

THE NEW UNIFORM SECURITIES ACT

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

In early August, the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) adopted the Uniform Securities Act (2002) at its annual meeting.¹ At that time, there were two earlier versions of the Uniform Securities Act in force.

The Uniform Securities Act of 1956 (“1956 Act”) had been adopted at one time or another, in whole or in part, by 37 jurisdictions.² The Revised Uniform Securities Act of 1985 (“RUSA”) had been adopted in only a few States.³ Both Acts have been preempted in part by the National Securities Markets Improvement Act of 1996 (“NSMIA”)⁴ and the Securities Litigation Uniform Standards Act of 1998.⁵

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.⁶

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Let me also personally thank the other members of the Drafting Committee: John Fox Arnold, Henry M. Kittelson, Andrew Richner, Michael Sullivan, Howard Swibel, Lee Yeakel, and particularly Justin Vigdor who served as chair during the last months.

1. New Uniform Securities Act Approved, National Conference of Commissioners on Uniform State Laws, Press Release, August 5, 2002. *See generally* JOEL SELIGMAN, THE NEW UNIFORM SECURITIES ACT (Aspen 2003), which includes the Statute, Official Comments, and Reporter’s Notes. To date the Act has been endorsed by the American Bar Association, the National Association of Securities Dealers, the New York Stock Exchange, the North American Securities Administration Association, and the Securities Industry Association in the Spring of 2003. Missouri, then Oklahoma, became the first states to enact the new Uniform Securities Act.

For up-to-date information on endorsements and adoptions, see <http://www.NCCULS.org>.

2. Unif. Sec. Act 1956 (amended 1958), 7B U.L.A. 509 (1968).

3. Unif. Sec. Act (amended 1988), 7C U.L.A. 1 (2000).

4. *See generally* 1 LOUIS LOSS & JOEL SELIGMAN: SECURITIES REGULATION 60-67 (3d ed. rev. 1998) [hereinafter 1 LOSS & SELIGMAN].

5. Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998).

6. The Act has been organized to follow, in large part, the NCCUSL PROCEDURAL AND

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 the Preface and the Official Comments.

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 given the Committee's goal to seek adoption of the new Uniform Securities Act in all state jurisdictions.

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. Section 203 of the Act also authorizes state administrators 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 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 ("NASAA"), 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.⁷ 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. This effort appears to have succeeded. NCCUSL adopted the Act by a vote of 47-1.

Second, the Committee faced the technical challenge of drafting a new Act that would both achieve the basic goal of uniformity among states, as well as conform with applicable federal laws, all 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.

There are three overarching themes of the New Uniform Securities 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.⁸ 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.

Section 608(c) lists some joint or coordinated efforts which might be

7. See Dennis C. Hensley, *The Development of a Revised Uniform Securities Act*, 40 BUS. LAW. 721 (1985); Dennis C. Hensley, *The Revised Uniform Securities Act—The Debate Continues*, 43 BUS. LAW. 765 (1988); Mark A. Sargent, *Blue Sky Law: RUSA Revisited*, 17 SEC. REG. L.J. 79 (1989); Mark A. Sargent, *Some Thoughts on the Revised Uniform Securities Act*, 14 SEC. REG. L.J. 62 (1986).

8. 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. 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.

I. DEFINITIONS AND OTHER GENERAL PROVISIONS

Definitions in securities laws often perform a pivotal role as scope provisions. In this Act, the definitions of “security,” “federal covered security,” “broker-dealer,” “agent,” “investment adviser,” “federal covered investment adviser,” “investment adviser representative,” “institutional investor,” “bank,” and “depository institution” in particular perform this role.

A. Security

In the parlance of the Drafting Committee, there was an “above the line” and “below the line” dimension to the definition of “security” in Section 102(28). “Above the line,” the definition was identical to the current Section 2(a)(1) of the Securities Act of 1933.¹¹

“Below the line,” five enumerated paragraphs were the products of a long consensus-building process. The term security:

(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;

11. 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, SECURITIES REGULATION 923-1138.19 (3d ed. rev. 1999) [hereinafter, 2 LOSS & SELIGMAN].

The most recent amendments to Section 2(a)(1) of the Securities Act of 1933 were added by the Commodity Futures Modernization Act of 2000, which added or revised language addressing security futures and securities puts, calls, straddles, options, or privileges to the Securities Act. Identical language has been included in Section 102(28) of this Act to harmonize interpretation of the federal and state definition of a “security.” With respect to a security futures product, Section 28(a) of the Securities Exchange Act of 1934, as amended by the Commodity Futures Modernization Act of 2000, further provides: “No provision of 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 LOSS & SELIGMAN, at 979-81.

(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 or limited liability company and an investment in a viatical settlement or similar agreement.

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.¹²

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.¹³

12. *Cf. Thomas v. State*, 65 S.W.3d 38 (Tex. Crim. App. 2001) (Under Texas law, evidence of indebtedness requires a writing).

13. 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.

Section 102(28)(C) includes the exception from RUSA to the 1956 definition for “an interest in a contributory or noncontributory pension or welfare plan subject to the Employee Retirement Income Security Act of 1974.”

The first clause in Section 102(28)(D) is derived from the leading case of *Sec. Exch. Comm’n v. W.J. Howey Co.*,¹⁴ 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. Exch. Comm’n v. Glenn W. Turner Enter., Inc.*¹⁵

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

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 on each state and reflects the philosophy of financial services modernization.

In the view of the North American Securities Administration 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. Exch. Comm’n v. Variable Annuity Life Ins. Co. of Am.*, 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”].

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.”

14. 328 U.S. 293 (1945).

15. 474 F.2d 476, 482 n.7 (9th Cir. 1973).

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.¹⁶

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.¹⁷

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,”¹⁸ 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 settlements and similar agreements, which otherwise satisfy the definition of an investment contract, are securities.¹⁹

B. Federal Covered Security

Section 102(7) defines a “federal covered security” to mean a security that is, or upon completion of a transaction will be, a covered security under Section 18(b) of the Securities Act of 1933 or rules or regulations

16. See generally 2 LOSS & SELIGMAN, *supra* note 11, at 989-97.

17. See, e.g., *Williamson v. Tucker*, 645 F.2d 404, 424 (5th Cir. 1981); see generally 2 LOSS & SELIGMAN, *supra* note 11, at 1019-33.

18. 2 LOSS & SELIGMAN, *supra* note 11, at 1019-31.

19. This is intended to reject the holding of one court that a viatical contract could not be a security. See *Sec. Exch. Comm'n v. Life Partners, Inc.*, 87 F.3d 536 (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 Theresa A. 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* note 11, at 939-40 n.50.

adopted pursuant to Section 18(b). 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 15(A) 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 those prohibitions to four types of “covered securities”:

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

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

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

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

(A) Sections 4(1) (transactions by persons other than an issuer, underwriter or dealer) and 4(3) (dealers after specified periods of time),

but only if the issuer files reports with the Commission under Sections 13 or 15(d) of the Securities Exchange Act;

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

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

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

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

The National Securities Markets Improvement Act, in essence, preempts aspects of the securities registration and reporting processes for specified federal covered securities. The Act does not diminish state authority to investigate and bring enforcement actions generally with respect to securities transactions.²⁰

C. Broker-Dealer

The definition of “broker-dealer” in Section 102(4) generally follows the definition in Section 401(C) of the 1956 Act but replaces a de minimis exclusion from the definition with exemptions in Section 401(b) and replaces the categorical exclusion for “banks” with Section 104(E), which excludes:

[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

20. The states are authorized to require filings of any document filed with the Securities and Exchange Commission (“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.” National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, Section 18(c)(2) (1996). 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.

(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)).

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, but does not include the private placement and de minimis brokerage activities of banks in Sections 3(a)(4)(B)(vii) and (xi). This Act also reaches savings institutions. Under this Act, banks and savings institutions, unless limiting their activities to the specific listed excluded activities, are required to register as broker-dealers.

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

D. Agent

Section 102(2), defining “agent,” in part, follows the 1956 Act definition. The 1956 Act used the term “agent,” while 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 Section 402(b) of this Act.

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.²¹ Section 102(2) is intended to

21. *See, e.g.,* Norwest Bank Hastings v. Clapp, 394 N.W.2d 176, 178 (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. Comm’r of Sec., 1971-1978 Blue Sky L. Rep. (CCH) ¶ 71,348 (May 18, 1977) (unlicensed 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. Thus, the individual would not be a statutory agent under this Act. *See, e.g.,* Baker, Watts & Co. v. Miles & Stockbridge, 620 A.2d 356, 367 (Md. Ct. Spec. 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

include any individual who acts as an agent, whether or not the individual is an employee or independent contractor.²² 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.²³

E. Investment Adviser

The definition of “investment adviser” is in Section 102(15). 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.²⁴

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.²⁵ 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)-(H) are exclusions from the term “investment adviser.” An excluded person can be held liable for fraud in providing investment advice, under Section 502, but would not be subject to the registration and regulatory provisions in Article 4.²⁶

v. Potomac Ins. Co., 858 F.2d 1104 (5th Cir. 1988). 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.

22. *Cf.* Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990) (*en banc*).

23. *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.*, Conn. Nat’l Bank v. Giacomi, 699 A.2d 101, 111-12 (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).

24. 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.

25. *Cf.* Investment Advisers Act of 1940, Investment Advisers Release No. IA-1,092, 39 SEC Docket 494 (Oct. 8, 1987) (similar approach in SEC Interpretative Release).

26. 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.

The exclusion in Section 102(15)(G) is required by the National Securities Markets Improvement

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 [the] clause . . . 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.²⁷

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. Exch. Comm’n*²⁸ 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

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).

27. 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.

28. 472 U.S. 181 (1985).

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.²⁹

Responsive to this language, RUSA rewrote this exclusion in § 101(7)(v) to encompass:

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

Recent experiences 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.³⁰

F. Federal Covered Investment Adviser

The definition in Section 102(6) 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, under the Investment Advisers Act of 1940 Rule 203A-1, required of investment advisers having at least \$30 million of assets under

29. *Id.* at 204.

30. *Cf.* Sec. Exch. Comm’n v. Park, 99 F. Supp. 2d 889, 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”).

management. 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 under state law. This division of labor is intended to eliminate duplicative regulation of investment advisers.

G. Investment Adviser Representative

The definition in Section 102(16) is new. Investment adviser representatives were not required to register under the federal Investment Advisers Act, before or after the National Securities Markets Improvement Act.

Investment adviser representatives have roughly the same relationship to investment advisers that agents have to broker-dealers:

“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.

There is an exclusion in Section 102(16)(B) which parallels the exclusion in Section 102(15)(C) for “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.”

The exclusion in Section 102(16)(C) is necessary to harmonize the new Uniform Securities Act with the federal Investment Advisers Act after NSMIA.

H. Institutional Investor

The lengthy definition of “institutional investor” involved particularly detailed discussions.

Sections 102(11)(A)-(K) are based on Rule 501(a) of the Securities Act of 1933, but do not include the paragraphs of Rule 501(a) that address 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 the \$5 million minimum earlier used in Rule 501(a).

Sections 102(11)(L)-(N) add similar exemptions for federal covered investment advisers acting for their own accounts, qualified institutional investors as defined in Rule 144A(a)(1) of the Securities Act of 1933, other than those defined under Rule 144A(a)(1)(H), and major U.S. institutional investors as defined in Rule 15a-6(b)(4)(i) of the Securities Exchange Act of 1934.

Section 102(11)(O) is meant to reach persons similar to those listed in Sections 102(11)(A)-(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).

Significantly, sales to all institutional investors are exempt transactions under Section 202(13).

I. "Bank" and "Depository Institution"

The definition of "bank" in Section 102(3) is substantively identical to the definition in Section 3(a)(6) of the Securities Exchange Act and among other applications, provides the basis for the exclusion of many bank securities activities from the definition (and registration requirements) of broker-dealer.

The definition of "depository institution" in 102(5) is broader. This term not only includes "bank" but also several other types of depository institutions including savings institutions, trust companies, and credit unions. This definition is of consequence to Section 201(3) which provides exempt security status for securities issued or guaranteed by depository institutions *and* banks, of consequence to the definition of institutional investor in Section 102(11), and of consequence to a related transaction exemption in Section 202(13).

Many other definitions will prove familiar to prior users of the 1956 Act or RUSA.³¹

31. The Act retains the opening "unless the context otherwise requires" phrase as well as the definition of "fraud" in Section 102(9); "guaranteed" in Section 102(10); "issuer" in Section 102(17); "nonissuer transaction or nonissuer distribution" in Section 102(18); "person" in Section 102(20); "sale" in Section 102(26); and "state" in Section 102(31).

Nineteen new definitions were added to define the following terms: "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

Article 1 also includes Section 103, which addresses references to federal statutes, and Section 104, which addresses references to federal agencies. Subsumed in Section 103 is one of the conundrums of uniform *state* law drafting in a federal system. This Section lists the federal statutes subsequently cited in the new Act, then concludes that references to these statutes “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].”

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, non-preemptive provisions of the federal laws where coordination between federal and state securities law is in the public interest.

Section 12(d) of the Uniform Statute and Rule Construction Act, adopted by NCCUSL in 1995, provides as follows: “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 common 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.

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.

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.

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.

II. EXEMPTIONS FROM REGISTRATION OF SECURITIES

Section 201 includes exempt securities, and Section 202 includes exempt transactions. Both exempt securities and exempt transactions are exempt from securities registration, the notice filing requirement of Section 302, and the filing-of-sales literature requirement of 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 before each transaction.

Neither the exempt security nor the transaction exemptions are meant to be mutually exclusive. A security or transaction may qualify for two or more exemptions.³²

With specified exceptions, securities exemptions are either retained or broadened in Article 2. 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.

A. Exempt Securities

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.³³

32. 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.

33. 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)

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 is adopted here as Sections 102(3) and 102(5)), and a common exemption (*see* RUSA Section 401(b)(3)), which is adopted in this subsection.

Banks specified in Section 3(a)(2) of the Securities Act of 1933 issue federal covered securities under Section 18(b)(4)(C) of the Securities Act of 1933. Section 201(3)(C) applies to securities issued by depository institutions without depository insurance. Under Section 204, the administrators 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.

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 the Securities 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.

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.”³⁴

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

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

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

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

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

34. See Section 102(7). See *Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101 (2d Cir. 2001).

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 before the development of standardized options markets.³⁵

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

Securities issued under Section 3(a)(4) are not treated as federal covered securities in Section 18(b)(4)(C), although a separate Section 3(a)(13) exemption provides that certain church plan securities can be 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) “[i]f at least ten days before a sale of the security the person has filed with the [Administrator] a notice setting forth the material terms of the proposed sale and copies of any sales and advertising literature to be used and the [Administrator] by order does not disallow the exemption within the next five full business days.”

This exemption is of particular concern to state securities administrators.³⁶

Under Section 6 of the Philanthropy Protection Act, Congress preempted application of the registration provisions of state securities laws to the issuance of securities covered by Section 3(C)(10) of the Investment

35. 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).

36. *See, e.g., State Regulators Announce Dramatic Rise in Religious Scams; Tens of Thousands Lured*, 33 Sec. Reg. & L. Rep. (BNA) 1189 (2001).

Company Act of 1940, unless states acted within three years of enactment (December 1998) to pass special state legislation canceling 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, such as local church bond offerings, national church bond offerings, church extension funds, and 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.³⁷

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.³⁸

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 as follows:

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

37. See Timothy L. Horner & Hugh H. Makens, *Securities Regulation of Fundraising Activities of Religious and Other Nonprofit Organizations*, 27 STETSON L. REV. 473 (1997).

38. The 1956 Act Section 402(a)(12) had instead provided: “insert any desired exemption for cooperatives.” The Reporter of the 1956 Act had found such sharp variation among the 18 states that then had adopted a cooperative exemption that “no common pattern can be found.” LOUIS LOSS, COMMENTARY ON THE UNIFORM SECURITIES ACT 118 (1976).

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.

B. Exempt Transactions

Sections 202(1)-(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)-(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).

1. 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 is left to the states to develop. Historically, under state law, there has been somewhat varied case law development of the term “isolated transactions.”³⁹

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, or merely too frequent to be considered “isolated” under the relevant state law.⁴⁰

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

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

39. 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 not to exceed four persons solicited in a 12-month period); *Nelson v. State*, 355 P.2d 413, 420 (Okla. Crim. App. 1960) (“[a]n ‘isolated sale’ means one standing alone, disconnected from any other”); see generally 1 LOSS & SELIGMAN, *supra* note 4, at 125-30.

40. See 2 LOSS & SELIGMAN, *supra* note 11, at 1138.50-1138.52.

securities industry. This Section generally follows the NASAA amendment.

3. 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.

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

5. 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 1934.⁴¹ Nationally recognized statistical rating organizations have been identified by the Securities and Exchange Commission and include such organizations as Moody's or Standard and Poor. Rating categories typically begin with AAA and under this Act would include BBB as the fourth highest rating category.

Section 202(5)(B) follows the 1956 Act and RUSA, but also addresses blank check and similar offerings, which became major concerns at the state and federal levels during the past two decades.⁴²

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

6. Section 202(6): Unsolicited brokerage transactions: Prior Provisions: 1956 Act Section 402(b)(3); RUSA Section 402(5). Section 18(b)(4)(B) of the Securities Act of 1933 defines transactions as federal covered securities when they are subject to Section 4(4) of the Securities Act of 1933, "brokers' 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 an exemption for nonagency transactions by dealers not within the scope of Section 4(4).⁴³

7. 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.

8. 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.

9. 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.

10. Section 202(10): Underwriter transactions: Prior Provisions: 1956

41. See 2 LOSS & SELIGMAN, *supra* note 11, at 649-53.

42. Cf. 17 C.F.R. § 230.419 (2003).

43. 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 sale 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).

Act Section 402(b)(4); RUSA Section 402(6). This subsection is substantively identical to the 1956 Act and RUSA.

11. 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.

12. 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.

13. 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).

14. Section 202(14): Limited offering transactions: Prior Provisions: 1956 Act Section 402(b)(9); RUSA Section 402(11). 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)). Under the 1956 Act, 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). Furthermore, RUSA prohibited any 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 SEC 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 subparagraph does not prohibit a capital 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, coordinated to varying degrees with Regulation D. The authority to adopt this and other exemptive rules is provided in Section 203.

15. 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 Section 18(a) of the Securities Act of 1933. Otherwise, this exemption is substantively identical to the 1956 Act and RUSA.

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

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

17. 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 Provision: RUSA Section 402(16). A solicitation of interest document must accompany a registration by qualification as specified in Section 304(b)(13). Oral offers may be made after a registration statement has been filed, both before and after a registration statement is effective. This exemption does not operate unless the administrator adopts a rule under 202(17)(B).

18. 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 be registered under the Securities Act of 1933. In 1972, the SEC adopted Rule 145, which defined

many mergers and similar transactions to be sales and abandoned its earlier “no sale” doctrine.⁴⁴

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.

19. Section 202(19): Rescission offers: No Prior Provision. Section 202(19) is a new provision that addresses rescission offers.

20. Section 202(20): Out-of-state offers or sales: Source of Law: Colo. Section 11-51-102(7). In *A. S. Goldmen & Co., Inc. v. New Jersey Bureau of Securities*,⁴⁵ the court 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. This subsection, in contrast, provides an exempt transaction for:

[A]n 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].

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 regulation and does not address an administrator’s power to investigate and bring enforcement actions under Articles 5 and 6.

21. 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.

44. See 3 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1262-80 (3d ed. rev. 1999).

45. 163 F.3d 780 (3d Cir. 1999).

In 1979, the United States Supreme Court, in *International Brotherhood of Teamsters v. Daniel*,⁴⁶ held that a noncontributory, mandatory pension plan subject to the Employee Retirement Income Security Act of 1974 was not a security within the meaning of the Securities Act of 1933 or the Securities Exchange Act of 1934. The Securities and Exchange Commission staff subsequently took the position that the interests of employees in involuntary, contributory plans are not securities.⁴⁷ Both contributory and noncontributory pension or welfare plans subject to ERISA are excluded from the definition of security in Section 102(28).

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

22. Section 202(22): Specified dividends and tender offers and judicially recognized reorganizations: Prior Provisions: 1956 Act Section 401(j)(6)(B) and (D); RUSA Section 101(13)(vi). Sections 202(22)(A)-(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.

23. Section 202(23): Nonissuer transactions involving specified foreign issuer securities traded on designated securities exchanges: No Prior Provision. This exemption expressly covers Toronto Stock Exchange issuers that are public reporting issuers under Canadian securities law and

46. 439 U.S. 551 (1979).

47. Employee Benefit Plans, Securities Act Release No. 33-6,188, 19 SEC Docket 465, 473 (Feb. 1, 1980).

meet the 180 day continuous reporting requirement. In conformance with the North American Free Trade Agreement and General Agreement on Trade in Services, 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.

C. Additional Exemptions and Waivers

1. Under the type of exemption in Section 203, 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 the ULOE or Rule 144A exemptions because of their complexity and the likelihood of periodic updating of the provisions. Rule 144A, and similar exemptions in ULOE, can be most effectively implemented by rule rather than statute.⁴⁸

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.

D. Denial, Suspension, Revocation, Condition, or Limitation of Exemptions

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.

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.⁴⁹

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

49. *See, e.g., Johnson-Bowles Co., Inc. v. Div. of Sec.*, 829 P.2d 101 (Utah Ct. App. 1992).

III. REGISTRATION OF SECURITIES AND NOTICE FILING OF FEDERAL COVERED SECURITIES

Relatively modest changes were made to Article 3, which concerns registration of securities.⁵⁰ 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 Sections 306(d)-(f).

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

[T]he 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.

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."⁵¹ A new Section 306(b) provides: "To the

50. 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.

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 SEC and the states, which would be 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 EDGAR system or otherwise. Section 304 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.

Section 305, governing securities registration filings, 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.

51. As of September 2002, 47 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

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).” Notice will address one criticism of merit regulation. Statements of Policy of NASAA that have been adopted by a state would provide notice in compliance with Section 306(b). Similarly, other state rules or orders could be adopted in the future to address new types of securities as they occur.

An order under Section 306(b) can be adopted after a securities registration statement has been filed. Under Section 306(b), an administrator, by rule or order, for example, could adopt a standard that would provide the basis for a stop order denying effectiveness to a development state company that has no specific business purpose or plan 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, which was adopted under the Securities Act of 1933.

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

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 similarly 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)), which have been earlier discussed. NSMIA led also to the new federal covered investment adviser notice filing procedure in Section 405.

Sections 401, 402, 403, and 404, respectively, address the registration requirements and exemptions of broker-dealers, agents, investment advisers, and investment adviser representatives.

Section 401(b)(1) broadly exempts:

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”). See I LOSS & SELIGMAN, *supra* note 4, at 79-81.

[A] broker-dealer without a place of business in this State if its only transactions effected in this State are with:

- (A) the issuer of the securities involved in the transactions;
- (B) a broker-dealer registered 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].⁵²

Collectively, these exemptions in Section 401(b) expand the range of activity in which a broker-dealer can engage without registration. 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. Under Section 401(b)(1)(E)-(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”).

Significantly, Section 401(d) also 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 only effective if the administrator adopts a rule or order. To give effect to action taken by rule or order under Section 401(d), a state also must take concurrent action by rule or order under Section 203 and create 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).

Section 402 concerning agents is similar in structure,⁵³ but has a different pattern of exemptions in Section 402(b):

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

52. Section 401(b)(2) creates a more limited exemption for certain persons that deal solely in United States government securities.

53. 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 category of activity permitted under this Act for securities activities.

(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].

Under Sections 402(b)(3) and (5), an agent may be exempt if acting for an issuer and receiving compensation (for example, to be a corporate

executive), as long as the compensation is not a commission or other remuneration based on transactions in the issuer's own securities. 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, as long as the agent is not being compensated directly or indirectly for participation in the specified securities transactions.

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 his or her customers.

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

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 under Section 402(a) or exempt from registration under Section 402(b). Registration under Section 402(c) is only effective while an agent is employed by or associated with a broker-dealer or an issuer.

The investment adviser registration requirement and exemption provision in Section 403 generally parallels Section 401⁵⁴ (broker-dealers), and Section 404 (investment advisers) similarly parallels Section 402 (agents).

Under this Act, a sole practitioner may register as an investment adviser under Section 403. IARD 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 registration.

Section 404(f) is new and permits the following:

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

54. Section 403(b)(2) is consistent with NSMIA, 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.

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.

This subsection provides a limited dispensation for payments to third party solicitors who are registered under this Act.⁵⁵

Section 405 provides a notice filing requirement for federal covered investment advisers. Section 405(b)(1) does not require a federal covered investment adviser without a place of business in a state to make a notice filing if its only clients in the state are in one of the following categories:

- “(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].”

As required by NSMIA, Section 405(b)(2) similarly does not require a federal covered investment adviser to make a notice filing if it has a place of business outside of a state and has had, during the previous 12 months, no more than five clients who are residents in the state in addition to those specified in Section 405(b)(1).⁵⁶

Section 406 is a general provision applicable to broker-dealers, agents, investment advisers, and investment adviser representatives. Section 406 addresses the application for initial registration, amendment, effectiveness of registration, registration renewal, and additional conditions or waivers.

Under Section 406(a), the administrator is authorized to accept

55. The SEC has adopted a rule that addresses referral fees in Rule 206(4)-3 of the Investment Advisers Act of 1940. For those states that intend to extend Section 404(f) to those broker-dealers and investment advisers who are not required to register and those federal covered investment advisers not required to file a notice, this subsection should read:

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 if not required to register under this [Act], a federal covered investment adviser 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.

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

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 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.

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.

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 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, when there has been a change of control of a broker-dealer or investment adviser.

Section 408 is a particularly consequential provision concerning termination and transfer of employment or association of agents and investment adviser representatives.

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

To expedite transfer to a new broker-dealer or investment adviser, Section 408(b) provides a procedure by which agent 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 Web-CRD or IARD 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.

In effect, Section 408 represents a Faustian bargain. Section 408(b) provides for immediate, if temporary, effectiveness⁵⁷ of an agent's or

57. Whether a transfer is immediate or only temporarily effective turns on whether an agent's

investment adviser representative's registration when a transfer occurs. This automatic process was eagerly sought by the securities industry. In agreeing to this provision, the securities regulators bargained for Section 408(d), which provides: "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."

In contrast, Section 408(e) continues a time honored registration cancellation, termination, or denial provision for registrants or applicants no longer in existence, the subject of an adjudication of incapacity, or subject to the control of a committee, conservator, or guardian, or who cannot reasonably be located.

Similarly, Section 409 is a generic withdrawal of registration provision applicable to broker-dealers, agents, investment advisers, or investment adviser representatives.

Section 409 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. Today, a registrant will ordinarily file a standardized form such as Form U-5, BD-W, or ADV-W to withdraw registration.

Section 410 addresses filing fees. This Act is intended, to the extent practicable, to be revenue neutral in its impact on existing laws. Accordingly, each state should determine the appropriate fees for each type of registration and for each type of renewal, denial, or withdrawal of a registration.⁵⁸

Sections 411(a)-(c) and (e)-(f) implicitly refer to "capital, custody, margin, financial responsibility, making and keeping records, bonding, or financial or operational reporting requirements." Under NSMIA, 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 1940.⁵⁹

Web-CRD record or an investment adviser representative's IARD record contains a disciplinary disclosure within the preceding 12 months.

58. 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 or remove Section 410(g) from applicability in their state.

59. 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., In re Ridgeway, McLeod & Assoc.*, 281 A.2d 390 (N.J. Super. Ct. App. Div. 1971) (continuing minimum capital requirement); *Nat'l Grange Mut. Ins. Co. v. Prioleau*, 236 S.E.2d 808 (S.C. 1977) (continuing bond requirement).

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.⁶⁰

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

Section 411(d) is intended to be a broad authorization of the administrator's powers to conduct reasonable periodic, special, or other audits or inspections "at any time or without prior notice."

The administrator's power to copy and examine records in Section 411(d) is subject to all applicable privileges.⁶¹ 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.

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

Section 411(h) is a new authorization for a rule or order to require agents or investment adviser representatives to participate in continuing education.

Section 412 is a generic disciplinary provision which amplifies 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. 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

60. *Cf.* Safe Harbor Rule for Projections, Securities Act Release No. 33-6,084, 17 SEC Docket 1048, 1054 (June 25, 1979) ("persons are continuing to rely on all or any material portion of the statements"); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 444-50 (1976).

61. *See, e.g.*, 10 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4921-25 n.69 (3d ed. rev. 1996) [hereinafter 10 LOSS & SELIGMAN].

denial, revocation, suspension, cancellation, withdrawal, restriction, condition, or limitation both (1) is in the public interest and (2) involves one of the enumerated grounds in Section 412(d).⁶²

As restructured, Sections 412(a)-(c) separately delineate disciplinary conditions for (a) applicants and (b) registrants as well as (c) disciplinary penalties for registrants. Section 412 includes 14 grounds for discipline in Section 412(d).

Sections 412(a)-(c) authorize 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(b), “any partner, officer, director, or any person having a similar status or performing similar functions” can include a branch manager, assistant branch manager, or other supervisor.

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.

There is no time limit or statute of limitations on felony convictions in Section 412(d)(3) as a ground for disciplinary action.

The present tense of the verb “is” in Sections 412(d)(4)-(6) and (12) means that an injunction, order, adjudication, or determination that has expired or been vacated is no longer a ground for discipline.

62. *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 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 3056-57 (3d ed. 1990) [hereinafter 6 LOSS & SELIGMAN] (under federal securities laws). The public interest will not require imposition of a sanction for every minor or technical violation of subsection (d).

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.

Under Section 412(d)(7), the administrator may not proceed against a broker-dealer or investment advisory firm on the basis of the insolvency of a partner, officer, director, controlling person, or other person specified in subsection (b), unless it is a sole proprietorship.

Section 412(d)(8) can be violated by a refusal to cooperate with an administrator's reasonable audit or inspection, including 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).

The term "failed to supervise reasonably" in Section 412(d)(9) is intended both to require reasonable supervisory procedures to be in place as well as a proper system of supervision and internal control.⁶³

The term "dishonest and unethical practices" in Section 412(d)(13) has been held not to be unconstitutionally vague.⁶⁴ 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.

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.

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

63. *Cf.* Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990). Section 15(b)(4)(E) of the Securities Exchange Act of 1934 similarly addresses "failure to supervise reasonably." *See* 6 LOSS & SELIGMAN, *supra* note 62, at 3097-4001.

64. *See, e.g.*, Brewster v. Maryland Sec. Comm'r, 548 A.2d 157, 160 (Md. 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., Inc., 829 P.2d 101, 114 (Utah 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).

for more than one year if there are additional material facts which are actually known to the administrator within the last year.⁶⁵

V. FRAUD AND LIABILITIES

Article 5 on fraud and liabilities and the definition of fraud in Section 102(9) are almost totally unaltered. Article 5 includes the general fraud provision in Section 501,⁶⁶ 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 burdens in Section 503⁶⁷ and the criminal

65. "Actually known" in Section 412(i) is used to signify that the mere filing of material facts in the Web-CRD or IARD 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.

66. Section 501, which was Section 101 in the 1956 Act, was modeled after Rule 10b-5, which was 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).

There are no exemptions from Section 501. 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 include a rescission offer under Section 510. 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 broker-dealer, agent, investment adviser, or investment adviser representative registration under Section 412; criminal prosecution under Section 508; civil enforcement proceedings under Section 603; and administrative proceedings under Section 604.

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.

The culpability required to be pled or proven 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.

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.

67. 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.

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. Shott v. Tehan*, 365 F.2d 191, 195 (6th Cir. 1966) (Ohio blue sky law constitutionally shifts burden of production to defendant); *State v. Andresen*, 773 A.2d 328 (Conn. 2001) (an exemption from registration is an affirmative defense to the charge of selling unregistered securities); *Commonwealth v. David*, 309 N.E.2d 484, 488 (Mass. 1974) (exemption is an affirmative defense); *State v. Frost*, 387 N.E.2d 235, 239 (Ohio 1979) (it is not unconstitutional to require the burden of proof as an affirmative defense to prove a securities law exemption).

penalties in Section 508.⁶⁸

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.⁶⁹ 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 502(a) applies to any person who commits fraud in providing investment advice. Section 502(b) is not limited to persons registered as investment advisers or investment adviser representatives. A person can

68. 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.

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.

The definition of willfulness in Section 508 has been followed by most courts. *See, e.g.*, *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. 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. 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. Dumke*, 901 S.W.2d 100, 102 (Mo. Ct. App. 1995) (*mens rea* not required); *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); *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. 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. 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).

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 for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.” The “no knowledge” clause in Section 508(a) is only relevant to sentencing. The person convicted has the burden of persuasion to prove no knowledge at sentencing. Because this does not impose a burden on the defendant to disprove the elements of a crime, Section 32(a) of the Securities Exchange Act of 1934 has been held not to raise a constitutional problem. *United States v. Mandel*, 296 F. Supp. 1038, 1040 (S.D.N.Y. 1969).

Under Section 508(b), the appropriate state prosecutor 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.

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 of imprisonment.

69. 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 NSMIA.

violate both Section 501 and Section 502 if the person violates Section 502 in connection with the offer, purchase, or sale of a security.

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).

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 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,⁷⁰ 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.⁷¹

70. 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.,* *Andrews v. Prudential Sec., Inc.*, 160 F.3d 304 (6th Cir. 1998); *Glennon v. Dean Witter Reynolds Inc.*, 83 F.3d 132 (6th Cir. 1996); *Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704 (7th Cir. 1994); *Prudential Sec., Inc. v. Dalton*, 929 F. Supp. 1411 (N.D. Okla. 1996); *Eaton Vance Distrib., Inc. v. Ulrich*, 692 So.2d 915 (Fla. Dist. Ct. App. 1997). *See generally* *Acciardo v. Millennium Sec. Corp.*, 83 F. Supp.2d 413 (S.D.N.Y. 2000) (discussing both New York qualified and absolute immunity cases); Anne H. Wright, *Form U-5 Defamation*, 52 WASH. & LEE L. REV. 1299 (1995).

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 LOSS & SELIGMAN, *supra* note 61, at 4818-21.

71. In 1994, the Securities and Exchange Commission Division of Market Regulation published *The Large Firm Project: A Review of Hiring, Retention and Supervisory Practices*, cited in F. Sec. L. Rep. (CCM) ¶85,348 (May 1994), which found that a small number of “rogue brokers” were

More thought was devoted to civil liability under Section 509 than any other provision. As ultimately drafted, much in this Section is the same as its counterpart in 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)).⁷²

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 partners with passive investments.⁷³

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).⁷⁴

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).⁷⁵

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).

In 1998, to address this problem the National Association of Securities Dealers proposed qualified immunity for statements made in Forms U-4 and U-5. This proposal was reprinted in Self Regulatory Organizations, Securities Exchange Act Release No. 34-39,892, 66 SEC Docket 2473 (April 21, 1998). This proposal was limited to arbitration proceedings. It was not approved by the Securities and Exchange Commission.

72. Sections 509(e)-(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.” Official Comment to 509(e)-(f). Neither provision is intended to limit other state law claims for providing investment advice.

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).

73. *See* 9 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4408-4427 (3d ed. rev. 1992). The measure of damages in Section 509(b)(3) is that contemplated by Section 12 of the Securities Act of 1933. *Id.* at 4242-46. The measure of damages in Section 509(c)(3), however, is that contemplated by Rule 10b-5. *Id.* at 4408-27. 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 to also seek damages.

74. *See Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561 (1995).

75. *See Ritch v. Robinson-Humphrey Co.*, 748 So.2d 861 (Ala. 1999); *Kaufman v. I-Stat Corp.*, 754 A.2d 1188 (N.J. 2000); *Gohler v. Wood*, 919 P.2d 561 (Utah 1996).

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

The control liability provision in Section 509(g)(1) is modeled on that in the 1956 Act.⁷⁶

The defense of lack of knowledge in Sections 509(g) is also modeled on the 1956 Act.⁷⁷

Significant changes were made in Sections 509(j), the statute of limitations provision. Current state law provides a wide range of statutes of limitations. 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(e) 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.⁷⁸

76. On the meaning of “control,” see 4 LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 1707-30 (3d ed. rev. 2000).

77. 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).

State court decisions typically follow analogous federal law in deciding whether a person may be deemed a control person. *See, e.g.*, *Hines v. Data Line Sys., Inc.*, 787 P.2d 8, 13-16 (Wash. 1990).

Washington’s Supreme Court contrasts the defense in Section 509(g)(1)-(2) with the corporate law business judgment rule and “requires affirmative action on the part of a director who wished to avail himself of this defense.” *Id.* at 18. Several jurisdictions have interpreted the provision to Section 509(g) to impose strict liability on partners, officers, and directors unless the statutory defense of lack of knowledge is proven. *See, e.g.*, *Taylor v. Perdition Minerals Group, Ltd.*, 766 P.2d 805, 809 (Kan. 1988), *Hines*, 787 P.2d at 17. The plaintiff obviously does not have to allege a defendant’s scienter to deprive the defendant of the reasonable care defense. *See Currie v. Cayman Res. Corp.*, 595 F. Supp. 1364, 1374 (N.D. Ga. 1984).

Under Section 509(g)(2), an outside director may be held liable without actively participating in any of the illegal transactions. *See Hines*, 787 P.2d at 16-18. The Michigan precursor to Section 509(g)(2) imposes liability on directors of corporations offering securities who know or reasonably should have known of the presence of information that was false and misleading. There was no requirement that the plaintiff prove a specific intent to defraud. *Molecular Tech. Corp. v. Valentine*, 925 F.2d 910, 920 n.7 (6th Cir. 1991).

On the interpretation of “materially aids” in Section 509(g)(3)-(4), see *Quick v. Woody*, 747 S.W.2d 108 (Ark. 1988); *Connecticut Nat’l Bank*, 699 A.2d 101 (Conn. 1997); *State ex rel. Goettsch v. Diacide Distrib., Inc.*, 596 N.W.2d 532 (Iowa 1999). In *Metal Tech Corp. v. Metal Techniques Co., Inc.*, 703 P.2d 237, 245-246 (Or. Ct. App. 1985), the court observed that merely acting as a scrivener or otherwise merely preparing and executing documents would not involve material aid.

78. *See, e.g.*, *Reshal Assoc., Inc. v. Long Grove Trading Co.*, 754 F. Supp. 1226, 1242-43 (N.D. Ill. 1990); *McCullough v. Leede Oil & Gas, Inc.*, 617 F. Supp. 384, 390-91 (W.D. Okla. 1985); *Martin v. Pacific Ins. Co. of N.Y.*, 431 S.W.2d 239, 240 (Ark. 1968); *Norden v. Friedman*, 756 S.W.2d 158, 163 (Mo. 1988) (*en banc*); *Weisz v. Spindletop Oil & Gas Co.*, 664 S.W.2d 423, 425-26 (Tex. App. 1983). But some state statutes expressly provide, or have been construed to provide, for tolling. *See, e.g.*, *Barton v. Peterson*, 733 F. Supp. 1482, 1492-93 (N.D. Ga. 1990); *Platsis v. E.F. Hutton & Co.*,

Before the July 2002 enactment of the Sarbanes-Oxley Act, Rule 10b-5 of the Securities Exchange Act of 1934, as construed by the United States Supreme Court in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*,⁷⁹ prohibited equitable tolling under the federal securities law one year after discovery and three years after the Act formula. The Sarbanes-Oxley Act added 28 U.S.C. §1658(b) which provides, in part, as follows:

[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),⁸⁰ 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).

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.

A rescission offer must meet the specific requirements of Section 510

Inc., 642 F. Supp. 1277, 1305 (W.D. Mich. 1986), *aff'd per curiam*, 829 F.2d 13 (6th Cir. 1987).

79. 501 U.S. 350 (1991). *See generally* 10 LOSS & SELIGMAN, *supra* note 61, at 4505-25.

80. *See, e.g.,* Law v. Medco Research, Inc., 113 F.3d 781 (7th Cir. 1997).

for civil liability under Section 509 to be extinguished.⁸¹

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.

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.

VI. ADMINISTRATION AND JUDICIAL REVIEW

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.⁸² Section 602 addresses investigations and subpoenas. Sections 602(a)-(b) concerning the administrator's power to investigate follow the 1956 Act, which was modeled generally on Sections 21(a)-(d) of the Securities Exchange Act of 1934 as it then read. Standards for issuance of subpoenas have been generally established in federal and state securities law.⁸³ 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

81. *Cf. Binder v. Gordian Sec., Inc.*, 742 F. Supp. 663, 666 (N.D. Ga. 1990). *See generally* Michelle Rowe, *Rescission Offers Under Federal and State Securities Law*, 12 J. CORP. L. 383 (1987).

82. 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.

Section 601(c) makes clear that nothing in the Act alters the availability of evidentiary privileges. That question is left to the general law of the particular state.

83. *See, e.g.*, 10 LOSS & SELIGMAN, *supra* note 61, at 4917-37 (discussing *Oklahoma Press Pub. Co. v. Walling*, 327 U.S. 186 (1946) and other cases).

individual invokes the privilege against self-incrimination, Section 602(d) allows the administrator to apply to the appropriate court to compel testimony under a “use immunity” provision barring the record compelled or other evidence obtained from being used in a criminal case.⁸⁴

The phrase “directly or indirectly” in Section 602(d) is intended to include testimony, other evidence, or other information derived from immunized testimony, statements, records, or evidence.

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.

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.

Where appropriate under Section 602(e), an administrator can move to authorize admission of a requesting state’s attorney under existing *pro hac vice* rules.⁸⁵

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, the opportunity to be heard, and findings of facts and conclusions of law in a written record.

84. See *People v. District Court of Arapahoe County*, 894 P.2d 739 (Colo. 1995).

85. Section 602(f) authorizes assistance to the securities regulator of another jurisdiction and is consistent with the Securities Litigation Uniform Standard Act of 1998, which provides in Section 102(e) as follows:

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.

Official Comment to § 602(f).

Section 603 or 604 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. 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.

Section 605 on rules, forms, orders, interpretative opinions, and hearings has been modestly amplified to take into account the impact of NSMIA on state authority to require financial statements and the modern practice of administrative issuance of interpretative opinions.⁸⁶

Similarly, Section 606 only modestly changes prior administrative file and opinion provisions.

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.⁸⁷

Judicial review of orders, and judicial review of rules in those states that so choose, defers to state administrative procedure acts in Section 609.

86. 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.

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.

87. 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.

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).

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 is discussed at *supra* note 8 and accompanying text.

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.⁸⁸

Section 610 defines the application of the Act to interstate or international transactions when only some of the elements of a violation occur in the 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.

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 or the sale is made in this State.”⁸⁹

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).⁹⁰ The act of State B would also apply 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 persons 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.

88. The Internet raises new jurisdictional issues, as one commentator theorizes, because application of state blue sky laws to securities transactions has traditionally been based on location, that is, the laws of a given state seek to regulate transactions occurring within the state's boundaries. Denis T. Rice, *The Regulatory Response to the New World of Cybersecurities*, 51 ADMIN. L. REV. 901, 930-31 (1999). It is uncertain whether the existing statutory approach will remain adequate: “Despite the additional complexities, existing principles can be used to view e-mail over the Internet as similar to traditional postal mail and phone calls in providing a basis for jurisdiction.” *Id.* at 933. See also *id.* at 944-45; ABA Global Cyberspace Jurisdiction Project, *Achieving Legal & Business Order in Cyberspace: A Report on Global Jurisdiction Issues Created by the Interest*, 55 BUS. LAW. 1801, 1931-37 (2000).

89. Courts have interpreted the precursor to Section 610(a) as applicable if there was a physical nexus between the sale or offer to sell and a specific state. See, e.g., *Ah Moo v. A.G. Becker Paribas, Inc.*, 857 F.2d 615, 620 (9th Cir. 1988).

In *Booth v. Verity, Inc.*, 124 F. Supp.2d 452, 459 (W.D. Ky. 2000), the court held that the mere ability to view a passive web page or mass media report was an insufficient contact with a state to render an out-of-state defendant subject to that state's jurisdiction.

90. The Section 610(c)(2) “place to which it is directed” would include a post office box at which a person receives mail. Application of the Section 610(c)(2) formula has been held to afford due process of law. *Green v. Weis, Voisin, Cannon, Inc.*, 479 F.2d 462 (7th Cir. 1973).

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 purchasers 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 provides jurisdiction in cases involving investment advice and misrepresentations under Sections 404(a), 405(a), 502, 505, and 506 with respect to a person whose act, practice, or course of business is instrumental, whether the person or the act, practice, or course of business is in or out of the state, in effecting the prohibited or actionable conduct in the state.

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, Investment Advisers, Broker-Dealer Agents and Investment Adviser Representatives Using the Internet for General Dissemination of Information on Products and Services (Apr. 27, 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 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).

An issuer is not required to file a consent to service of process unless it proposes to offer a security in the 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.⁹¹

CONCLUSION

More than one representative of the state securities regulators and the securities industry articulated the view that the Act, “while not perfect, was fair.” The effort to achieve consensus appeared to have been appreciated because of a balancing of the benefits potentially available to the securities regulators and implicitly to investors on the one hand, and to representatives of the variegated securities industry on the other.

From the point of view of the securities regulators and investors, the new Act is particularly significant for the following reasons:

- Clarification of the definition of “security” in Section 102(28) will reach certain forms of investment contracts which involve vertical commonality or involve new forms of exotic financial instruments. As one NASAA representative put it, the definition of investment contract “is the DNA of securities law.”

91. 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. This section was originally based on the type of nonresident motorist statute whose constitutionality was sustained in *Hess v. Pawloski*, 274 U.S. 352 (1927) and subsequently in other contexts. *See, e.g.*, *Travelers Health Ass’n v. Virginia ex rel State Corp. Comm’n*, 339 U.S. 643 (1950); *Int’l Shoe Co. v. State*, 326 U.S. 310 (1945).

- The new Act gives broader coverage and liability for investment advisers and investment adviser representatives. A major change in the nature of securities trading since 1956 has been the increasingly significant role of the investment adviser and investment adviser representative.
- Functional regulation of variable insurance products and banks is available for those states that choose to omit the bracketed phrase “or variable” in Section 102(28)(B) and to incorporate the recommended exclusionary language from the definition of broker-dealer in Section 102(4).
- The new Act provides the opportunity for securities administrators to subject previously exempt nonprofit securities transactions to a variety of regulatory regimes including full registration depending upon local circumstances.
- The new Act tightens the unit secured transactions exemption in Section 202(11).
- The new Act gives broad flexibility to securities administrators either to add additional securities exemptions in Section 203 or to deny, condition, limit, or revoke specified exemptions in Section 204.
- The Act preserves, depending upon local preferences, each of the three current forms of merit regulation in Section 306.
- It provides the broad inspection provision in Section 411(d).
- The new Act broadens the grounds for discipline in Section 412. Among other changes that were of consequence to NASAA was a longer lookback period of ten years rather than five years in several paragraphs of Section 412(d); the reference to any felony in Section 412(d)(3); the broadening of the types of misdemeanors which could lead to discipline in Section 412(d)(3); a new provision addressing firms that refuse to allow inspections in Section 412(d)(8); new language addressing violations of the laws of foreign jurisdictions in Section 412(d)(11); as well as treatment of control persons in Section 412(h).
- It broadens the civil liability Section’s statute of limitations in Section 509(j) to parallel the recently amended two-years-after-discovery and five-years-after-the-violation provisions under federal securities law.
- It adds new language in Sections 601(d)-(e) to address investor education and its financing.

- The new Act amplifies the investigation, administrative, and civil enforcement provisions in Sections 602 through 604.

From the point of view of the securities industry, the changes in the Act are also of great benefit. These benefits include:

- The probability that there will be greater uniformity among the states and with the SEC and greater harmonization of the NSMIA provisions.
- The facilitation of electronic filing of documents and the movement toward a more technologically effective system of securities regulation.
- A significant broadening of the exemptions from securities registration, particularly with new exemptions doing the following: addressing foreign governments in Section 201(2); amplifying the manual exemption in Section 202(2); addressing foreign marginable securities in Section 202(3); addressing specified fixed income stocks in the highest debt-rating levels in Section 202(5); significantly broadening the exemption for institutional investors in the definition of institutional investor in Section 102(11) and the specified investor exemption in Section 202(13); broadening the limited offering exemption in Section 202(14); and adding new exemptions for controlled transactions in 202(18) and new exemptions addressing rescission offers in Section 202(19), out-of-state offers or sales in Section 202(20), and employee benefit plans in Section 202(21).
- The systematic revision of the broker-dealer, agent, investor adviser, and investment representative exemptions to address such new issues as “snowbirds” and to wrestle with the difficult questions of professional persons performing multiple roles in the securities industry. Novel provisions such as that in Section 404(f), for example, address the increasingly common issue of referral fees.
- An effort to more effectively address the immediate transfer of agents and investment adviser representatives after termination from one firm under most circumstances.
- A new qualified immunity provision to provide a limited defense against defamation claims typically also in the circumstance of the departure of an agent or an investment adviser representative from a firm.
- A rescission provision to facilitate the avoidance of civil liability in Section 510.

undertaken. Other appropriate cooperative activities are also encouraged.

A second overarching theme of the Act is achieving consistency with NSMIA.⁹

A third theme of the Act involves facilitating electronic records, signatures, and filings. New definitions were added to address filing (Section 102(8)),¹⁰ 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), Investment Adviser Registration Depository (“IARD”), the Securities and Exchange Commission’s Electronic Data Gathering, Analysis, and Retrieval System (“EDGAR”), and successor institutions. Electronic communication also has led to an amplification of the jurisdiction of Section 610.

The Act itself contains six substantive articles:

1. Definitions and Other 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

In addition, Article 7 briefly addresses transitional issues.

9. New definitions were added to define “federal covered investment adviser” in Section 102(6) and “federal covered security” in Section 102(7). 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).

10. The definition of “filing” in Section 102(8) “means the receipt under this [Act] of a record by the administrator or a designee of the administrator.” In the RUSA definition in Section 101(4), 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.

- More globally, a systematic effort to address due process in disciplinary actions. This is particularly reflected in Sections 306, 412, 603, and 604. The securities industry generally was willing to support broad enforcement powers for the securities administrators, but in effect wanted minimal mandates of fundamental fairness for persons subject to discipline.

The Act, in sum, is lengthy, detailed, and reticulate. But it represents a good faith effort on the part of all involved to modernize state securities regulation and to seek a fair balance between the claims of investor protection and capital formation.