor's risk at text accompanying notes 85-86 *supra*.

135 These devices have been described as "media created primarily for exchange." See Mundheim & Henderson, *Applicability of the Federal Securities Laws to Pension and Profit-Sharing Plans*, 29 LAW & CONTEMP. PROB. 795, 809 n.45 (1964).

136 SEC Securities Act Release No. 3890, 1 CCH FED. SEC. L. REP. ¶ 1041 (Jan. 25, 1958).

137 Extreme risk seems to be the only reasonable basis for the holding in Strauss v. State, 147 S.E.2d 367 (Ga. Ct. App. 1966) (money orders).

138 These transactions typically involve the buyer's transfer of property or a large initial sum of money to a corporation in exchange for a long-term lease of an apartment and stock in the corporation. At first blush, it certainly appears that the buyer assumes the same risks to his initial investment as any other percentage-share purchaser. See text accompanying notes 83-84 *supra*. But "no profit or income is generally anticipated." Op. Ariz. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70554 (Aug. 11, 1961).

139 "The substance of the purchase of such a share would amount to . . . securing a place to live . . . ." *Ibid.*

said that property received has been recommitted to use by an enterprise in the *Howey* sense.[140] It could be argued, with considerable force, that part of the initial value furnished for the apartment was paid in recognition of the future success of the apartment complex, *i.e.*, the fair market value of the apartment was probably ascertained by taking into account the anticipated but unrealized success of the apartment enterprise as a whole. Thus, the buyer's initial value would be subject to the risks of an enterprise in the sense of *SEC v. C. M. Joiner Leasing Corp.*[141] On the other hand, the apartment dwellers often exercise control in the affairs of the apartment complex, so that the joint control exception might apply.[142] In sum, it seems impossible to say unequivocally that the ground for excluding these arrangements from security classification is the lack of an expectation of "profits"; the crucial consideration may be the absence of risk.[143]

Thus, while it appears rather certain that the expectation of "profits" will not cause a transaction to be a security where the buyer has not furnished initial value which is in some way subjected to the risks of an enterprise,[144] it is difficult to say with certainty that a transaction involving a high degree of risk to initial investment, but lacking the expectation of profits, will not be called a security.[145]

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[140] See text accompanying notes 87-101 *supra* for a discussion of transactions in which the buyer receives property (other than a creditor's claim or a proprietary interest) which has a fair market value equal to initial value but which is immediately recommitted to use by an enterprise.

[141] 320 U.S. 344 (1943). See text accompanying notes 102-10 *supra*.

[142] Willmont v. Tellone, 137 So. 2d 610 (Fla. Dist. Ct. App. 1962). "The purpose of the corporation was to be purely incidental to the actual lease of the co-operative apartment—in other words, a vehicle by which control could be exercised." *Id.* at 612.

[143] The California blue sky administrator has indicated that a cooperative apartment would be considered a security if the apartment complex were still in the developmental stages. On the reasoning of *Silver Hills*, part of the buyer's original value would then clearly be paid in recognition of the yet unrealized success of the entire complex. See Sobieski, *Securities Regulation in California: Recent Developments*, 11 U.C.L.A.L. REV. 1, 7-8 (1963). However, as we shall see, the *Silver Hills* fact pattern contains an element of expected profits, and so the analysis of that case does little to answer the question of whether risk to initial value, without reasonable expectation of profit, will support a security finding.

[144] This would be the situation in which the buyer receives property which is not a proprietary interest or a creditor's claim, which is not recommitted for use by an enterprise, and which has a present fair market value (no part of which is determined by taking into account the anticipated but unaccomplished success of an enterprise) equal to the buyer's original investment.

[145] *But see* Note, 14 HASTINGS L.J. 181 (1962): "[H]istorically the courts have firmly recognized that the investor must put up money or its equivalent for a share or

Nevertheless, two generalities may safely be stated about the relationship between risk to initial value and reasonable expectation of "profit": First, both factors are necessary in most security transactions. Second, as the degree of risk to initial value increases, the need for a well-defined "profit" motive lessens; *i.e.*, the elements of risk to initial value and reasonable expectation of profits are on a sliding scale of inverse proportionality. The preceding statements underscore the need for an accurate analysis of the various types of "profit."

(b) Species of "Profits."—Properly considered, "profits" refer to payments or distributions which may be either fixed[146] or variable[147] and either conditioned upon[148] or unrelated to[149] the

stake in an enterprise or venture *with the expectation of* profit before his interest can be classified as a security." *Ibid.* (Footnotes omitted.)

[146] Farrell v. United States, 321 F.2d 409 (9th Cir. 1963), *cert. denied*, 375 U.S. 992 (1964); United States v. Attaway, 211 F. Supp. 682, (W.D. La. 1962); SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961) (fixed and variable); Donovan v. Dixon, 261 Minn. 455, 113 N.W.2d 432 (1962); State v. Davis, 131 N.W.2d 730 (N.D. 1964); Yoder v. So-Soft, Inc., 202 N.E.2d 329 (Ohio C.P. 1963).

[147] Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1965); United States v. Schaefer, 299 F.2d 625 (7th Cir.), *cert. denied*, 370 U.S. 917 (1962) (limited to ten times original investment); SEC v. Latta, 250 F. Supp. 170 (N.D. Cal.), *aff'd per curiam*, 356 F.2d 103 (9th Cir. 1965), *cert. denied*, 384 U.S. 940 (1966); Nicewarner v. Bleavins, 244 F. Supp. 261 (D. Colo. 1965); Lennerth v. Mendenhall, 234 F. Supp. 59 (N.D. Ohio 1964); Bellerue v. Business Files Institute, Inc., 61 Cal. 2d 488, 393 P.2d 401, 39 Cal. Rptr. 201 (1964); Smith v. Sherman, 206 Cal. App. 2d 93, 23 Cal. Rptr. 487 (Dist. Ct. App. 1962); Rivlin v. Levine, 195 Cal. App. 2d 13, 15 Cal. Rptr. 587 (Dist. Ct. App. 1961); People v. Woolson, 181 Cal. App. 2d 657, 5 Cal. Rptr. 766 (Dist. Ct. App. 1960); People v. Smith, 180 Cal. App. 2d 420, 4 Cal. Rptr. 282 (Dist. Ct. App. 1960).

Where property has been recommitted to an enterprise for management, there are several ways in which profits can be determined. For example, where the property being managed is productive, three possible situations may occur. First, the produce of each owner's property may be sold and the net profits accounted for separately. Second, the produce from all properties managed may be pooled for selling, with the net profits being divided in proportion to the produce derived from each owner's property. See SEC v. W. J. Howey Co., 328 U.S. 293 (1964); Blackwell v. Bentsen, 203 F.2d 690 (5th Cir. 1953), *cert. denied*, 347 U.S. 925 (1954). The schemes for division of profits are not clear in some cases. See SEC v. Orange Grove Tracts, 210 F. Supp. 81 (D. Mass. 1962); SEC v. Bailey, 41 F. Supp. 647 (S.D. Fla. 1941). Third, the produce may be pooled for selling and the net profits divided in proportion to the quantity or value of each owner's property. Op. Fla. Att'y Gen. 3 BLUE SKY L. REP. ¶ 70653 (Dec. 14, 1964).

Where the managing enterprise has the power to sell the recommitted property, such property may be pooled for sale and the proceeds divided according to the ratio that the quantity of each owner's property bears to the total quantity of all propery sold. See SEC v. Great W. Land & Dev., Inc., CCH FED. SEC. L. REP. ¶ 91537 (D. Ariz. 1965) (Transfer Binder 1964-1966), *rev'd on other grounds and remanded*, 355 F.2d 918 (9th Cir. 1966); SEC v. Comstock Coin Co., CCH FED. SEC. L. REP. ¶ 91414 (D. Nev. 1964) (Transfer Binder 1964-1966); SEC v. Willoughy Coin Exch., CCH FED. SEC. L. REP. ¶ 91355 (S.D. Cal. 1964). On the other hand, each buyer's property may be sold and the proceeds accounted for separately. United States v. Herr, 338 F.2d 607 (7th Cir. 1964), *cert. denied*, 382 U.S. 999 (1966).

profits shown on the income statement of the risk enterprise. The reference point of profitability is the buyer. The important consideration here is whether the buyer has been led reasonably to expect some benefit over and above his initial investment, whether or not the inurement is conditioned upon the overall internal profitability of the risk enterprise.[150]

Must the benefit which the buyer is led to expect be in the nature of realized income? *SEC v. C. M. Joiner Leasing Corp.*[151] and *Roe v. United States*[152] tell us that it is sufficient if the buyer is led reasonably to believe that property which he receives will appreciate in value over and above his initial investment.[153] *Silver Hills Country Club v. Sobieski*[154] presents a somewhat more complicated problem. The buyer, in consideration of his initial value, received a membership in a then-unfinished country club, but he received no interest in the assets or profits of the club. It has been said that the "profit" which the buyer was led to expect was the future use of valuable club facilities.[155] On the facts of the case, this theory will not stand up, for the buyer was required to pay continuing monthly dues for the use of club facilities. It seems more accurate to say that the buyer purchased an intangible piece of property in the nature of an entrance privilege. The price paid for the entrance privilege was probably less than it would have been had the club

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[148] See authorities, except United States v. Schaefer, cited in the first paragraph of note 147 *supra*. See also Donovan v. Dixon, 261 Minn. 455, 113 N.W.2d 432 (1962).

[149] See authorities, except Donovan v. Dixon *supra* note 148, cited note 146 *supra* and in the second and third paragraphs of note 147 *supra*. See also United States v. Schaefer, 299 F.2d 625 (7th Cir.), *cert. denied*, 370 U.S. 917 (1962); Yoder v. So-Soft, Inc., 202 N.E.2d 329 (Ohio C.P. 1963).

[150] The following consideration would seem to be irrelevant: "There is no reference to profits in the Advertising Commission Agreement. The Commission is payable . . . whether or not the company makes a profit on any particular sale or for any period of time." Pennsylvania Sec. Comm'n v. Consumers Research Consultants, Inc., 3 BLUE SKY L. REP. ¶ 70631, at 66352 (Pa. C.P. 1963), *aff'd*, 414 Pa. 253, 199 A.2d 428 (1964). Unfortunately, the *Howey* formula did not specify to *whose* profits it referred. Upon close analysis, it appears clear that the court was not referring to the internal operating profits of the management enterprise to which the buyer's property had been recommitted.

[151] 320 U.S. 344 (1943).

[152] 287 F.2d 435 (5th Cir.), *cert. denied*, 368 U.S. 824 (1961).

[153] "A reasonably prudent-imprudent, prospective purchaser was certainly entitled to infer that the promised bonanza would come to him without any expenditure on his part." *Id.* at 438, n.4.

[154] 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961).

[155] "The purchaser, by buying a promotional membership, was risking his capital in the expectation that the potential benefits of a country club membership would materialize." Note, 50 CALIF. L. REV. 156, 158 (1962).

been completed. Thus, the buyer had reason to believe that his entrance privilege would appreciate in value.

The question remains, however, whether the buyer's expectation of valuable *non-pecuniary* benefits will fulfill the requirement for profit inducement. In a proper case, it seems that the *Silver Hills* rationale would be appropriate.[156]

And so it appears that the restrictive readings of the word "profits" in the *Howey* formula are unjustified.[157] It is sufficient if the seller is responsible for leading the buyer to believe that *some valuable benefit*, over and above his initial investment, will accrue as a result of the operations of an enterprise.

(c) The "Speculation" Red Herring.—Before leaving this analysis of the essential characteristics of a security, it is well to note that "speculation" is not such a characteristic.[158] Risk to initial value is a prerequisite, but the degree of risk need not be so high as to make the investment "speculative."[159]

E. The Desirability of a Pervasive Definition

As already noted, the definition sections of the federal and many state securities statutes contain a list of rather specific devices and arrangements,[160] plus a group of general classifications which have no readily identifiable content.[161] In cases where the form of the alleged security transaction does not come within the literal coverage of the specific definitional categories, the courts and agencies, in the process of applying the general statutory language, have been forced to evolve statements of the essential characteristics of a

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[156] For example, an enterprise, still in the initial promotional stages, sells coupons entitling the buyers to goods or services having a fair market value greater than the initial value furnished.

[157] See, *e.g.*, Pennsylvania Sec. Comm'n v. Consumers Research Consultants, Inc., 3 BLUE SKY L. REP. ¶ 70631 (Pa. C.P. 1963), *aff'd*, 414 Pa. 253, 199 A.2d 428 (1964); Emery v. So-Soft, Inc., 199 N.E.2d 120 (Ohio Ct. App. 1964).

[158] "We reject the suggestion . . . that . . . [a security] is necessarily missing where the enterprise is not speculative . . . ." SEC v. W. J. Howey Co., 328 U.S. 293, 301 (1946). Similarly, "the term 'speculation' does not signal automatic subjection to corporate securities regulation." Sarmento v. Arbax Packing Co., 231 Cal. App. 2d 421, 424, 41 Cal. Rptr. 869, 871 (Dist. Ct. App. 1964).

[159] Thus, the following statement appears to be somewhat misleading: "The important facts here are the speculative nature of the interest sold and its size." Nicewarner v. Bleavins, 244 F. Supp. 261, 265 (D. Colo. 1965).

[160] *E.g.*, "any note, stock . . . bond . . . evidence of indebtedness." Securities Act § 2(1), 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b(1) (1964).

[161] *E.g.*, "certificate of interest or participation in any profit-sharing agreement . . . transferable share, investment contract . . . or, in general, any interest or instrument commonly known as a security." *Ibid.*

security.[162] However, even though the tests for identifying a security have been developed in the context of the general definitional classifications, there is no reason why such tests should not pervade the entire section. If the security formula and its underlying analysis[163] accurately describe the essential economic factors which create a need for the fundamental fraud protections of the securities laws, then presumably they should be controlling even where the form of the transaction comes within the literal coverage of the definition section. This approach has been suggested by the courts[164] and urged by the commentators.[165]

The precise issue here is whether, in the absence of one or more of the essential economic characteristics of a security, a transaction should nonetheless be classified as a security simply because it fits into one of the readily identifiable pigeonholes of the definition statute.[166] It has already been noted that some adjudicators are wont to exclude transactions from the literal coverage of the definition provisions where the buyer exercises some management control over the risk enterprise[167] and where the elements of risk to initial value

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[162] *E.g.*, SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943); Polikoff v. Levy, 55 Ill. App. 2d 229, 204 N.E.2d 809, *cert. denied*, 382 U.S. 903 (1965).

[163] See text accompanying notes 47-159 *supra*.

[164] Recall the general mandate of *Howey* that "form [is] . . . disregarded for substance and emphasis [is] . . . placed upon economic reality." 328 U.S. at 298. See Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961), wherein the following rule of interpretation was announced: "[The transaction] . . . qualifies . . . [as a security] within the literal language of the [statute] . . . . The crucial question nevertheless remains whether the sale of such a membership comes within the regulatory purpose of the . . . Securities Act." *Id.* at 814, 361 P.2d at 908, 13 Cal. Rptr. at 188.

In People v. Davenport, 13 Cal. 2d 681, 91 P.2d 892 (1939), the court stated:

> [W]ords . . . may be given a contracted meaning dependent upon the connection in which they are employed, and considering the general purpose or scheme entertained by the legislature . . . and the rule that words will not be given their literal meaning when to do so would evidently carry the operation of the enactment far beyond the legislative intent . . . [make it] clear that the legislature intended by use of the words . . . in [the definition section] . . . such as 'note' and 'evidence of indebtedness,' that each such expression should possess the same general characteristics as the word 'security' . . . . *Id.* at 685-86, 91 P.2d at 895.

[165] "This doctrine of 'substance-over-form' . . . should be, and apparently is available for purposes of definitional exclusion as well as inclusion." Pasquesi, *The Expanding "Securities" Concept*, 49 ILL. B.J. 728, 732 (1961).

[166] The question of whether certain transactions ought to be excluded from the coverage of the securities laws even though *all* the essential economic characteristics of a security are present will be discussed in text accompanying notes 184-204 *infra*.

[167] See authorities cited note 123 *supra*. Hargiss v. Royal Air Properties, Inc., 206 Cal. App. 2d 406, 23 Cal. Rptr. 678 (Dist. Ct. App. 1962) (involving both stock and notes).

or reasonable expectation of profits are lacking.[168] However, in some cases, where the transactions at issue possessed all the characteristics of a security and could have been classified as securities on the basis of an "economic realities" analysis, the courts have evinced a tendency to reach cursory results based simply on literal coverage.[169] There are at least two spurious considerations which have led some courts to forego full analysis of transactions which appear to be securities *in form.*

(1) "Handy Latin Aphorisms": The Ejusdem Generis Carousel.—The misty maxims of statutory construction are often double-edged swords. In *SEC v. C. M. Joiner Leasing Corp.*,[170] the form of the transaction at bar did not come within one of the specific categories of the definition statute. The defendant claimed, therefore, that the general classifications of the definition (*e.g.*, "investment contract" or "any interest or instrument commonly known as a 'security'") must be limited by the specific categories (*e.g.*, "stock" and "bond"). But Mr. Justice Jackson chose to "construe the details of . . . [the] act in conformity with its dominating general purpose, . . . [reading] text in the light of context."[171] As the Fifth Circuit later commented, *Joiner* has "rejected any construction of the Act on the basis of handy Latin aphorisms."[172]

In a subsequent case, however, where the alleged "security" transaction was a "note" and thus came within the literal coverage

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[168] *E.g.*, trading stamps, theater tickets, etc. SEC Securities Act Release No. 3890, 1 CCH FED. SEC. L. REP. ¶ 1041 (Jan. 25, 1958).

These are certainly "evidences of indebtedness." The cooperative apartment transactions (involving corporate stock) are also illustrative of the practice of analyzing a transaction for its security aspects even though it appears prima facie to be within the literal coverage of the statute. See text accompanying notes 138-43 *supra. E.g.*, Willmont v. Tellone, 137 So. 2d 610 (Fla. Dist. Ct. App. 1962) (stock).

[169] See Farrell v. United States, 321 F.2d 409 (9th Cir. 1963), *cert. denied*, 375 U.S. 992 (1964) (mortgage notes). "Appellants complain that the instruction [to the jury] fails to define the terms 'any note' or 'evidence of indebtedness' appearing in [Securities Act § 2(1), 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b(1) (1964)] . . . . In our view such ordinary terms are self-defined and require no further definition." Farrell v. United States, *supra* at 417. See Llanos v. United States, 206 F.2d 852 (9th Cir. 1953), *cert. denied*, 346 U.S. 923 (1954); United States v. Monjar, 47 F. Supp. 421, 427 (D. Del. 1942), *aff'd*, 147 F.2d 916 (3d Cir. 1944) ("receipts [for personal loans] certainly fall within the category of an 'evidence of indebtedness'"); Whitlow & Associates v. Intermountain Brokers, Inc., CCH FED. SEC. L. REP. ¶ 91800 (D. Hawaii, March 25, 1966) (Transfer Binder 1964-1966); SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961); State v. Davis, 131 N.W.2d 730 (N.D. 1964).

[170] 320 U.S. 344 (1943).

[171] *Id.* at 350-51.

[172] Roe v. United States, 287 F.2d 435, 437 (5th Cir.), *cert. denied*, 368 U.S. 824 (1961).

of the definition section,[173] the defendant claimed that the specific categories should be limited, when necessary, by the generic notions which had been developed under the amorphic phraseology of the statute (*e.g.*, "transferable share," "investment contract," or "any commonly known as a security").[174] The court, noting that the *ejusdem generis* argument had already been judicially rejected, stated summarily: "This instrument is clearly an 'evidence of indebtedness,' and as such falls within the statutory definition of securities."[175]

The foregoing illustrates the futility of talking in terms of aphoristic rules of construction. They are simply "anodynes for the pains of reasoning." *Joiner* rejected one interpretative approach because it seemed inappropriate. *Llanos v. United States*[176] summarily rejected a seemingly proper method of construction because it was based on an *ejusdem generis* argument.[177]

(2) A Liberal-Formal Construction: The Double Threat.—Although Mr. Justice Jackson expressly opted in *Joiner* to perform the task of statutory interpretation unencumbered by rules of liberality or strictness, it has been the overwhelming consensus of the recent opinions that the securities laws are to be liberally construed. While this approach is normally harmless, there is one instance in which it can have pernicious effects. As has already been seen, some courts are inclined to the view that all transactions falling within the specific categories of the definition sections are conclusively securities, without the need for further inquiry to determine whether they possess the economic characteristics which would create a need for the application of the securities laws.[178] If such courts also adopt a practice of liberally defining the terms "stock," "bond," "note," or "evidence of indebtedness," any examination of "economic realities" might well be foreclosed with respect to the majority of alleged "security" transactions.[179]

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[173] Llanos v. United States, 206 F.2d 852 (9th Cir. 1953), *cert. denied*, 346 U.S. 923 (1954).

[174] See generally Securities Act § 2, 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b (1964).

[175] Llanos v. United States, 206 F.2d 852, 854 (9th Cir. 1953), *cert. denied*, 346 U.S. 923 (1954).

[176] 206 F.2d 852 (9th Cir. 1953), *cert. denied*, 346 U.S. 923 (1954).

[177] Fortunately, the court would have probably reached the same result if it had pursued the interpretative approach suggested by the defendant.

[178] *E.g.*, Commonwealth *ex rel.* Pa. Sec. Comm'n v. Consumers Research Consultants, Inc., 414 Pa. 253, 199 A.2d 428 (1964).

[179] This radical approach might have been responsible for the puzzling result in Strauss v. State, 147 S.E.2d 367 (Ga. Ct. App. 1966), wherein money orders were held to be securities simply because they were "evidences of indebtedness." *Id.* at 370.

(3) Prognosis.—So far, and fortunately, few questionable decisions have resulted from a failure to apply the "economic realities" test to transactions which come within the literal meaning of the specific definitional categories.[180] Moreover, the cases which have faced the issue squarely have given the "economic realities" test primacy over literal coverage.[181] On the merits, this is the most desirable approach. If the formula and its underlying analysis properly delineate the essential elements of the "security" concept, it should be applied pervasively. By use of the introductory phrase "unless the context otherwise requires,"[182] the present definitional provisions seem to sanction the use of an overriding test for identifying a security. On the other hand, if future decisions follow a pattern of making literal coverage determinative of security status without further inquiry, the definition sections of the securities laws should probably be amended to provide expressly that satisfaction of the literal or formal aspects of the statute are not conclusive of its applicability.[183]

F. The Isolated and Private Transaction

As the final topic of this article, the thorny problem of determining the proper analysis and treatment for isolated and private transactions, such as loan or purchase money notes and the small offering of limited partnership interests, will be discussed. The word "isolated" will be used to refer to the limited number of transactions, and the term "private" will describe the buyers' financial sophistication or their knowledge of the risk enterprise.

First, it should be noted that the transactions now under consideration ordinarily possess, to some degree, all the essential economic characteristics of a security which were previously elaborated. Of course, it may happen that the buyer, in addition to being familiar with the operations of the risk enterprise (so that the transaction is "private"), may also play an active management role. In such a case, one of the essential economic elements of a security would be missing, and the "joint control" doctrine would apply.[184]

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[180] As already noted, most of the cases which have taken the ultra-literal approach would, coincidentally, have reached the same result by applying the "economic realities" test.

[181] See authorities cited note 164 *supra.*

[182] *E.g.*, Securities Act § 2, 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b (1964).

[183] Such a statute might first state the general and controlling test for a security in terms of the "economic realities" formula. The categories in the present statute might then be described as being prima facie or presumptively securities.

[184] See text accompanying notes 123-31 *supra.*

What should be the result if the control prerogative is lacking? The question will be viewed first in the light of the present statutory structure.

(1) Implications of the Statutory Scheme.—One has the feeling that the special fraud protection of the securities laws should not be applicable to the huge number of isolated transactions in which the buyers are financially sophisticated and familiar with the operations of the risk enterprise. However, as the statutes are presently written, the isolated nature of a transaction and the element of privateness are generally relevant only to the issue of whether a transaction should be exempt from registration or state administrative approval. If a transaction is isolated and private, the danger of fraud is reduced both quantitatively and qualitatively; in other words, these elements are factors which mitigate, but do not eliminate, the probability of fraud. In the federal context, sections 3 and 4(2) of the Securities Act[185] deal with such mitigating factors, but neither section exempts a transaction from the anti-fraud provisions of sections 12(2) and 17(a).[186]

In the case of a promissory note, there is a further complication arising from the introductory language of section 3(a).[187] The statute exempts various "classes of securities" from registration under circumstances where the likelihood of fraud is substantially mitigated. One of the classes listed is "any note" having certain characteristics which increase the probability that it will be circulated among sophisticated or knowledgeable buyers. Thus, by the express language of section 3(a), there is a further statutory indication that notes are "classes of securities" even though they are issued under circumstances which greatly reduce the chances of fraud being practiced upon the buyer.[188] Stated differently, section 3(a) furnishes additional support for the proposition that factors in mitigation of the probability of fraud are relevant to the issue of exemption — not to the issue of security status. This inference is

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[185] 48 Stat. 75, 77 (1933), as amended, 15 U.S.C. §§ 77c, 77d(2) (1964).

[186] In the state context, UNIFORM SECURITIES ACT § 402, 1 BLUE SKY L. REP. ¶ 4932 (1958) does not exempt transactions from the anti-fraud provisions of §§ 101 and 410(a)(2), 1 BLUE SKY L. REP. ¶¶ 4902, 4940 (1958).

[187] See also UNIFORM SECURITIES ACT § 402(a), 1 BLUE SKY L. REP. ¶ 4932 (1958).

[188] This argument has been made with respect to the California securities law. "The exemption gives recognition to partnership interests . . . as securities. The [exemption] statute, in fact, expressly calls such interests securities. They are merely exempted under certain conditions . . . ." Jahn, *When Is a Security a Security?*, 40 LOS ANGELES B. BULL. 75, 77 (1964). *But cf.* authorities cited note 195 *infra.*

strengthened by the fact that Congress *did* exclude certain "notes" from the *definition* of "security" in the Securities Exchange Act.[189]

Securities Exchange Act Rule 3a11-1[190] is also relevant. By its provisions, "limited partnership" interests are included without qualification in the "equity security" category. The language of the rule certainly cuts against the view that the isolated and private nature of such interests might result in their escaping "security" classification.[191]

In summary, there seems to be little statutory justification for excluding a transaction from "security" classification solely because of its isolated and private nature. Still, for purposes of subsequent discussion, it should be remembered that the danger of fraud is qualitatively reduced if the transaction is private (involving buyers who are financially sophisticated or who have knowledge of the risk enterprise) and quantitatively reduced if the transaction is isolated (involving only a few buyers).

(2) The "Cut-Off" Consideration.—Although the present statutes may tend to indicate that a transaction should not escape security classification just because it is isolated and private, it may be argued that Congress and the state legislatures did not intend the special fraud procedures, protections, and remedies of the securities laws to be applicable to every isolated and private purchase money note or limited partnership interest. The policy of the argument would probably be one of judicial and administrative economy. The SEC, state agencies, and the courts should not have to resort to the special anti-fraud machinery of the securities laws every time ABC Corp. and John Doe issue a purchase money note. In other words, there should be a point at which the applicability of all the provi-

189 "The term 'security' . . . shall not include . . . any note . . . which has a maturity at the time of issuance of not exceeding nine months . . . ." Exchange Act § 3(a)(10), 48 Stat. 884 (1934), 15 U.S.C. § 78c(a)(10) (1964).

190 17 C.F.R. § 240.3a11-1 (Supp. 1966). Presumably an "equity security" is basically a "security." See Exchange Act § 3(a)(11), 48 Stat. 884 (1934), 15 U.S.C. § 78c(a)(11) (1964).

191 See 1 LOSS, SECURITIES REGULATION 504-05 (2d ed. 1961), where it is suggested that an isolated and private offering of interests in a limited partnership formed under the Limited Partnership Act might not be considered an offering of securities. However, it should be noted that, although a limited partner must consent to the substitution of new partners, he must also remain passive with respect to the management of the enterprise. The joint control exception would therefore seem unavailable. Moreover, the troublesome characteristics of risk to initial investment and expectation of profits are clearly present. When the foregoing considerations are coupled with the implications of the statutory structure, it is difficult to find much support for the suggestion that an isolated and private offering of limited partnership interests should not be deemed to involve the sale of securities. But, then, *quandoque bonus dormitat Homerus.*

sions of the securities laws is "cut off," even when the economic realities of a security are present. Such an argument seems hard to digest simply on the ground that Congress and the state legislatures did not intend to be picayune. However, the argument gains some strength and perhaps tips the scales when it is thrown into the balance with the previous suggestion that the danger of fraud is reduced both qualitatively and quantitatively if a transaction is isolated and private.

(3) The Decisions.—Even if it be assumed that an isolated and private note is not a security at the time of its making, such a note may later become a security if it is bought up and distributed to the public.[192] Similarly, loan or purchase money notes of an individual[193] or a corporation[194] may constitute securities when they are offered to the public by the makers.

There is some judicial authority which would support the view that an isolated and private note is not a security at the time of its issuance.[195] On the other hand, it must be remembered that the term "note" is one of the specific predicaments of the definition provisions,[196] and, as already observed, some courts show a marked tendency to make literal coverage determinative on the issue of "security" status.[197]

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[192] Farrell v. United States, 321 F.2d 409 (9th Cir. 1963), *cert. denied*, 375 U.S. 992 (1964); Op. Cal. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70239 (Aug. 25, 1954); Op. Mich. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70360 (Oct. 29, 1957).

[193] Llanos v. United States, 206 F.2d 852 (9th Cir. 1953), *cert. denied*, 346 U.S. 923 (1954); SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961); United States v. Monjar, 47 F. Supp. 421 (D. Del. 1942), *aff'd*, 147 F.2d 916 (3d Cir. 1944).

[194] People v. Leach, 290 Pac. 131 (Cal. Dist. Ct. App. 1930), *appeal dismissed*, 283 U.S. 808 (1931); State v. Davis, 131 N.W.2d 730 (N.D. 1964).

[195] *Cf.* Cecil B. DeMille Prods., Inc. v. Woolery, 61 F.2d 45 (9th Cir. 1932); People v. Davenport, 13 Cal. 2d 681, 91 P.2d 892 (1939); Nicholl v. Ipsen, 278 P.2d 927 (Cal. Ct. App. 1955); People v. Leach, *supra* note 194 (dictum). In California, there is an exemption for notes not offered to the public. CAL. CORP. CODE § 25102(c). Nonetheless, the language of the cases seems to go beyond the exemption and to imply that private and isolated loan and purchase money notes are not really securities at all.

[196] Recall, however, that the definition section of the Exchange Act excludes certain "notes." Exchange Act § 3(a)(10), 48 Stat. 884 (1934), 15 U.S.C. § 78c(a)(10) (1964).

[197] See authorities cited notes 169, 179 *supra*. In a rather elliptically written opinion, the district of Hawaii has come as close as any court to holding that a private and isolated note is a security. See Whitlow & Associates v. Intermountain Brokers, Inc., CCH FED. SEC. L. REP. ¶ 91800 (D. Hawaii, March 25, 1966) (Transfer Binder 1964-1966). The ultra-literal approach is dominant, with no discussion of the possible distinctions arising from the fact that only one note was involved and was to be issued to a buyer who appeared to be fully informed and financially sophisticated.

In the absence of facts supporting a finding of "joint control,"[198] recent opinions evidence a willingness to classify limited partnership interests as securities,[199] even when the offerings seem rather isolated and private.[200]

(4) Summary.—Unless the buyer actively participates in the control of the issuer's activities, it seems that there is virtually no statutory support for,[201] and only slim judicial recognition of, the view that notes and limited partnership interests should be excluded from the "security" category simply because they are isolated and private transactions.[202] Nonetheless, if it be recognized that the danger of fraud is quantitatively and qualitatively reduced where a transaction is both isolated and private, there is persuasive force in the argument that the application of the special fraud procedures, protections, and remedies of the securities laws should be cut off short of the thousands of transactions which involve only a handful of knowledgeable or sophisticated buyers.

In any event, if it were decided that transactions which are both isolated and private should be excluded from the definition of "security," such a result could be assured only by an amendment of the definition provisions.[203] One result of such an amendment would be to exclude entirely from the coverage of the securities laws some of those transactions which are currently exempted only from registration or administrative approval. A second result would be that the "joint control" exception would be partly subsumed by the definitional exclusion.[204]

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[198] Such a case would be highly unlikely in the context of a true limited partnership, since the passive partners lose their limited liability status if they so much as poke their noses in management's door.

[199] Conroy v. Schultz, 194 A.2d 20 (N.J. Super. Ct. 1963) (public offering).

[200] Op. Nev. Att'y Gen., 3 BLUE SKY L. REP. ¶ 70691 (Nov. 12, 1965) (twenty-four interests).

[201] The words, "unless the context otherwise requires," (*e.g.*, at the beginning of Securities Act § 2, 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b (1964)) seem to be eclipsed by the other inferences to be drawn from the statutory structure.

[202] A recent opinion seems to hold the contrary. Whitlow & Associates v. Intermountain Brokers, Inc., CCH FED. SEC. L. REP. ¶ 91800 (D. Hawaii, March 25, 1966) (Transfer Binder 1964-1966).

[203] The "economic realities" formula could be modified as indicated in note 47 *supra*.

[204] The requirements under the present doctrine would seem to be at least (1) familiarity with the risk enterprise at the time of the alleged security transaction, and (2) the right to actively participate in the management of the enterprise thereafter. Under an "isolated and private" exclusion, familiarity with the enterprise alone would suffice if the transaction were truly isolated, *i.e.*, involved few enough offerees.

III. Conclusion

What is a "security"? This simple question has assumed major proportions in light of the judicial and administrative trend towards including many different types of transactions within the statutory definition. The issue is all the more important in view of the expanding jurisdictional base of the federal statutes and the increased number of statutory remedies being successfully employed by securities purchasers.[205]

The subjection of the buyer's initial value to the risks of an enterprise with which he is not familiar and over which he exercises no control seems to be the "economic reality" which most clearly creates a need for the special fraud procedures, protections, and remedies of the securities laws. There are several manifestations of risk, some of which are difficult to discern, and therefore each transaction must be carefully analyzed to make certain that the risk factor has been accurately appraised.

In general, it is also necessary that the seller be responsible for leading the buyer reasonably to expect some valuable benefits over and above initial investment. Here again, it must be recognized that there are several different species of valuable benefit.

Formulas can only serve as guidelines for reasoning. Accordingly, this article has set forth what is thought to be an accurate shorthand test for identifying a security and a pattern of analysis which should aid the process of isolating each of the "economic realities" of a security.

Once the essential characteristics of a security have been accurately identified and stated in the form of an analytical test, it is only reasonable that such test should be controlling, even where the form of a particular transaction comes within the literal coverage of the definition provisions of the securities laws. If courts do not follow this approach, it should be legislatively adopted by amending the definition provisions.

On balance, there seems to be persuasive merit in the suggestion

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[205] Suppose *S* sells vacuum cleaners at an over-charge and promises to pay the buyers a portion of the profits made on future referral sales. Assume also that such a transaction is held to be a "certificate of interest or participation in [a] profit sharing agreement." See SEC Rule 3a11-1, 17 C.F.R. § 240. 3a11-1 (Supp. 1966). If enough sales are made and the seller has "total assets" exceeding one million dollars, registration of these arrangements under the Exchange Act might be required. See Exchange Act § 12(g), 48 Stat. 892 (1934), as amended, 15 U.S.C. § 78*l*(g) (1964).

that isolated *and* private transactions should be excluded from security classification, even though all the economic realities of a security may be otherwise present. However, the present statutory structure gives rise to a clear inference that the isolated or private nature of a transaction is relevant to the issue of exemption and not to the question of security status. Therefore, if isolated and private transactions are not to be considered securities, amendments will be in order.

Exhibit 11

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somewhat easier to apply than the weighing and balancing of recent decisions of sister circuits."[65]

In 1990 the Supreme Court unanimously adopted a variant of Judge Friendly's family resemblance test in *Reves v. Ernst & Young*,[66] with four justices dissenting only from a separate holding that the commercial paper exemption was available given the facts of the case. The majority opinion stated in part:

> This case presents the question whether certain demand notes issued by the Farmer's Cooperative of Arkansas and Oklahoma are *securities* within the meaning of §3(a)(10) of the Securities Exchange Act of 1934. We conclude that they are.
>
> The Co-Op is an agricultural cooperative that, at the time relevant here, had approximately 23,000 members. In order to raise money to support its general business operations, the Co-Op sold promissory notes payable on demand by the holder. Although the notes were uncollateralized and uninsured, they paid a variable rate of interest that was adjusted monthly to keep it higher than the rate paid by local financial institutions. The Co-Op offered the notes to both members and nonmembers, marketing the scheme as an "Investment Program." Advertisements for the notes, which appeared in each Co-Op newsletter, read in part: "YOUR CO-OP has more than $11,000,000 in assets to stand behind your investments. The Investment is not Federal [*sic*] insured but it is . . . Safe . . . Secure . . . and available when you need it." App. 5 (ellipses in original). Despite these assurances, the Co-Op filed for bankruptcy in 1984. At the time of the filing, over 1,600 people held notes worth a total of $10 million. . . .

[65] Exch. Nat'l Bank v. Touche Ross & Co., 544 F.2d 1126, 1138 (2d Cir. 1976), *cert. denied*, 469 U.S. 884. In *Exchange National Bank*, Judge Friendly then wrote:

> A more desirable solution would be for Congress to change the exclusions to encompass "a note or other evidence of indebtedness issued in mercantile transaction," as is proposed in the ALI's Federal Securities Code, §297(b)(3), and complement this by a grant of power to the SEC to explicate the quoted phrase by rule much as §216A of the ALI Code does with respect to the exemption for commercial paper, see also §301(1).

At the same time, Friendly clearly preferred the *literal* approach "[s]o long as the statutes remain as they have been. . . ." Ibid.; see also Chem. Bank v. Arthur Andersen & Co., 726 F.2d 930, 936–937 (2d Cir. 1984), *cert. denied*, 469 U.S. 884; SEC v. Am. Bd. of Trade, Inc., 751 F.2d 529, 540 (2d Cir. 1984).

[66] 494 U.S. 56 (1990), 29 Duq. L. Rev. 853 (1991), 21 Mem. St. U. L. Rev. 387 (1991), 20 Stetson L. Rev. 613 (1991).

. . . Congress' purpose in enacting the securities laws was to regulate *investments*, in whatever form they are made and by whatever name they are called.

A commitment to an examination of the economic realities of a transaction does not necessarily entail a case-by-case analysis of every instrument, however. Some instruments are obviously within the class Congress intended to regulate because they are by their nature investments. In *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985), we held that an instrument bearing the name "stock" that, among other things, is negotiable, offers the possibility of capital appreciation, and carries the right to dividends contingent on the profits of a business enterprise is plainly within the class of instruments Congress intended the securities laws to cover. *Landreth Timber* does not signify a lack of concern with economic reality; rather, it signals a recognition that stock is, as a practical matter, always an investment if it has the economic characteristics traditionally associated with stock. Even if sparse exceptions to this generalization can be found, the public perception of common stock as the paradigm of a security suggests that stock, in whatever context it is sold, should be treated as within the ambit of the Acts. Id., at 687, 693. . . .

. . . While common stock is the quintessence of a security, *Landreth Timber, supra*, at 693, and investors therefore justifiably assume that a sale of stock is covered by the Securities Acts, the same simply cannot be said of notes, which are used in a variety of settings, not all of which involve investments. Thus, the phrase *any note* should not be interpreted to mean literally *any note*, but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts.

Because the *Landreth Timber* formula cannot sensibly be applied to notes, some other principle must be developed to define the term *note*. A majority of the Courts of Appeals that have considered the issue have adopted, in varying forms, "investment versus commercial" approaches that distinguish, on the basis of all of the circumstances surrounding the transactions, notes issued in an investment context (which are *securities*) from notes issued in a commercial or consumer context (which are not).

The Second Circuit's "family resemblance" approach begins with a presumption that *any* note with a term of more than nine months is a *security*. See, e.g., *Exchange Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126, 1137 (CA2 1976). Recognizing that not all notes are securities, however, the Second Circuit has also devised a list of notes that it has decided are obviously not

securities. Accordingly, the "family resemblance" test permits an issuer to rebut the presumption that a note is a security if it can show that the note in question "bear[s] a strong family resemblance" to an item on the judicially crafted list of exceptions, id., at 1137-1138, or convinces the court to add a new instrument to the list. See, e.g., *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 939 (CA2 1984).

In contrast, the Eighth and District of Columbia Circuits apply the test we created in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), to determine whether an instrument is an *investment contract* to the determination whether an instrument is a *note*. Under this test, a note is a security only if it evidences "(1) an investment; (2) in a common enterprise; (3) with a reasonable expection of profits; (4) to be derived from the entrepreneurial or managerial efforts of others." *Arthur Young & Co. v. Reves*, 856 F.2d at 54. Accord *Baurer v. Planning Group, Inc.*, 215 U.S. App. D.C. 384, 391–393, 669 F.2d 770, 777-779 (1981). See also *Underhill v. Royal*, 769 F.2d 1426, 1431 (CA9 1985) (setting forth what it terms a "risk capital" approach that is virtually identical to the *Howey* test).

We reject the approaches of those courts that have applied the *Howey* test to notes; *Howey* provides a mechanism for determining whether an instrument is an *investment contract*. The demand notes here may well not be *investment contracts*, but that does not mean they are not *notes*. To hold that a *note* is not a *security* unless it meets a test designed for an entirely different variety of instrument "would make the Acts' enumeration of many types of instruments superfluous," *Landreth Timber*, 471 U.S., at 692, and would be inconsistent with Congress' intent to regulate the entire body of instruments sold as investments, see supra, at 3–5.

The other two contenders — the "family resemblance" and "investment versus commercial" tests — are really two ways of formulating the same general approach. Because we think the "family resemblance" test provides a more promising framework for analysis, however, we adopt it. The test begins with the language of the statute; because the Securities Acts define *security* to include *any note*, we begin with a presumption that every note is a security. We nonetheless recognize that this presumption cannot be irrebutable. As we have said, supra, at 3–4, Congress was concerned with regulating the investment market, not with creating a general federal cause of action for fraud. In an attempt to give more content to that dividing line, the Second Circuit has identified a list of instruments commonly denominated *notes* that nonetheless fall without the *security* category. See *Exchange Nat'l Bank*, supra, at 1138 (types of notes

that are not *securities* include "the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized"); *Chemical Bank*, supra, at 939 (adding to list "notes evidencing loans by commercial banks for current operations").

We agree that the items identified by the Second Circuit are not properly viewed as *securities*. More guidance, though, is needed. It is impossible to make any meaningful inquiry into whether an instrument bears a "resemblance" to one of the instruments identified by the Second Circuit without specifying what it is about *those* instruments that makes *them* non-*securities*. Moreover, as the Second Circuit itself has noted, its list is "not graven in stone," ibid., and is therefore capable of expansion. Thus, some standards must be developed for determining when an item should be added to the list.

An examination of the list itself makes clear what those standards should be. In creating its list, the Second Circuit was applying the same factors that this Court has held apply in deciding whether a transaction involves a *security*. First, we examine the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a *security*. If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a "security." See, e.g., *Forman*, 421 U.S., at 851 (share of *stock* carrying a right to subsidized housing not a security because "the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit"). Second, we examine the "plan of distribution" of the instrument, *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 353 (1943), to determine whether it is an instrument in which there is "common trading for speculation or investment," id., at 351. Third, we examine the reasonable expectations of the investing public: The Court will consider instruments to be "securities" on the basis of such public expectations, even where an economic analysis of the circumstances of the particular transaction might suggest that

the instruments are not *securities* as used in that transaction. Compare *Landreth Timber*, 471 U.S., at 687, 693 (relying on public expectations in holding that common stock is always a security) with id., at 697–700 (Stevens, J., dissenting) (arguing that sale of business to a single informed purchaser through stock is not within the purview of the Acts under the economic reality test). See also *Forman*, supra, at 851. Finally, we examine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary. See, e.g., *Marine Bank*, 455 U.S., at 557–559, and n.7.

We conclude, then, that in determining whether an instrument denominated a *note* is a *security*, courts are to apply the version of the "family resemblance" test that we have articulated here: a note is presumed to be a "security," and that presumption may be rebutted only by a showing that the note bears a strong resemblance (in terms of the four factors we have identified) to one of the enumerated categories of instrument. If an instrument is not sufficiently similar to an item on the list, the decision whether another category should be added is to be made by examining the same factors.

Applying the family resemblance approach to this case, we have little difficulty in concluding that the notes at issue here are *securities*. Ernst & Young admits that "a demand note does not closely resemble any of the Second Circuit's family resemblance examples." Brief for Respondent 43. Nor does an examination of the four factors we have identified as being relevant to our inquiry suggest that the demand notes here are not *securities* despite their lack of similarity to any of the enumerated categories. The Co-Op sold the notes in an effort to raise capital for its general business operations, and purchasers bought them in order to earn a profit in the form of interest. Indeed, one of the primary inducements offered purchasers was an interest rate constantly revised to keep it slightly above the rate paid by local banks and savings and loans. From both sides, then, the transaction is most naturally conceived as an investment in a business enterprise rather than as a purely commercial or consumer transaction.

As to the plan of distribution, the Co-Op offered the notes over an extended period to its 23,000 members, as well as to nonmembers, and more than 1,600 people held notes when the Co-Op filed for bankruptcy. To be sure, the notes were not traded on an exchange. They were, however, offered and sold to a broad segment of the public, and that is all we have held to be necessary to establish the requisite "common trading" in an instrument. . . .

The third-factor — the public's reasonable perceptions — also supports a finding that the notes in this case are *securities*. We have consistently identified the fundamental essence of a *security* to be its character as an "investment." See supra, at 4, 7–8. The advertisements for the notes here characterized them as "investments," see supra, at 1, and there were no countervailing factors that would have led a reasonable person to question this characterization. In these circumstances, it would be reasonable for a prospective purchaser to take the Co-Op at its word.

Finally, we find no risk-reducing factor to suggest that these instruments are not in fact securities. The notes are uncollateralized and uninsured. Moreover, unlike the certificates of deposit in *Marine Bank*, supra, at 557–558, which were insured by the Federal Deposit Insurance Corporation and subject to substantial regulation under the federal banking laws, and unlike the pension plan in *Teamsters v. Daniel*, 439 U.S. 551, 569–570 (1979), which was comprehensively regulated under the Employee Retirement Income Security Act of 1974, 88 Stat. 829, 29 U.S.C. §1001 *et seq.*, the notes here would escape federal regulation entirely if the Acts were held not to apply.

The court below found that "[t]he demand nature of the notes is very uncharacteristic of a security," 856 F.2d at 54, on the theory that the virtually instant liquidity associated with demand notes is inconsistent with the risk ordinarily associated with *securities*. This argument is unpersuasive. Common stock traded on a national exchange is the paradigm of a security, and it is as readily convertible into cash as is a demand note. The same is true of publicly traded corporate bonds, debentures, and any number of other instruments that are plainly within the purview of the Acts. The demand feature of a note does permit a holder to eliminate risk quickly by making a demand, but just as with publicly traded stock, the liquidity of the instrument does not eliminate risk all together. Indeed, publicly traded stock is even more readily liquid than are demand notes, in that a demand only eliminates risk when and if payment is made, whereas the sale of a share of stock through a national exchange and the receipt of the proceeds usually occur simultaneously.

We therefore hold that the notes at issue here are within the term *note* in §3(a)(10). Id. at 58–70.[67]

[67] 494 U.S. at 58–70.

The *Reves* opinion is a step forward in its emphatic reaffirmation that each type of financial instrument described in §2(a)(1) is susceptible to a separate analysis that employs separate analytical concepts.[68] The Court was clearly correct in holding that two equity tests, *Howey* and the *risk capital approach*, should not be applied to a debt instrument.

As we had earlier urged, the Second Circuit family resemblance test was preferable because "it does 'adhere more closely to the language of the statutes and it may be somewhat easier to apply than the weighing and balancing of recent decisions of sister circuits.'"[69]

What was troublesome about the Supreme Court's version of the family resemblance test was its guidance concerning the standards underlying the family resemblance list. This type of explanation is potentially as indeterminate as the investment/commercial dichotomy or risk capital test that Judge Friendly intended to replace with his version of the family resemblance test. For example, where the Court lists "the profit the note is expected to generate" as a factor in determining whether a note is a *security*, it then has to define *profit* to mean:

> "a valuable return on an investment," which undoubtedly includes interest. We have, of course, defined "profit" more restrictively in applying the *Howey* test to what are claimed to be "investment contracts." See, e.g., *Forman*, 421 U.S., at 852. "[P]rofit" under the *Howey* test means either "capital appreciation" or "a participation in earnings." To apply this restrictive definition to the determination whether an instrument is a *note* would be to suggest that notes paying a rate of interest not keyed to the earning of the enterprise are not *notes* within the meaning of the Securities Acts. Because the *Howey* test is irrelevant to the issue before us today, see supra, at 7, we decline to extend its definition of "profit" beyond the realm in which that definition applies.[70]

But did the Court simply mean that any interest will be a profit or that something like a market rate or an above-market rate interest

[68] See supra ch. 3.A.1.a.

[69] *Quoting* Judge Friendly's opinion in Exch. Nat'l Bank of Chicago v. Touche Ross & Co., 544 F.2d 1126, 1137–1138 (2d Cir. 1976), *cert. denied*, 469 U.S. 884, supra this chapter.

[70] 494 U.S. at 68 n.4.

rate is a profit? If it meant the former, profit would be relevant only in the unlikely event of an interest-free transaction. If it meant the latter, then we are left with the sometimes tricky issue of how to define "market" rate. *Reves* itself did not answer these questions.

Similarly, the emphasis on the "reasonable expectations" of the public as a factor to define when a note is a security, "even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not 'securities' as used in that transaction," potentially made it more difficult to resolve, as a matter of law, whether new forms of notes are securities, in view of the need to receive factual evidence concerning "reasonable expectations."

In contrast the Court's citation of "the plan of distribution of the instrument" is a factor that deserved far more consideration than a single sentence in the opinion. Presumably the Court did not mean to suggest that a note sold in a public offering generally would not be a security. For, as we recognized, otherwise "we might expect to see all debt instruments termed 'notes.'" On the other hand, in the context of this decision, this factor alone could have been considered decisive in concluding that this note was a security. This note was offered to approximately 23,000 members of the Co-Op as well as nonmembers. At the time the suit was filed, over 1600 people held the notes. An advantage of focusing on the nature of the offering in a case like *Reves* is that this focus obviates the need to consider more subjective evidence such as the motivations that would prompt a reasonable seller and buyer or the reasonable expectations of the investing public.[71]

[71] On remand the Eighth Circuit concluded that the demand notes in the *Reves* case were securities also under Arkansas law. Arthur Young & Co. v. Reves, 937 F.2d 1310, 1324 (8th Cir. 1991).

When a court applies the *Reves* family resemblance test and finds that the evidence is ambiguous as to whether a note is a security, then the note is entitled to a presumption that it is a security. Wong v. Aragona, 815 F. Supp. 889, 895 (D. Md. 1993).

For other judicial applications of the *Reves* criteria, see Holloway v. Peat, Marwick, Mitchell & Co., 900 F.2d 1485 (10th Cir. 1990), *cert. denied sub nom.* KPMG Peat Marwick v. Holloway, 498 U.S. 958; Mercer v. Jaffe, Snider, Raitt & Heuer, P.C., 736 F. Supp. 764, 768–771 (W.D. Mich. 1990), *aff'd without pub. op.*, 933 F.2d 1008 (6th Cir. 1991), *& sub nom.* Schreimer v. Greenburg, 931 F.2d 893 (6th Cir. 1991); Trust Co. of La. v. N.N.P. Inc., 104 F.3d 1478, 1488–1490 (5th Cir. 1997) (notes purportedly secured by a security interest

in GNMAs; court noted that a "debt instrument may be distributed to but one investor, yet still be a security"); Stoiber v. SEC, 161 F.3d 745, 748–752 (D.C. Cir. 1998), *cert. denied*, 526 U.S. 1069 (noting the "open question of whether state law can ever be an adequate substitute under the fourth *Reves* favor"); Great Rivers Coop. of S.E. Iowa v. Farmland Indus., Inc., 198 F.3d 685, 697–701 (8th Cir. 1999) (applying *Howey* instead of *Reves* in assessing capital credits with farm cooperative); SEC v. Better Life Club of Am., Inc., 203 F.3d 54 (D.C. Cir. 1999); Sotereanos v. Passodelis, 1999–2000 Fed. Sec. L. Rep. (CCH) ¶90,730 (3d Cir. 1999); Jeanne Piaubert, S.A. v. Sefrioui, 2000 Fed. Sec. L. Rep. (CCH) ¶90,909 (9th Cir. 2000); Bass v. Janney Montgomery Scott, Inc., 210 F.3d 577, 583–586 (6th Cir. 2000) (bridge loans in anticipation of private placement were not securities, but warrants were, even though they were coupled with the loans); McNabb v. SEC, 298 F.3d 1126, 1130–1133 (9th Cir. 2002); SEC v. Wallenbrock, 313 F.3d 532 (9th Cir. 2002) (notes ostensibly, but not actually, secured by accounts receivable were securities; court noted, among other things, that "a patch-work of state regulation . . . cannot displace the federal regime" as a sufficient risk-reduction factor); United States v. Tucker, 345 F.3d 320, 329 (5th Cir. 2003) (demand note); Rayman v. Peoples Sav. Corp., 735 F. Supp. 842 (N.D. Ill. 1990); Reeder v. Succession of Palmer, 736 F. Supp. 128 (E.D. La. 1990) (postdated checks), *aff'd without pub. op.*, 917 F.2d 560 (5th Cir. 1990); Singer v. Livoti, 741 F. Supp. 1040, 1046–1051 (S.D.N.Y. 1990); Washington v. Sass, 1990–1991 Blue Sky L. Rep. (CCH) ¶73,276 (Wash. Ct. App. 1990) (state law); Varnberg v. Minnick, 760 F. Supp. 315, 324–326 (S.D.N.Y. 1991); Banco Español de Credito v. Sec. Pac. Nat'l Bank, 763 F. Supp. 36, 41–44 (S.D.N.Y. 1991), *aff'd*, 973 F.2d 51 (2d Cir. 1992); Premier Microwave Corp. v. Comtech Telecommunications Corp., 1990-1991 Fed. Sec. L. Rep. (CCH) ¶95,789 (S.D.N.Y. 1991); Gomez v. Leonzo, 788 F. Supp. 604, 606 (D.D.C. 1992) ("Based on current law, the savings passbooks must be considered securities. . . ."); Heine v. Colton, Hartnick, Yamin & Sheresky, 786 F. Supp. 360, 371–372 (S.D.N.Y. 1992) (postdated checks *held* not to be securities when no business or investment underlay defendant's schemes); Prochaska & Assoc., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 798 F. Supp. 1427, 1429–1431 (D. Neb. 1992) (short term notes secured by a lien on a small business or its assets are not securities); Deal v. Asset Mgmt. Group, 1992–1993 Fed. Sec. L. Rep. (CCH) ¶97,244 at 95,089–95,090 (N.D. Ill. 1992) (notes secured by a mortgage on a single family residence *held* to be securities); NBW Comm'l Paper Litig., 813 F. Supp. 7 (D.D.C. 1992); Bradford v. Moench, 809 F. Supp. 1473 (D. Utah 1992) (thrift certificates, savings passbooks, and other industrial loan corporation accounts *held* to be securities), Calozza Litig., 1995 Fed. Sec. L. Rep. (CCH) ¶98,724 (W.D. Wash. 1995); SEC v. Cross Fin. Serv., Inc., 908 F. Supp. 718, 728–729 (C.D. Cal. 1995); Bank of La. v. D & A Funding Corp., 1997 U.S. Dist. LEXIS 16,407 (E.D. La. 1997) (finding no security); LeBrun v. Kuswa, 24 F. Supp. 2d 641 (E.D. La. 1998) (finding no security); SEC v. Current Fin. Serv., Inc., 100 F. Supp. 2d 1,

3–5 (D.D.C. 2000) (subordinated debenture agreements were securities); SEC v. Todt, 1999–2000 Fed. Sec. L. Rep. (CCH) ¶90,770 (S.D.N.Y. 2000), *aff'd*, 7 Fed. Appx. 98 (2d Cir. 2001); Leemon v. Burns, 175 F. Supp. 2d 551, 558–559 (S.D.N.Y. 2001) ("The fact that the Note's original principal could be converted into . . . common stock is a strong factor for holding that the Note is a security."); Roer v. Oxbridge Inc., 198 F. Supp. 2d 212, 222–225 (E.D.N.Y. 2001) (secured notes were securities); Eagle Trim, Inc. v. Eagle-Picher Indus., Inc., 205 F. Supp. 2d 746, 749–753 (E.D. Mich. 2002) (mortgage note issued to finance acquisition of a business not a security); SEC v. Tyler, 2002 U.S. Dist. LEXIS 2952 (Tex. 2002) (fractional shares in viatical settlement agreements); SEC v. Global Telecom Serv. L.L.C., 325 F. Supp. 2d 94, 113–115 (D. Conn. 2004); Conde v. SLS West, LLC, No. 104CV1925JDTTAB, 2005 WL 1661747, at *4-6 (S.D. Ind. July 15, 2005) (note not a security); Robyn Meredith, Inc. v. Levy, 440 F. Supp. 2d 378 (D.N.J. 2006) (note issued to finance sale of a business not a security); Sias v. Herzog, Civil No. 04-3832 (JNE/JSM), 2006 WL 2418950 (D. Minn. Aug. 21, 2006); John P. Goldsworthy, Sec. Ex. Act Rel. 45,926, 77 SEC Dock. 1805, 1808–1809 (2002) (promissory notes were securities); Bradford Homes, Inc., 1997 WL 767437 (SEC No-Action Letter avail. Dec. 11, 1997) (staff position that notes secured by a deed of trust are securities).

See also Fin. Sec. Assurance, Inc. v. Stephens, Inc., 500 F.3d 1276 (11th Cir. 2007), in which the court explained: "We do not disagree that FSA acquired the bonds through operation of the insurance policy. However, although FSA became the *owner* of the bonds, it did not acquire a *security* because, by the [Official Statement's] own terms, FSA acquired no right to receive interest or principal in the bonds after disbursement. Under the [Official Statement], once the bonds or a portion of the bonds were redeemed, the owners of such bonds or portions thereof ceased to be entitled to any benefit or security under the Bond Resolution." Id. at 1286 (citation omitted).

Cf. United States v. McKye, 2013 Fed. Sec. L. Rep. (CCH) ¶97,612 (10th Cir. 2013), where the court reversed a criminal conviction when the District Court instructed the jury that notes were securities rather than asking the jury to determine whether the notes were securities. The court characterized the question whether a note is a security as "a mixed question of fact and law." Id. at 97,573.

In Febles v. S&G Investco Inc., 2009–2010 Fed. Sec. L. Rep. (CCH) ¶95,627 (S.D. Fla. 2010), the court held that an investment of funds, evidenced by a promissory note, was a security when it was alleged that the funds would be managed and invested by defendants in the foreign currency exchange market.

See also SEC v. Novus Tech., LLC, 2010 Fed. Sec. L. Rep. (CCH) ¶95,941 (D. Utah 2010) (holding that promissory notes and joint ventures agreements were securities under *Reves* as well as *Howey*).

In Fox v. Dream Trust, 743 F. Supp. 2d 389 (D.N.J. 2010), a loan participation agreement was held to be a note under *Reves*, even when it was only marketed to plaintiff's family, when "the seller's was interested in both the profit the note is expected to generate, and the underlying investment." Id. at 399. See also Simmons Inv., Inc. v. Conversational Computing Corp., 2011 Fed. Sec. L. Rep. (CCH) ¶96,219 (D. Kan. 2011) (convertible notes were securities).

A note secured by a deed of trust on a home was held not to be a security applying the *Reves* test. Corales v. Flagstar Bank, FSB, 822 F. Supp. 2d 1102, 1111 (W.D. Wash. 2011). Cf. Fragin v. Mezei, 2012–2013 Fed. Sec. L. Rep. (CCH) ¶96,986 (S.D.N.Y. 2012), where the court followed *Reves* and held that trusts' two-year notes were securities.

In Carlucci v. Han, 886 F. Supp. 2d 497, 512–513 (E.D. Va. 2012), the court applied the *Reves* family resemblance test and held notes to be securities after the motivation was to make a profit, the plaintiff was solicited to invest, and the notes were convertible into stock.

In SEC v. Mulholland, 2013 Fed. Sec. L. Rep. (CCH) ¶97,319 (E.D. Mich. 2013), demand notes were securities under the *Reves* test.

In SEC v. Zada, 2013 Fed. Sec. L. Rep. (CCH) ¶97,581 (E.D. Mich. 2013), a note was held to be a security when the promoter's primary motivation was "the profit the note [was] expected to generate" and the notes were offered to a broad range of investors from different states. "[I]t [was] not required that the investments were made on a public exchange." Id. at 97,337.

In Nat'l Bank of Yugoslavia v. Drexel Burnham Lambert, Inc., 768 F. Supp. 1010 (S.D.N.Y. 1991), time deposits representing and placed by Yugoslavia's central bank with an investment banking firm, to be returned within a four month period with interest at a specified rate, and "on the understanding that they would, in turn, be placed in specific, safe investments, rather than used for [the firm's] operating expenses or purchases," did not bear a strong family resemblance to notes evidencing commercial bank loans. Id. at 1015.

In Iacobucci v. Universal Bank of Md., 1991 Fed. Sec. L. Rep. (CCH) ¶96,075 at 90,418 (S.D.N.Y. 1991), cash management accounts opened by individuals to secure credit cards issued to them were held not to be securities. The motivation was to secure the credit cards rather than to obtain a return on their investment.

In Diaz Vicente v. Obenauer, 736 F. Supp. 679 (E.D. Va. 1990), the court rejected as "meritless" the argument that face-to-face negotiations involving the alleged security deprived plaintiffs of the protection of the securities laws.

In Griffin v. Jones, 975 F. Supp. 2d 711, 721–723 (W.D. Ky. 2013), the court followed *Reves* and held under its four factor version of the family resemblance test that a note was a security despite a lack of a plan to distribute the alleged notes to a broad segment of the public.

In Frankfurt v. Mega Entertainment Group II, 2016 Fed. Sec. L. Rep. (CCH) ¶99,111 (S.D.N.Y. 2016), the defendants failed to demonstrate that the promissory notes sold to plaintiff satisfied the four factor *Reves* test. Among other points, the notes were sold to raise money for various projects including a restaurant and banquet hall.

In SEC v. Riel, 282 F. Supp. 3d 499 (N.D.N.Y. 2017), the court also followed *Reves* and held that promissory notes intended to serve as investments were securities even though the offering was "not comparable to publicly traded stocks." Id. at 523. A reasonable investor would have viewed the offer as an investment given a 150 Percent Returns Website. Ibid.

In United States v. Han, 280 F. Supp. 3d 144, 153–54 (D.D.C. 2017), the court declined to resolve at the indictment phase of a criminal trial whether promissory notes constituted a *security*. The court characterized such a resolution as premature.

See also Aubrey v. Barlin, 159 F. Supp. 3d 752 (W.D. Tex. 2016) (finding notes were securities under *Reves* even though the notes were not distributed broadly, focusing on the need for the securities laws to protect investors).

On post-*Reves* blue sky cases generally, see Warren, The Treatment of *Reves Notes* and Other *Securities* Under the State Blue Sky Laws, 47 Bus. Law. 321 (1991); Ascher v. Commonwealth of Virginia, 12 Va. App. 1105, 1108, 408 S.E.2d 906 (1991); Autin v. Martin, 1991–1993 Blue Sky L. Rep. (CCH) ¶73,542 (La. App. 1991) (check kiting scheme); Schwartz v. Oberweis, 826 F. Supp. 280, 285–287 (N.D. Ind. 1993) (following *Reves*); MacCollum v. Perkinson, 913 P.2d 1097 (Ariz. Ct.App. 1996) (promissory note was a security under Arizona Securities Act, following *Reves*); Manns v. Skolnik, 666 N.E.2d 1236 (Ind. Ct. App. 1996) (following *Reves*); Carder v. Burrow, 327 Ark. 545, 940 S.W.2d 429 (Ark. 1997) (secured creditor note held not to be a security under Arkansas law); State v. Friend, 118 Nev. 115, 40 P.3d 436 (2002) (following *Reves*); Battig v. Simon, 237 F. Supp. 2d 1139, 1144 (D. Or. 2001) (following *Reves* under Oregon law); State v. Johnson, 257 Wis. 2d 736, 652 N.W.2d 642 (Ct. App. 2002) (a loan, even if not recorded in a writing, can be a note following *Reves*); Tanner v. State Corp. Comm'n, 265 Va. 148, 574 S.E.2d 525 (2003) (notes held to be securities). See also 1 Blue Sky L. Rep. (CCH) ¶1691 (promissory notes as securities under state blue sky laws); Mac-Ritchie, Is a Note a *Security*? Current Tests Under State Law, 46 S.D. L. Rev. 369 (2001).

See generally Kerr & Eisenhauer, *Reves* Revisited, 19 Pepp. L. Rev. 1123 (1992); Note, Even after *Reves*, Securities Do Not Have Families: Returning to Economic and Legal Realities Through a Connotative Definition of a Security, 1992 U. Ill. L. Rev. 249.

In SEC v. Thompson, 732 F.3d 1151, 1160 (10th Cir. 2013), the court viewed determination of whether a debt instrument was a security under the family-resemblance test as a question of law, not fact (citing cases). Here the court determined that each of the four *Reves* factors was satisfied. Id. at 1161–1170.

In a civil suit, determination of whether a note is a *security* under the family resemblance test has both factual and legal components. Nonetheless, courts have determined that whether a note is a security is for the court to make as a matter of law. Chao Xia Zhang v. Layer Saver LLC, 84 F. Supp. 3d 757, 763 (N.D. Ill. 2015) (finding that the note was not a security as a matter of law), citing SEC v. Thompson, 732 F.3d 1151, 1160–1161) (10th Cir. 2013)).

Cf. United States v. McKye, 734 F.3d 1104 (10th Cir. 2013), *cert. denied*, 136 S. Ct. 2522, where the court reversed a criminal conviction when the District Court instructed the jury that notes were securities rather than asking the jury to determine whether the notes were securities. The court characterized the question whether a note is a security as "a mixed question of fact and law." Id. at 1109.

In SEC v. Zada, 2013 Fed. Sec. L. Rep. (CCH) ¶97,581 (E.D. Mich. 2013), *aff'd*, 787 F.3d 375 (6th Cir. 2015), a note was held to be a security when the promoter's primary motivation was "the profit the note [was] expected to generate" and the notes were offered to a broad range of investors from different states. "[I]t [was] not required that the investments were made on a public exchange." Id. at 97,337. On appeal, the defendant in SEC v. Zada, 787 F.3d 375 (6th Cir. 2015), was unable to satisfy the family resemblance test when the sale of fraudulent notes by a man who falsely claimed to be related to Saudi royalty satisfied none of the *Reves* factors.

In Matthews v. Stolier, 207 F. Supp. 3d 678 (E.D. La. 2016), the court held that a $1.2 million note with a maximum term of ten years, no interest, and a repayment schedule contingent on the profitability of the issuer was not a security. The court found that the note was commercial, not investment in nature, not offered to a broad segment of the population, and not advertised as an investment with little investment risk since the note was secured by a lien, stating in part:

> It is beyond dispute that JLTAC's primary purpose in issuing the note was not to raise money for general use; rather it was to finance the acquisition of LSH, an asset owned by WJLT. Even[] viewing the facts as alleged in the Complaint and its amendments in the light most favorable to the Plaintiffs, this transaction appears commercial in nature. The Court also finds important the lack of interest charged on the note. In finding notes to be securities, the Supreme Court in *Reves* noted that the purchasers invested "[i]n order to earn a profit in the form of interest." Here, however, there was no profit associated with the transaction, as the note bore no interest. WJLT's interest in the note was to receive payment, over time, for the sale of its asset.

Id. at 684.

Cf. Dinnen v. Kneen, 2017 Fed. Sec. L. Rep. (CCH) ¶99,882 at 101,742 (D. Colo. 2017), where the court held that contributing funds based on a letter of intent could not constitute a security without analyzing whether this might constitute a note.

Exhibit 12

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3

Definitions

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§ 3.01 Introduction

Since the Act does not differentiate in the text between a defined word or term and a word or term that is not defined, the reader must consult the definition section as the first step in working with the Act. The Uniform Act is the source of most of the definitions, and the Official Comments and Draftsmen's Commentary should be consulted for further explanation. In addition, many of the terms defined in the Act are also defined terms under the federal securities laws and the securities laws of other states. Cases decided under those other laws should be consulted in connection with problems involving definitions under the Act.[1]

Section 401 of the Act, notwithstanding its title, does not contain all the definitions. A number of provisions authorize the administrator to define terms. See, for instance, the Section 401(g) definition of *issuer*, which gives the administrator specific authority "by rule or order to exempt any person from the definition of commodity issuer." This, of course, amounts to a power to define. Also, Section 412(a) authorizes the administrator to define, among other things, "any terms, whether or not used in this act, insofar as the definitions are not inconsistent with this act."[2] The administrator has made use of this authority.[3]

In addition, a number of words critical to proper interpretation of the Act are not defined—for example, *isolated transaction* and *distribution*, which are used in identifying transactional exemptions. *See* chapter 5.

It should be noted that the definitions in Section 401 are qualified by the phrase "unless the context otherwise requires," thus indicating that they need not always be read literally. This qualification has been of importance in cases involving the definition of *security*, some of which

For guidance in determining when an offer or sale is deemed to take place in Michigan (and thus be subject to the Act), see Section 414 discussed in § 3.14 in connection with the definition of *state*.

§ 3.12 The Federal Securities Acts—Section 401(k)

Section 401(k) identifies the various federal securities and related acts—the 1933 Act, the 1934 Act, the Public Utility Holding Company Act of 1935, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Investor Protection Act of 1970, the Commodity Futures Trading Commission Act of 1974, and the Small Business Investment Act of 1958. Except for its reference to the Commodity Futures Trading Commission Act of 1974 and the Small Business Investment Act of 1958, the definition is identical to the one in the Uniform Act. It is worth noting that it refers to these acts "as amended before or after the effective date" of the 1964 Act. These federal statutes are referred to principally as a means of indicating a status or state of being—for example, the status of a registration statement that became effective under the 1933 Act or of a broker-dealer who was the subject of an order of a securities association that was registered under the 1934 Act. The definitions of *commodity* in the Commodity Futures Trading Commission Act of 1974, as it may be amended in the future, are incorporated in the Act under the definition of *commodity*.

§ 3.13 Security—Section 401(*l*)

A. The Definition

The definition of *security* as set forth in Section 401(*l*) is central to the Act; unless a transaction involves a security or a commodity contract, the Act does not apply.[51] Real estate,[52] commodities,[53] mines,[54] and miscellaneous investment interests in plants or animals can be securities, as can interests in employee benefit plans[55] or franchises.[56]

Among the specific items that constitute securities are certain types of oil, gas, and mining interests, as specified in the definition.[57]

A transaction that obviously involves a security (for example, the issuance of a bond) may include another, less obvious security (for example, the guarantee of the bond by a person other than the issuer),[58] which must also be considered when available exemptions and the need for registration are analyzed. In almost any business transaction, the practitioner would be well advised to consider whether a security is involved and, if so, what provisions of the Act are applicable.

Until the 1978 Amendments, the Michigan definition was virtually identical to the one in the Uniform Act.[59] Amendments gave the administrator authority to exclude transactions or agreements from the definition[60]

and added the risk capital concept contained in the second sentence.[61] With those exceptions (and the other minor ones discussed in the Official Comments and Draftsmen's Commentary to Section 401(*l*) of the Uniform Act),[62] the Michigan definition of *security* is substantially the same as the definition in Section 2(1) of the 1933 Act. The numerous cases decided under the federal law are useful in construing the Act.[63]

Most of the items listed in the first sentence of the definition are fairly obviously securities according to the common understanding of the word. However, it should be noted that the introductory language of Section 401 includes the phrase "unless the context otherwise requires" and that form will therefore not control substance. Thus, even when an instrument is called stock, it may be held not to be a security if the established judicial tests are not satisfied.[64] Section 401(*l*) also provides that the administrator may exclude transactions or agreements from the definition.

B. Investment Contracts

Among the items listed in the definition is an investment contract. This is the catchall provision, the concept that has given rise to most of the litigation on the definition of *security*.[65]

There are three tests that have been used to define *investment contract*: the *Howey* test, the risk capital theory, and a combination of those two tests. *SEC v. W. J. Howey Co.*[66] is the leading case on the definition of *investment contract*. In that case, the U.S. Supreme Court held that the sale of a parcel of land in a citrus grove, together with a management contract providing for operation of the parcel and payment of any profits to the investor, was the sale of an investment contract and thus of a security. The widely cited test formulated by the *Howey* Court is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."[67] The test is often divided into three elements: (1) an investment (2) in a common enterprise (3) with an expectation of profits to be realized solely from the efforts of others.[68]

Before the 1978 Amendments, the *Howey* test was the only judicially recognized test for the existence of an investment contract in Michigan.[69] Thus, a sale of diamonds with an agreement to buy them back at any time at the current market price was held not to be the sale of a security since it lacked the common enterprise concept required under *Howey*.[70]

The second test, the so-called risk capital theory, is based on the decision in *Silver Hills Country Club v. Sobieski*,[71] and related cases. In *Silver Hills*, the California Supreme Court held that the sale of memberships in a new country club in order to raise funds for initial development

of the club was a sale of securities under the California Blue Sky Law. The essence of this test is that when an investor provides money to be used as capital that is subjected to the risks of the enterprise, the protection of the securities laws should be available. The federal courts have considered the risk capital test,[72] and it has been adopted in the Ninth Circuit.[73] As discussed below, the risk capital test (in modified form) was made part of the Michigan definition by the 1978 Amendments.[74]

The third test for the existence of an investment contract is a blend of the *Howey* and risk capital theories, which was formulated by Professor Ronald J. Coffey in a well-known article[75] and first applied in the Hawaii Supreme Court case *State v. Hawaii Market Center, Inc.*[76] The test has four elements:

1. The investor furnishes initial value.
2. Some portion of the value is subjected to the risks of the business.
3. The investor is induced to furnish the initial value by the expectation of some benefit over and above the value originally furnished, which results from the operation of the business.
4. The investor has no practical right to control the management decisions of the business.[77]

In essence, this test amounts to the risk capital concept plus the "from the efforts of others" (but not *solely* from their efforts) portion of the *Howey* test. The 1978 Amendments added the substance of the Coffey formulation to the Act.[78]

The second sentence of the Michigan definition, in Clauses (1)–(4), incorporates the test formulated in the Coffey article, with some slight variations, and, in Clause (5), adds a fifth element.[79] In the first element, the Act substitutes the word *capital* for *value* and specifically excludes cases where only services are furnished. The second element is virtually identical to Coffey's. In the third element, the Act is again more specific, providing that the representations must come from an issuer, promoter, or their affiliates (all of which are defined terms discussed elsewhere in this chapter) and that the expected benefit must be "tangible." The Michigan version of the fourth element focuses on the investor's intention to be actively involved in management rather than a contractual right to control the enterprise.[80] Finally, Clause (5) adds the requirement that "a promoter or its affiliates" anticipate, at the time of the investment, that financial gain may be realized as a result. Clause (5) was intended to separate purely social or cooperative ventures from promotional ones.[81] The risk capital concept and its variations, though rarely expressly included in state securities laws,[82] have been accepted by other state courts in construing the term *investment contract*.[83] As a general proposition, the second sen-

tence of the Michigan definition expands the meaning of *security* and that some arrangements that would not have satisfied the "solely from the efforts of others" element of *Howey* will be deemed securities under the Act.

Although few reported Michigan cases construe the definition,[84] it may nevertheless be regarded as having encompassed a wide variety of arrangements, even before the 1978 Amendments. Certain of those flow from the express terms of the definition and others from the investment contract concept, the application of which is illustrated not only by reported Michigan cases but also by the administrator's cease-and-desist proceedings and cases from other jurisdictions with similar statutory definitions.[85]

C. Guaranteed Securities, Notes, and Sales of Stock

Guarantees of other securities are themselves separate securities under the definition. If guaranteed securities are to be registered, the guarantee interests should be registered as well. If a transactional exemption applies to the underlying security, it will usually, though not always, also cover the guarantee. However, when relying on an exemption for a particular type of security, care should be taken to see that the exemption in question (or another exemption) applies to the guarantee.[86]

The definition of *security* expressly includes "any note [or] evidence of indebtedness." A public offering of notes by a corporation, for example, obviously involves the offer and sale of securities. However, an ordinary commercial loan (e.g., from a bank) is generally deemed not to be a sale of a security.[87] Between these extremes, of course, there are many transactions in which the result is not so easy to predict, and an issuer or seller of any note should take the conservative course of at least considering that the note might involve a securities transaction.

The federal definition of security was considered in *Reves v. Ernst & Young*,[88] where the Supreme Court of the United States adopted a version of the "family resemblance" test to find demand notes issued by a farmers cooperative to be securities.[89] Frequently, an exemption from registration will be available,[90] but one should keep in mind both federal and state antifraud provisions when deciding the disclosures to make to the lender or purchaser of the note.[91]

Loan participations may also be securities.[92] The Michigan Court of Appeals in 1990 held that an unusual loan participation was not a security.[93] The court emphasized that in determining when a security is present, the court should look at the substance of the transaction "paying close attention to economic realities."[94] It did not discuss the "family resemblance" test of *Reves*.

During the late 1970s and early 1980s, a line of federal court cases developed holding that selling stock in order to sell an entire business did not involve a sale of securities,[95] but the authorities were divided. The Supreme Court of the United States in *Landreth Timber Co. v. Landreth*[96] and *Gould v. Ruefenacht*[97] rejected the sale-of-business doctrine and held that where an instrument bears the label "stock" and possesses all the characteristics typically associated with stock, a court will not be required to look beyond the character of the instrument to the economic substance of the transaction.[98] The result will be persuasive authority under the Act, and securities fraud claims are now more likely to be asserted in stock acquisition situations. Other terms within the definition of *security* may also be subject to strict construction.

D. Real Estate and Franchises

An interest in real estate may be a security. This is what was involved in the *Howey* case itself, and the result would almost certainly be the same in Michigan under similar facts. In a lengthy 1976 declaratory ruling that analyzed the term *investment contract*, the administrator took the position that vacation time-sharing units were securities.[99]

Real estate ventures, of course, are often structured as partnerships (general or limited) or joint ventures. General partnership interests normally are not securities since general partners usually take an active role in managing a business,[100] and the interests would thus satisfy neither the "solely from the efforts of others" portion of *Howey*, if strictly applied, nor Clause (4) of the Act's risk capital formulation. However, the interest of a passive investor who is a general partner probably is a security.[101] Limited partnership interests necessarily bear the attributes of securities[102] and have been deemed securities under the Act.[103] Joint ventures are similar to general partnerships except that they are formed for a particular transaction instead of a continuing, generalized business.[104]

The administrator has determined in no-action letters that the offer and sale of condominium units together with an optional rental or management agreement does not constitute the offer and sale of a security so long as there is full compliance with other applicable Michigan law.[105] The administrator has issued an opinion letter to the effect that a lease agreement for space in a stable that has not yet been built is a security under both the risk capital and investment contract portions of the definition.[106] The same position applies to leases of retirement cottage units.[107]

Whatever the name given to real estate participation interests, the facts of any given case should be analyzed in light of *Howey* and the Act's risk capital language.[108]

abuse and misinterpretation, having been used by illicit operations to argue that their issuance of notes did not constitute offers or sales of securities. *See* Corporation and Securities Bureau Analysis of House Bill 5624 (1988). The Bureau had previously ruled that the exclusion applied only to the loan of securities. In re First Nat'l Acceptance Corp. (declaratory ruling June 18, 1979); *but see* Ansorge v. Kellogg, 172 Mich. App. 63, 431 N.W.2d. 402 (1988) (issuance of notes held bona fide loan).

46. SEC Release No. 33-929 (July 29, 1936).

47. I.R.C. § 305(b)(1).

48. Letter re Energy Resources Corp., File No. E-8293 (Jan. 5, 1983).

49. Letter re Eastover Corp., File No. E-9664 (May 9, 1984); *see also* Letter re The Home-Stake Royalty Corp. & The Home-Stake Oil & Gas Co., File No. E-8447 (Jan. 27, 1983); Letter re Chemfix Technologies, Inc., File No. E-6434 (Sept. 8, 1981).

50. 11 U.S.C.A. § 101 *et seq.* (1978). Under § 3(a)(7) of the 1933 Act, these are exempt securities. *See* Letter re The Diana Corp., File No. 500738 (Aug. 10, 1992); Letter re Tandon Corp., File No. 500529 (Mar. 14, 1989) (settlement of class actions); Letter re O.F.C. Corp., File No. 500580 (June 29, 1990) (replacement bonds).

51. *See* Loss & Seligman, at 867–1083. A discussion of cases under federal law can be found in Lowenfels & Bromberg, *What Is a Security Under the Federal Securities Laws?*, 56 Albany L. Rev. 473 (1993); Schneider, *The Elusive Definition of a "Security"—1990 Update*, 24 Rev. Sec. & Comm. Reg. 13 (1991) (updating Schneider, *The Elusive Definition of a "Security,"* 14 Rev. Sec. & Comm. Reg. 981 (1981), *Developments in Defining a "Security,"* 16 Rev. Sec. & Comm. Reg. 985 (1983), and *Definition of a "Security"—1983/1984 Update*, 17 Rev. Sec. & Comm. Reg. 851 (1984)). For state developments in the definition of *security*, see Sowards & Hirsch, at ch. 2, and Carpenter & Stevenson, *Blue Sky Litigation*, 44 Bus. Law. 605 (1989).

52. *See* notes 99–108.

53. *See* notes 125–126.

54. *See* note 57.

55. *See* note 38.

56. *See* notes 109–111.

57. Under the former Michigan act, such interests were held to be securities under the facts of People v. Blankenship, 305 Mich. 79, 8 N.W.2d 919 (1943), but not under the facts of Hathaway v. Porter Royalty Pool, Inc., 296 Mich. 90, 295 N.W. 571 (1941).

58. *See* note 86.

59. The Act, in accordance with the option under the Uniform Act, omits the words *a fixed sum of* before the word *money* in the sentence dealing with insurance policies and annuities, thus excluding variable annuities from the definition.

60. At this writing, the administrator has not issued any rules pursuant to this authority.

61. *See* notes 57 and 79–86.

62. The evolution of the definition in the Uniform Act is discussed in Sowards & Hirsch, § 2.01[1].

63. *See* § 415 of the Act; *Dempster*, *supra* note 9 (Act should be construed so as to coordinate with federal law); Dep't of Commerce v. DeBeers Diamond Inv., Ltd., 89 Mich. App. 406, 410, 280 N.W.2d 547, 550 (1979); *Breckenridge*, *supra* note 45; *accord* Sauve v. K.C., Inc., 19 Wash. App. 659, 577 P.2d 599 (1978) (state borrowing federal legislation also borrows federal courts' construction). The federal definition is analyzed in detail in Loss & Seligman, at 869–1083.

64. *See* Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985); *United Hous. Found.*, *infra* note 122; *Hathaway*, *supra* note 57. See also the discussions in § 3.13C of the security versus loan cases. The administrator has used the rationale of *United Housing Foundation* as a basis for no-action letters relating to the common stock of purchasing cooperatives. Letter re Am. Hardware Supply Co., File No. E-9585 (Mar. 19, 1984); Letter re Hardware Wholesalers, Inc., File No. E-9469 (Jan. 24, 1984). It has taken the same position with respect to shares of a mobile home park that merely permitted the owners to live in the park and participate in its management, Letter re Lakeside Ranch Inv. Corp., File No. E-9488 (Feb. 17, 1984), and shares in a farmers market held by vendors, Letter re Farmers Mkt. Assocs. of Toledo, No. 500780 (June 21, 1993). Regarding housing cooperatives, the administrator has stated, "With respect to housing cooperative projects, it has been the Bureau's position that generally the sale of shares in housing cooperatives would constitute the sale of "securities" under Section 401(l). *See* Release No. 1981-2. It has also been the Bureau's position that generally nontransferable shares of capital stock issued by a not-for-profit cooperative corporation where such shares are offered and sold only to members of such corporation, or where the purchase of such shares is necessary and incident to establishing membership in such corporation, would be excluded from the definition of the term 'security' under the following conditions: (1) where no person expects or intends to make a profit directly or indirectly from the organization or establishment of such issuer, any activity associated therewith or from the operation of such issuer, or remuneration, other than a reasonable salary received from such issuer; and (2) where no commission or other

remuneration is paid or given directly or indirectly in connection with the offer and sale of such shares." Securities Division Policy Manual 407.01; *see also* Letter re Ann Arbor Bd. of Realtors, File No. 500564 (Apr. 5, 1991); Letter re Grand Rapids Real Estate Bd., File No. E-7442 (Oct. 14, 1982). The Bureau has issued some § 402(b)(20) exemption orders for stock in a cooperative. See ch. 4 for a discussion of *agent* in connection with apartment sales.

65. For collections of cases on the investment contract concept under state securities laws, see Sowards & Hirsch, § 2.03.

66. 328 U.S. 293 (1946). The *Howey* formulation is not always rigidly followed in federal courts. *See* SEC v. Glenn Turner Enters., 474 F.2d 476 (9th Cir. 1973).

67. 328 U.S. at 301.

68. *See* H. Bloomenthal, Securities and Federal Corporate Law § 2.19 (1975 & Supps. through 1993); Sowards & Hirsch, § 2.03.

69. *DeBeers Diamond Inv., supra* note 63.

70. *Id.* at 412–416, 280 N.W.2d at 550–552.

71. 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961).

72. The Supreme Court has declined to adopt the test but has also refused to repudiate it. *United Hous. Found., infra* note 122.

73. Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc., 583 F.2d 426 (9th Cir. 1978); United Cal. Bank v. THC Fin. Corp., 557 F.2d 1351 (9th Cir. 1977); Great W. Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976). *But see* Hirsch v. duPont, 396 F. Supp. 1214, 1222 (S.D. N.Y. 1975).

74. Before the 1978 Amendments were passed, the administrator applied the risk capital theory in issuing a cease-and-desist order based on the "profit sharing agreement" portion of the definition. In re Vacation Internationale, Ltd., CCH Blue Sky ¶ 71,287.

75. Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. Res. L. Rev. 367, 377 (1967).

76. 52 Haw. 642, 485 P.2d 105 (1971).

77. *Id.* at 649, 485 P.2d at 109.

78. *See* app. C No. 67 in the first edition of this book.

79. This sentence was added by the 1978 Amendments and was based on Professor Coffey's article, note 75. It was intended to accommodate the administrator's desire to apply the risk capital theory in appropriate cases but with the limitations set forth in the article and Clause (5).

80. *Cf.* SEC v. Aqua-Sonic Prods. Corp., 687 F.2d 577 (2d Cir), *cert. denied*, 459 U.S. 1086 (1982) (holding "solely from the efforts of others" portion of *Howey* test was satisfied where investors had no real intention of actively participating in business even though they had right to do so).

81. *See* § 402(a)(8). Interests in a charitable pooled income fund are deemed securities, but no action will be taken if the fund solicits contributions in accordance with SEC Release No. 33-6175 (Jan. 10, 1980). Letter re Sisters of Charity Health Care Found. Pooled Income Fund, File No. 500428 (Nov. 23, 1988); Mich. Dep't of Commerce, Securities Release No. 89-5-S. The exemption for securities of nonprofit issuers is discussed in detail in ch. 5. *See also* app. C No. 67 in the first edition.

82. The risk capital idea is a part of the definition of security in several other states by statute or regulation. See Sowards & Hirsch, § 2.03.

83. *See, e.g.*, Hurst v. Dare To Be Great, Inc., 474 F.2d 483 (9th Cir. 1973) (Oregon law); Hamilton Jewelers v. Department of Corp., 37 Cal. App. 3d 330, 112 Cal. Rptr. 387 (1974); State v. George, 50 Ohio App. 2d 297; 362 N.E.2d 1223 (1975); State ex rel. Healy v. Consumer Business Sys., Inc., 5 Or. App. 294, 482 P.2d 549 (1971); *Sauve*, *supra* note 63.

84. *People v. Blankenship*, *supra* note 57; *Hathaway*, *supra* note 57; Link, Petter & Co. v. Pollie, 241 Mich. 356, 217 N.W. 60 (1928); Rzepka v Michael, 171 Mich. App. 748, 431 N.W.2d 441 (1988); Moffit v. Sederlund, 145 Mich. App. 1, 378 N.W.2d 491 (1985); Prince v. Heritage Oil Co., 109 Mich. App. 189, 311 N.W.2d 741 (1981); People v. Lyons, 93 Mich. App. 35, 285 N.W.2d 788 (1979); *DeBeers Diamond Inv.*, *supra* note 63; *People v. Breckenridge*, *supra* note 45.

85. Section 415 requires the Act to be construed so as to be uniform with the laws of other states and consistent with related federal provisions. *See* note 64.

86. The exemption under § 402(a)(1) for governmental obligations (including revenue bonds) expressly provides that an associated guarantee will be exempt. Similarly, the commercial paper exemption in § 402(a)(9) expressly includes guarantees, subject to certain conditions. The result may be different under other exemptions that do not expressly cover guarantees. *See* ch. 5.

87. Such a conclusion is typically based on an investment contract/*Howey* analysis. *See Sauve*, *supra* note 63. Michigan examples of loan transactions held not to involve the offer or sale of securities are *Ansorge*, *supra* note 45; *People v. Breckenridge*, *supra* note 45; and, by implication, *People v. Lyons*, *supra* note 84. *See also* Elson v. Geiger, 701 F.2d 176 (6th Cir. 1982) (mortgage loan participation not a security under federal law); Union Planters Nat'l Bank v. Commercial Credit Business Loans, Inc., CCH Fed. Sec. ¶ 97,996 (6th Cir. 1981) (commercial loan participation not a security under federal law).

88. 494 U.S. 56 (1990). Based on *Reves*, the Bureau found that land contracts constituted securities and denied a no-action request. Letter re Charles LaHaie, File No. 500666 (June 11, 1991) (land contract sales).

Michigan federal district court cases applying *Reves* are S.E.C. v. Great Lakes Equities Co., CCH Fed. Sec. ¶ 95,685 (E.D. Mich. 1990) (notes issued by broker were securities); Mercer v. Jaffe, Snider, Raitt & Heuer, P.C., 736 F. Supp. 764 (W.D. Mich. 1990) (notes secured by mortgages were securities). It is questionable whether Michigan courts would follow *Ansorge*, *supra* note 48 (notes issued by food processors to cherry growers not securities), in light of the *Reves* analysis. *See* Warren, *The Treatment of "Notes" and Other "Securities" Under the State Blue Sky Laws*, 47 Bus. Law. 321 (1991).

89. The Supreme Court stated that among the notes that would not be securities were "(i) a note delivered in consumer financing; (ii) a note secured by a mortgage on a home; (iii) a short term note secured by a lien on a small business or some of its assets; (iv) a note evidencing a character loan to a bank customer; (v) a short term note secured by an assignment of accounts receivable; (vi) a note which formalizes an open-account debt incurred in the ordinary course of business; and (vii) a note evidencing loans by commercial banks for current operations." 494 U.S. at 65.

90. *See* ch. 5.

91. *See* ch. 10.

92. Loss & Seligman, at 891–892.

93. Noyd v. Claxton, Morgan, Flockhart & Van Liere, 186 Mich. App. 333, 463 N.W.2d 268 (1990).

94. *Id.* at 338.

95. *See, e.g.*, Canfield v. Rapp & Son, Inc., CCH Fed. Sec. ¶ 98,227 (7th Cir. 1981); Chandler v. Kew, Inc., CCH Fed. Sec. ¶ 96,966 (10th Cir. 1977); Golden v. Garafalo, CCH Fed. Sec. ¶ 98,277 (S.D. N.Y. 1981); Reprosystem v. SCM Corp., CCH Fed. Sec. ¶ 98,207 (S.D. N.Y. 1981). This line of cases is analyzed in Seldin, *When Stock Is Not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws*, 37 Bus. Law. 637 (1982).

96. 471 U.S. 681 (1985).

97. 471 U.S. 701 (1985).

98. In *Landreth*, the Supreme Court reiterated the following five attributes of stock originally identified in *United Housing Foundation*: "(i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability; (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value." *Landreth*, 471 U.S. at 686; *United Hous. Found.*, 421 U.S. at 851.

99. In re Vacation Internationale, Ltd., CCH Blue Sky ¶ 71,287 (cease-and-desist order of administrator), *reprinted in* Corp. Fin. & Bus. L. Sec. Newsletter 34 (Sept.–Oct. 1976). No-action positions have been