

UNIFORM SECURITIES ACT (1956), AS AMENDED

AN ACT

[Relating to securities; prohibiting fraudulent practices in relation thereto; requiring the registration of broker-dealers, agents, investment advisers, and securities; and making uniform the law with reference thereto:]

[Be it enacted. . . .]

Part I Fraudulent and Other Prohibited Practices

Sec. 101. [SALES AND PURCHASES.] It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly

- (1) to employ any device, scheme, or artifice to defraud,
- (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or
- (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Official Code Comment

.01 [Sec. 101—Sanctions for unlawful conduct.]—This section is substantially the Securities and Exchange Commission's Rule X-10B-5, 17 Code Fed. Regs. § 240.10b-5, which in turn was modeled upon § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), except that the rule was expanded to cover the purchase as well as the sale of any security. There are no exemptions from § 101.

The sanctions for the conduct which is made "unlawful" by § 101 (or any other section which makes conduct "unlawful") are found in Parts II, III and IV of the statute. Those sanctions include administrative proceedings of various sorts under §§ 204 and 306 when a registration of a broker-dealer, agent, investment adviser or security is pending or effective under Part II or III; judicial injunction under § 408; and criminal prosecution under § 409. Section 410(h) provides that "unlawful" conduct does not result in civil liability except as provided in § 410.

Clause (1) does not prohibit an investment advisory contract which provides for compensation based upon the total value of a fund averaged over a definite period, or as of definite dates or taken as of a definite date. "Assignment," as used in clause (2), includes any direct or indirect transfer or hypothecation of an investment advisory contract by the assignor or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; but, if the investment adviser is a partnership, no assignment of an investment advisory contract is considered to result from the death or withdrawal of a minority of the members of the investment adviser having only a minority interest in the business of the investment adviser, or from the admission to the investment adviser of one or more members who, after admission, will be only a minority of the members and will have only a minority interest in the business.

Sec. 102. [ADVISORY ACTIVITIES.] (a) It is unlawful for any person who receives, directly or indirectly, any consideration from another person for advising the other person as to the value of securities or their purchase or sale, whether through the issuance of analyses or reports or otherwise,

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

- (2) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon the other person,
- (3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this subparagraph shall not apply to any transaction with a customer of a broker-dealer if such broker-dealer is not acting as an investment adviser in relation to such transaction; or
- (4) to engage in dishonest or unethical practices as the Administrator may define by rule.

(b) In the solicitation of advisory clients, it is unlawful for any person to make any untrue statement of a material fact, or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading.

(c) Except as may be permitted by rule or order of the Administrator, it is unlawful for any investment adviser to enter into, extend, or renew any investment advisory contract unless it provides in writing

- (1) that the investment adviser shall not be compensated on the basis of a share of capital gains upon or capital appreciation of the funds or any portion of the funds of the client;
- (2) that no assignment of the contract may be made by the investment adviser without the consent of the other party to the contract; and
- (3) that the investment adviser, if a partnership, shall notify the other party to the contract of any change in the membership of the partnership within a reasonable time after the change.

(d) Subparagraph (c)(1) does not prohibit an investment advisory contract which provides for compensation based upon the total value of a fund averaged over a definite period, or as of definite dates or taken as of a definite date. "Assignment," as used in subparagraph (c)(2), includes any direct or indirect transfer or hypothecation of an investment advisory contract by the assignor or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; but, if the investment adviser is a partnership, no assignment of an investment advisory contract is considered to result from the death or withdrawal of a minority of the members of the investment adviser having only a minority interest in the business of the investment adviser, or from the admission to the investment adviser of one or more members who, after admission, will be only a minority of the members and will have only a minority interest in the business.

(e) It is unlawful for any investment adviser to take or have custody of any securities or funds of any client if

- (1) The [Administrator] by rule prohibits custody; or
- (2) in the absence of rule, the investment adviser fails to notify the [Administrator] that he has or may have custody.

(f) The [Administrator] may by rule or order adopt exemptions from subparagraph (a)(3) and subparagraphs (c)(1), (c)(2) and (c)(3) where such exemptions are consistent with the public interest and within the purposes fairly intended by the policy and provisions of this act.

[Sec. 102 amended 10-14-81 (NASAA), 11-20-86 (NASAA).]

Official Code Comment

.01 [Sec. 102(a)—No exemption from fraud.]—This provision is modeled on §§ 206(1) and 206(2) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6(1) and (2), except that it avoids the use of the term “investment adviser.” The definition of “investment adviser” in § 401(f) contains a number of exceptions which look to the registration requirement in Part II. But, as in § 101, there are no exemptions from fraud.

[Sec. 102(b)—Written contracts—Contents.]—Clauses (1)-(3), together with the first sentence thereafter, are modeled on § 205 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-5. The definition of “assignment” in the last sentence is taken from the definition in §

1986 NASAA Comments

.15 In Section 102, the words “directly or indirectly” are added to the first line of subsection (a) to ensure that all persons, including officers, directors, and investment adviser representatives of an investment adviser, who receive compensation from an employer who renders investment advice rather than directly from a client, are subject to the section.

Subparagraph (a)(3) is the equivalent of section 206(3) or the Investment Advisers Act of 1940 which requires an adviser and persons associated with the adviser, who act as principal or effect transactions between clients, to disclose in writing the capacity in which the adviser or associated person is acting and obtain the consent of the client to the transaction prior to completion of the transaction.

The addition of subparagraph (a)(4) prohibits dishonest or unethical practices. The Administrator must define

202(a)(1) of the federal statute, 15 U.S.C. § 80b-2(a)(1). Section 102(b) does not require that the entire contract be in writing. An informal exchange of letters containing the three specified provisions would be sufficient.

[Sec. 102(c)—Broker acting as adviser.]—The Act does not prohibit the same person from being both a broker-dealer and an investment adviser. See the comment under § 201(c). Section 102(c)(1) is sufficiently flexible so that any rules adopted thereunder might be made inapplicable to persons acting in both capacities, or applicable only with respect to those clients who are charged specially for investment advice. Concerning the distinction between broker-dealers and investment advisers, see the comment under § 401(f).

these terms by rule to make subparagraph (4) operative. The violation of subparagraph (4) as well as the entire section gives rise to civil liabilities under section 410.

The addition of new subsection (b) is intended to cover fraudulent practices committed in the solicitation of clients rather than in the rendition of advice, which is addressed in subsection (a).

The effect of the proposed amendment [to subsec. (c)] is to reinstate in subsection (c) the language of the 1956 Uniform Securities Act as originally contained in subsection (b) and as deleted by the 1981 NASAA action.

New subsection (f) authorizes the Administrator to provide for exemptions by rule or order to accommodate, for example, fees permitted under Section 205 of the Investment Advisers Act of 1940.

Part II Registration and Notice Filing Procedures of Broker-Dealers, Agents, and Investment Advisers

Sec. 201. [REGISTRATION REQUIREMENT.] (a) It is unlawful for any person to transact business in this state as a broker-dealer or agent unless he is registered under this act.

(b) It is unlawful for any broker-dealer or issuer to employ an agent unless the agent is registered. The registration of an agent is not effective during any period when he is not associated with a particular broker-dealer registered under this act or a particular issuer. When an agent begins or terminates a connection with a broker-dealer or issuer, or begins or terminates those activities which make him an agent, the agent as well as the broker-dealer or issuer shall promptly notify the [Administrator].

(c) It is unlawful for any person to transact business in this state as an investment adviser or as an investment adviser representative unless (1) he is so registered under this act, or (2) he has no place of business in this state and (A) his only clients in this state are investment companies as defined in the Investment Company Act of 1940, other investment advisers, federal covered advisers, broker-dealers, banks, trust companies, savings and loan associations, insurance companies, employee benefit plans with assets of not less than one million dollars (\$1,000,000), and governmental agencies or instrumentalities, whether acting for themselves or as trustees with investment control, or other institutional investors as are designated by rule or order of the (Administrator), or (B) during the preceding twelve-month period has had no more than five clients, other than those specified in subparagraphs (A), whether or not he or any of the persons to whom the communications are directed is then present in this state.

(d) It is unlawful for (i) any investment adviser required to be registered to employ an investment adviser representative unless the investment adviser representative is registered under this act, provide that the registration of an investment adviser representative is not effective during any period when he is not employed by an investment adviser registered under this act; or (ii) federal covered adviser to employ, supervise, or associate with an investment adviser representative having a place of business located in this state, unless such investment adviser representative is registered under this act, or is exempt from registration. When an investment adviser representative begins or terminates employment with an investment adviser, the investment adviser (in the case of 201(d)(1)), or the investment adviser representative (in the case of 201(d)(ii)), shall promptly notify the [Administrator].

(e) Every registration or notice filing under this section expires December 31st unless renewed.

(f) Except with respect to advisers whose only clients are those described in section 201(c)(2) of this act, it is unlawful for any federal covered adviser to conduct advisory business in this state unless such person complies with the provisions of section 202(b) of this act.

[Sec. 201 amended 8-23-58 (NCCUSL), 10-14-81 (NASAA), 11-20-86 (NASAA), 10-9-88 (NASAA), 4-27-97 (NASAA).]

Official Code Comment

.01 [Sec. 201(a)—Definition of “agent”, “broker-dealer” and “to transact business in this state.”]—“Agent” and “broker-dealer” are defined in §§ 401(b) and 401(c). The scope of § 201(a) with reference to the phrase “to transact business in this state” is specified in §§ 414(a) and 414(b).

[Sec. 201(b)—Agent's change of employer.]—When an agent shifts from one broker-dealer or issuer to another, the last sentence requires all three persons—the agent, the old employer and the new employer—to notify the Administrator.

[Sec. 201(c)—Registration of investment advisers.]—Clause (2): The Act permits the same person to exercise both broker-dealer and advisory functions and to do so without dual registration. Clause (2) ties in with § 204(b)(5), which authorizes the Administrator to

condition a particular applicant's registration as a broker-dealer upon his not transacting business as an investment adviser if the Administrator finds that he is not qualified as an investment adviser.

Clause (3): This clause is based on § 203(b)(2) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-3(b)(2), which exempts an investment adviser from registration if his only clients are investment companies and insurance companies. But even such an investment adviser is subject to § 102. Clause (3) also ties into § 401(f)(6); see paragraph 12 of the comment under § 414(a)-(f).

The scope of § 201(c) with reference to the phrase “to transact business in this state” is specified in § 414(f).

[The Last Sentences in Brackets]: The bracketed language is intended for those states where every

registration today expires on December 31 or some other fixed date of each year. When any such state goes over to the scheme of § 201(d), the bracketed language will prevent its continuing to be deluged with a mass of renewal applications on the first of every year.

1986 NASAA Comment

.15 Subsection (c) has been extended to require the registration of investment adviser representatives. Former subparagraph 201(c)(2), which obviated the need for investment adviser registration by broker-dealers whose registration has not been conditioned under subparagraph 204(b)(5), has been deleted since it has no counterpart under federal law and does not reflect the prevailing practice in all states. Moreover, the forms required for broker-dealer registration do not reflect all of the information which registered investment advisers must provide.

The amendment also expands the list of accounts that should be considered sophisticated and institutional in nature and thus not in need of the protection of the act. The list of accounts, many of which were transferred from the section 401(f)(6) definitional exclusion in the 1956 Uniform Securities Act ends by giving the

Section 418(c) will automatically take care of the situation, without the bracketed language, in those states which already provide that every registration expires one year from its effective date unless renewed.

Administrator authority to designate, by rule or order, other kinds of institutional clients an investment adviser may service without being registered.

A de minimis exemption for out of state investment advisers and investment adviser representatives has been added to permit such persons to accommodate a limited number of noninstitutional clients. Persons availing themselves of the deminimis exemption, however, would remain subject to the antifraud provisions in Section 102. This exemption provided by subparagraph (c)(3) as well as the exemption provided by subparagraph (c)(2) apply to both investment advisers and investment adviser representatives.

Each state will need to amend the language of section 201(e) in order to facilitate its entry into the Central Registration Depository ("CRD"). An annual renewal date of December 31 is required by the CRD.

Sec. 201-A [LIMITED REGISTRATION OF CANADIAN BROKER-DEALERS AND AGENTS]

(a) A broker-dealer that is resident in Canada and has no office or other physical presence in this state may, provided the broker-dealer is registered in accordance with this section, effect transactions in securities with or for, or induce or attempt to induce the purchase or sale of any security by,

- (1) a person from Canada who is temporarily resident in this state, with whom the Canadian broker-dealer had a bona fide broker-dealer-client relationship before the person entered the United States; or
- (2) a person from Canada who is resident in this state, whose transactions are in a self-directed tax advantaged retirement plan in Canada of which the person is the holder or contributor.

(b) An agent who will be representing a Canadian broker-dealer registered under this section may, provided the agent is registered in accordance with this section, effect transactions in securities in this state as permitted for the broker-dealer in subsection (a).

(c) A Canadian broker-dealer may register under this section provided that it

- (1) files an application in the form required by the jurisdiction in which it has its head office;
- (2) files a consent to service of process;
- (3) is registered as a broker or dealer in good standing in the jurisdiction from which it is effecting transactions into this state and files evidence thereof; and
- (4) is a member of a self-regulatory organization or stock exchange in Canada.

(d) An agent who will be representing a Canadian broker-dealer registered under this section in effecting transactions in securities in this state may register under this section provided that he or she

- (1) files an application in the form required by the jurisdiction in which the broker-dealer has its head office;
- (2) files a consent to service of process; and
- (3) is registered in good standing in the jurisdiction from which he or she is effecting transactions into this state and files evidence thereof.

(e) If no denial order is in effect and no proceeding is pending under section (204), registration becomes effective on the 30th day after an application is filed, unless earlier made effective.

(f) A Canadian broker-dealer registered under this section shall

- (1) maintain its provincial or territorial registration and its membership in a self-regulatory organization or stock exchange in good standing;
- (2) provide the Administrator upon request with its books and records relating to its business in the state as a broker-dealer;
- (3) inform the Administrator forthwith of any criminal action taken against it (him or her) or of any finding or sanction imposed on the broker-dealer as a result of any self-regulatory or regulatory action involving fraud, theft, deceit, misrepresentation or similar conduct; and
- (4) disclose to its clients in the state that the broker-dealer and its agents are not subject to the full regulatory requirements in the Act.

(g) An agent of a Canadian broker-dealer registered under this section shall

- (1) maintain his or her provincial or territorial registration in good standing;
- (2) inform the Administrator forthwith of any criminal action, taken against him or her, or of any finding or sanction imposed on the agent as a result of any self-regulatory or regulatory action involving fraud, theft, deceit, misrepresentation or similar conduct.

(h) Renewal applications for Canadian broker-dealers and agents under this section must be filed before December 1 each year and may be made by filing the most recent renewal application, if any, filed in the jurisdiction in which the broker-dealer has its head office, or if no such renewal application is required, the most recent application filed pursuant to clause (1) of subsection (c) or clause (1) of subsection (d), as the case may be.

(i) Every applicant for registration or renewal registration under this section shall pay the fee for broker-dealers and agents as required under this Act.

(j) A Canadian broker-dealer or agent registered under this section may only effect transactions in this state (1) as permitted in subsection (a) or (b); (2) with or through (a) the issuers of the securities involved in the transactions, (b) other broker-dealers, and (c) banks,

savings institutions, trusts companies, insurance companies, investment companies as defined in the Investment Company Act of 1940, pension or profit-sharing trusts, or other financial institutions or institutional buyers, whether acting for themselves or as trustees; and (3) as otherwise permitted by this Act.

(k) A Canadian broker-dealer or agent registered under this section and acting in accordance with the limitations set out in subsection (j) is exempt from all of the requirements of this Act, except the anti-fraud provisions and the requirements set out in this section. Such Canadian broker-dealer or agent may only have its registration under this section denied, suspended or revoked for a breach of the anti-fraud provisions or the requirements in this section.

[Sec. 201-A added 10-25-95 (NASAA)]

1996 NASAA Comments

.35 [Sec. 201-A [Limited registration of Canadian broker-dealers and agents.] 1. The policy permits a limited registration for two distinct types of cross border trading. The first category covers trading by Canadian persons who are temporarily resident within the United States. The term "temporarily" is borrowed from SEC Rule 15(a)6 which exempts certain foreign broker-dealers from registering under the Exchange Act. The scope of coverage is extended to be co-extensive with that rule. The SEC does not define the term in its rule. The Ad Hoc Committee on Cross Border Trading (the "Committee") understands from the SEC staff that the term is interpreted in a broad sense. The adopting release for the SEC rule suggests a more limited scope, namely, that used in the tax laws. This standard measures temporary residence by the number of days the person is present in the U.S. in any one year. If it is less than 183 days, then the person is "temporarily" present. The Committee favors the former scope as this allows for those Canadians who are on a temporary work assignment to trade with their home broker-dealer and agent (assuming they are registered), as well as so-called "snowbirds" who winter in the warmer regions of the U.S.

The Committee notes that defining "temporarily" in terms of the state of the account holder makes compliance difficult. The Committee therefore recommends that a state take the position that if the broker-dealer has in its file a representation from the account holder that he or she intends to return to Canada at a future date, the broker-dealer may rely on this statement. Such a statement would have to be accompanied by the disclosure required in subsection (f)(4) of the proposed policy. In effect, it allows the customer to opt to continue doing business with a broker with whom he or she has a satisfactory relationship during such time that the customer is residing in the U.S.

The second category of activity covered by the policy is trading in self-directed tax advantaged retirement plan accounts. These accounts, which are called Registered Retirement Savings Plans ("RRSP's"), have two features

which make it impossible and impracticable to transfer them to a U.S. broker-dealer. First, the account must be sited in Canada with a Canadian trustee. The account cannot be run through the books of a non-Canadian broker. Second, the securities held in the account must be predominantly Canadian. Few U.S. brokers have sufficient trading activity in Canadian securities to justify the expense of following Canadian companies. These two factors counsel permitting Canadian persons to continue account activity with a Canadian broker-dealer. Collapsing the account results in draconian tax consequences for Canadian persons.

For purposes of subsection (a)(2), the terms "a person from Canada" is meant to refer to any person who was previously resident in Canada and is now in the United States, regardless of nationality. For instance, should a U.S. citizen move to Canada, establish an RRSP account and then return to the U.S., this person could continue to transact business with his or her Canadian broker without that broker needing to obtain a full registration. This prevents the U.S. citizen from having to liquidate the account and incur the adverse tax consequences.

Subsection (a) refers to "a broker-dealer that is resident in Canada and has no office or other physical presence in this state." That is intended to preclude a Canadian broker-dealer from setting up an office in the state and being fully registered in the state while at the same time being able to take advantage of the limited registration system. However, where a Canadian broker-dealer has a U.S. affiliate that has an office in the state, the Canadian broker-dealer would still be able to take advantage of the policy. This would be so even if the U.S. affiliate of the Canadian broker-dealer has designated an office in Canada of the Canadian broker-dealer to be an office of the U.S. affiliate. Some large dealers have affiliates registered in the U.S. to deal in the institutional market. The affiliate would not be suitable to account for dealings with the retail client.

2. The Committee determined that use of the home province forms would simplify compliance. The provincial regulators have adopted uniform forms for application. These forms are quite similar to the U.S. Forms BD and U-4. The Committee opted not to refer specifically to these forms because some of the provinces have additions and it is assumed that a state regulator would wish to see these additional materials. Also, the provinces do not have the same renewal cycles. Quebec has a continuous registration, and British Columbia uses two-year cycle. For that reason we refer generically to the forms in subsections (c)(1), (d)(1) and (h).

3. The assumption underlying this provision is that Canadian persons temporarily resident in the U.S. and those dealing in their RRSP's, will look to home regulations for protection. Although state administrators will retain jurisdiction to investigate activity outside the scope of the rule and activity which violates their anti-fraud provisions, it is contemplated that licensing surveillance will primarily be conducted by the provincial authorities. The Committee assumes that the antifraud provisions of the Uniform Act are very similar to those under provincial securities statutes. Should there be a difference with respect to a particular transaction, the Committee assumes that the state would defer to the provincial provisions.

4. The Committee chose December 1 as the renewal date because this is the pattern most prevalent among the states. It is expected that each state would adopt a date to fit its statutory scheme.

5. The policy makes clear that obtaining a limited registration allows the broker-dealer and agent to perform all the activities permitted by the policy and to conduct an institutional business as previously permitted under section 401(c) of the Uniform Securities Act. The policy further assumes that a Canadian broker-dealer must divest itself of all accounts held by the residents of the jurisdiction granting the limited registration which are not permitted under the limited registration.

6. The policy provides that a broker-dealer registered pursuant to this section is exempt from all provisions of the act except for those provisions specifically set forth in the policy and the anti-fraud provisions. Thus, a broker-dealer registered under this policy is exempt from all net capital, auditing, books and records and other operational requirements not specifically set forth in the policy. The broker-dealer is also exempt from the registration of securities section. This is consistent with the principle that the customer is relying on provincial law for his or her protection and, also, with the fact that many Canadian companies have no exemption from

registration under the provisions of state law. Moreover, these companies have no economic incentive to register or perfect any exemption.

7. Subsection (j) is designed to make clear that broker-dealers and agents can act only within the scope of the limited registration. Any activity beyond the scope of the registration would constitute unregistered activity and be subject to both state enforcement and civil liability. Also state enforcement and civil liability would attach to violations of the anti-fraud provisions (except as otherwise limited by section 410 of the Uniform Securities Act).

.40 [State notice re cross-border trading by broker-dealers and agents.] On October 25, 1995, NASAA recommended that states adopt the following notice provisions in conjunction with the adoption of Sec. 201-A of the Uniform Securities Act of 1956, as amended:

With respect to any Canadian broker-dealer or agent applying for registration in this state, the Securities Administrator has agreed not to make inquiries of the broker-dealer or agent concerning any possible failure to register in relation to:

(a) trading activities that may have been conducted in this state with any person from Canada:

(1) who was temporarily present in this state and with whom the Canadian broker-dealer or agent had a bona fide broker-dealer-client relationship before the person entered the United States; or

(2) who was present in this state, in relation to a self-directed tax advantaged retirement plan in Canada of which the person is the holder or contributor;

up until a date which is 120 days after the effective date of the limited registration regime for Canadian broker-dealers in this state; or

(b) any other trading activities that may have been conducted in the state prior to [December 31, 1995].

This does not preclude the state Securities Administrator from making inquiries where it comes to its attention that a Canadian broker-dealer or agent may have been engaged in improper trading activities in the state in addition to failing to register.

The Canadian Securities Administrators have agreed not to make inquiries of any American broker-dealer or agent on a reciprocal basis.

Sec. 202. [REGISTRATION AND NOTICE FILING PROCEDURE.] (a) A broker-dealer, agent, or investment adviser, or investment adviser representative may obtain an initial or renewal registration by filing with the [Administrator] or his designee an application together with a

consent to service of process pursuant to section 414(g). The application shall contain whatever information the [Administrator] by rule requires concerning such matters as (1) the applicant's form and place of organization; (2) the applicant's proposed method of doing business; (3) the qualifications and business history of the applicant; in the case of the broker-dealer or investment adviser, the qualifications and business history of any partner, officer, or director, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser; (4) any injunction or administrative order or conviction of a misdemeanor involving a security or any aspect of the securities business and any conviction of a felony; (5) the applicant's financial condition and history and (6) any information to be furnished or disseminated to any client or prospective client, if the applicant is an investment adviser. The [Administrator] may by rule or order require an applicant for initial registration to publish an announcement of the application in one or more specified newspapers published in this state. If no denial order is in effect and no proceeding is pending under section 204, registration becomes effective at noon of the thirtieth day after an application is filed. The [Administrator] may by rule or order specify an earlier effective date, and (he) may by order defer the effective date until noon of the thirtieth day after the filing of any amendment. Registration of a broker-dealer automatically constitutes registration of any agent who is a partner, officer, or director, or a person occupying a similar status or performing similar functions. Registration of an investment adviser automatically constitutes registration of any investment adviser representative who is a partner, officer, or director, or a person occupying a similar status or performing similar functions.

(b) Except with respect to federal covered advisers whose only clients are those described in section 201(c)(2) of this act, a federal covered adviser shall file with the [Administrator], prior to acting as a federal covered adviser in this state, such documents as have been filed with the Securities and Exchange Commission as the [Administrator], by rule or order, may require.

(c)

(1) Broker-dealers and broker-dealer agents. Every applicant for initial or renewal registration shall pay a registration fee as required by the [Administrator] in the case of a broker-dealer or agent.

(2) Investment advisers and investment adviser representatives. Every applicant for initial or renewal registration as an investment adviser, or as an investment adviser representative who is subject to registration under this act shall pay a registration fee as required by the administrator.

(3) Federal covered advisers. Every person acting as a federal covered adviser in this state, except with respect to federal covered advisers whose only clients are those described in section 201(c)(2) of this act, shall pay an initial and renewal notice filing fee as required by the [Administrator].

(d) A registered broker-dealer, federal covered adviser, or investment adviser may file an application for registration of a successor, whether or not the successor is then in existence, for the unexpired portion of the year. There shall be no filing fee.

(e) The [Administrator] may, by rule or order, require a minimum capital for registered broker-dealers, subject to the limitations of section 15 of the Securities Exchange Act of 1934, and establish minimum financial requirements for investment advisers, subject to the limitations of section 222 of the Investment Advisers Act of 1940, which may include different requirements

for those investment advisers who maintain custody of clients' funds or securities or who have discretionary authority over same and those investment advisers who do not.

(f) The [Administrator] may, by rule or order, require registered broker-dealers, agents, and investment advisers who have custody of or discretionary authority over client funds or securities to post bonds in amounts as the Administrator may prescribe, subject to the limitations of section 15 of the Securities Exchange Act of 1934 (for broker-dealers) and section 222 of the Investment Advisers Act of 1940 (for investment advisers) and may determine their conditions. Any appropriate deposit of cash or securities shall be accepted in lieu of any bond so required. No bond may be required of any registrant whose net capital, or, in the case of an investment adviser whose minimum financial requirements, which may be defined by rule, exceeds the amounts required by the Administrator. Every bond shall provide for suit thereon by any person who has a cause of action under section 410 and, if the [Administrator] by rule or order requires, by any person who has a cause of action not arising under this act. Every bond shall provide that no suit may be maintained to enforce any liability on the bond unless brought within the time limitations of section 410(f).

[Sec. 202 amended 11-20-86(NASAA), 4-27-97 (NASAA).]

Official Code Comment

.01 [Sec. 202(a)—Application for registration.]—Second sentence: This sentence is a conglomerate of a number of the present statutes as well as the comparable provisions of the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 together with the SEC's Forms BD and ADV for broker-dealers and investment advisers respectively. The language is sufficiently broad to cover everything required by those statutes and forms, and at the same time is sufficiently specific to facilitate the adoption of a uniform form for each of the three types of registration.

Clause (3): The phrase "any person occupying a similar status or performing similar functions," which modifies "partner, officer, or director" here and elsewhere in the Act, contemplates unincorporated, non-partnership organizations like Massachusetts trusts.

Last sentence: Section 401(b), which defines "agent," provides in its last sentence: "A director, officer, or partner of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is an agent only if he otherwise comes within this definition." The reasons for that provision are stated in the comment to that section. But, since § 202(a)(3) contemplates that qualifications and business history of partners, officers and directors will be disclosed in the application for registration of the partnership or corporation, there is no need to have the same information filed twice. Consequently, under the last sentence of § 202(a) the firm's registration automatically constitutes registration of any agent who is a partner, officer, or director; and, by virtue of this sentence in conjunction with the last sentence of § 401(b), the Administrator, if he deems it appropriate, may institute a proceeding to deny or revoke the registration of a particular partner, officer or director without disturbing

the status of the firm. At the same time, the disqualification of a director, officer or partner, as distinct from an ordinary agent, is also a basis for proceeding against the firm's registration if the Administrator finds it in the public interest to do so.

[Sec. 202(b)—When fees are returnable.]—The last sentence does not apply when a registration is suspended, revoked or canceled under § 204.

[Sec. 202(c)—Procedure on successions.]—This subsection is designed to avoid unnecessary interruptions of business by removing any doubt as to the propriety of a predecessor's filing an application for the registration of the successor—for example, when a contemplated change in the membership of a partnership may be considered to result in a new partnership under the local partnership law, or when a partnership or an individual contemplates incorporation. Particularly if the states which adopt this act adopt uniform registration forms which are coordinated with those of the SEC, they may also wish to coordinate their procedure on successions. See SEC Rule X-15B-4, 17 Code Fed. Regs. § 240.15-4. The regular procedure in § 202(a) concerning the time when an application for registration becomes effective applies also under § 202(c).

[Sec. 202(d)—Minimum capital rules.]—A few states have rules which, instead of prescribing a fixed minimum capital, follow the formula of the SEC and some of the stock exchanges in prescribing a ratio of 15-1 or 20-1 between aggregate indebtedness and net capital. Ill. Rule D-1B; Minn. Reg. VI(a); Wis. Adm. Code's § 1.01(2). Any state which wants to give its Administrator authority to adopt debt-capital ratio rules should add the following language at the end of Section 202(d): "or

prescribe a ratio between net capital and aggregate indebtedness.”

[Sec. 202(e)—Bonding requirements.]—Second sentence: The Administrator has no discretion whether to accept a deposit of cash or securities in lieu of a bond, but he does have reasonable discretion to determine whether the amount of the deposit and the type of securities deposited are appropriate.

Third sentence: This sentence applies whether or not the Administrator adopts minimum capital rules under § 202(d) or defines “net capital” under § 412(a) for purposes of the third sentence of § 202(e). If he remains silent, the question whether a broker-dealer has a net capital of \$25,000 should be determined in accordance with sound accounting principles.

Conditions of the bond: The first and fourth sentences leave the conditions of the bond to the rule-making authority of the Administrator. But the fourth sentence is designed to avoid the frequently ambiguous provisions concerning who may sue on the bond by making those

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.15 The amendments permit the Administrator to designate a person, such as the Central Registration Depository, to receive applications on behalf of the Administrator. The CRD will require a uniform application form. In addition, the amendments permit the Administrator to require the filing of any information to be furnished to present or prospective investment advisory clients. The Administrator may require, for example, that the applicant file information comparable to that mandated by the Securities and Exchange Commission’s “brochure rule.”

In providing that registration of an investment adviser constitutes automatic registration of investment adviser representatives who are partners, officers or directors, the amendments acknowledge that information

conditions of any required bond coterminous with the liability provisions of § 410 so far as causes of action under the Act are concerned. It is left to the Administrator to determine by rule or order whether suits should be allowed also for defalcations not involving sales of securities—for example, embezzlement of customer’s funds or securities. Thus, except for non-statutory causes of action, § 202(e) merely uses the bonding provision to reinforce any recovery which might be obtained under § 410; it creates no new civil liabilities. Since § 410 imposes civil liabilities only upon sellers of securities, any bond required of a person who is solely an investment adviser could apply only to such non-statutory defalcations as the Administrator might prescribe.

Statute of limitations: Since § 410(d) provides that every cause of action under this statute survives the death of any person who might have been a plaintiff or defendant, any bond required under § 202(e) must provide that suit may be brought for the specified two-year period even though the person who is bonded dies before the expiration of that period.

concerning those individuals is readily obtainable from Form ADV. Inasmuch as this provision is narrow in scope, it would not effect the need for separate registration of investment adviser representatives in the majority of cases.

The amendments to subsections (d) and (e) apply to investment advisers who have custody or possession of client funds or securities, or discretionary authority over the same and to broker-dealers and agents who customarily take custody or have possession of customer funds and securities. The amendments permit the Administrator to prescribe different financial requirements for various classes of investment advisers and allows for flexibility in the development of a uniform net worth standard.

Sec. 203. [POST-REGISTRATION PROVISIONS.] (a) Every registered broker-dealer and investment adviser shall make and keep such accounts, correspondence, memoranda, papers, books, and other records as the [Administrator] prescribes by rule or order, except as provided by section 15 of the Securities Exchange Act 1934 (in the case of a broker-dealer) and section 222 of the Investment Advisers Act of 1940 (in the case of an investment adviser). All records so required, with respect to an investment adviser, shall be preserved for such period as the [Administrator] prescribes by rule or order.

(b) With respect to investment advisers, the [Administrator] may require that certain information be furnished or disseminated as necessary or appropriate in the public interest or for the protection of investors and advisory clients. To the extent determined by the [Administrator] in his discretion, information furnished to clients or prospective clients of an investment adviser that would be in compliance with the Investment Advisers Act of 1940 and the rules thereunder may be used in whole or partial satisfaction of this requirement.

(c) Every registered broker-dealer shall file such financial reports as the [Administrator] may prescribe by rule or order, except as provided by section 15 of the Securities Exchange Act 1934 (in the case of a broker-dealer) and section 222 of the Investment Advisers Act of 1940 (in the case of an investment adviser).

(d) If the information contained in any document filed with the [Administrator] is or becomes inaccurate or incomplete in any material respect, the registrant or federal covered adviser shall file a correcting amendment promptly if the document is filed with respect to a registrant, or when such amendment is required to be filed with the Securities and Exchange Commission if the document is filed with respect to a federal covered adviser, unless notification of the correction has been given under section 201(b).

(e) All the records referred to in subsection (a) are subject at any time or from time to time to such reasonable periodic, special, or other examinations by representatives of the [Administrator], within or without this state, as the Administrator deems necessary or appropriate in the public interest or for the protection of investors. For the purpose of avoiding unnecessary duplication of examinations, the [Administrator], insofar as he deems it practicable in administering this subsection, may cooperate with the securities Administrators of other states, the Securities and Exchange Commission, and any national securities exchange or national securities association registered under the Securities Exchange Act of 1934.

[Sec. 203 amended 11-20-86 (NASAA), 4-27-97 (NASAA).]

Official Comment

.01 [Sec. 203(a)—Lists of securities by broker-dealers.]—This section is modeled on § 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78q(a). It is broad enough to permit a continuation of the practice which exist s in several states of requiring registered broker-dealers to keep lists of the securities they are handling.

[Sec. 203(d)—Visitorial powers—Fees.]—Subsection (d) is modeled on § 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78q(a). This is a visitorial power which is to be distinguished from the power to investigate and issue subpoenas under § 407. No subpoena is

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.10 The amendment to subsection (b) allows the Administrator to require, for example, that information be

necessary under § 203(d). Failure to submit to a reasonable inspection is a violation of the Act, which may result in an action by the Administrator for a mandatory injunction under § 408 or, if willful, a revocation of the broker-dealer's or investment adviser's registration under § 204(a)(2)(B) or a criminal prosecution under § 409.

In some states special fees are charged to defray the cost of examinations. The Act specifically provides for fees only in connection with registration under Parts II and III. Any additional fee provision which may be desired should be inserted in § 406(c).

delivered to investment adviser clients comparable to the requirements of the SEC's "brochure rule."

Sec. 204. [DENIAL, RVOICATION, SUSPENSION, CANCELLATION, AND WITHDRAWAL OF REGISTRATION]

(a) The [Administrator] may by order deny, suspend or revoke any registration, or bar or censure any registrant or any officer, director, partner or person occupying a similar status or performing similar functions for a registrant, from employment with a registered broker-dealer or investment adviser, or restrict or limit a registrant as to any function or activity of the business for which registration is required in this state, if he finds

- (1) that the order is in the public interest and
- (2) that the applicant or registrant:

- (A) has filed an application for registration which as of its effective date, or as of any date after filing in the case of an order denying effectiveness, was incomplete in any material respect or contained any statement which was, in light of the circumstances under which it was made, false or misleading with respect to any material fact;
- (B) Has willfully violated or willfully failed to comply with any provision of this act or a predecessor act or any rule or order under this act or a predecessor act, or any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, or the Commodity Exchange Act;
- (C) has been convicted, within the past ten years, of any misdemeanor involving a security or any aspect of the securities business, or any felony;
- (D) is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in or continuing any conduct or practice involving any aspect of the securities business;
- (E) is the subject of an order of the (Administrator) denying, suspending, or revoking registration as a broker-dealer, agent, or investment adviser or investment adviser representative;
- (F) is the subject of an adjudication or determination, after notice and opportunity for hearing, within the past 10 years by a securities or commodities agency or administrator of another state or a court of competent jurisdiction that the person has willfully violated the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940 or the Commodity Exchange Act, or the securities or commodities law of any other state;
- (G) has engaged in dishonest or unethical practices in the securities business;
- (H) is insolvent, either in the sense that his liabilities exceed his assets or in the sense that he cannot meet his obligations as they mature; but the [Administrator] may not enter an order against a broker-dealer or investment adviser under this clause without a finding of insolvency as to the broker-dealer or investment adviser;
- (H.1) has willfully violated the law of a foreign jurisdiction governing or regulating any aspect of the business of securities or banking or, within the past five years, has been the subject of an action of a securities regulator of a foreign jurisdiction denying, revoking or suspending the right to engage in the business of securities as a broker-dealer, agent or investment adviser or is the subject of an action of any securities exchange or self-regulatory organization operating under the authority of the securities regulator of a foreign jurisdiction suspending or expelling such person from membership in such exchange or self-regulatory organization; or

- (I) is not qualified on the basis of such factors as training, experience, and knowledge of the securities business, except as otherwise provided in subsection (b);
- (J) has failed reasonably to supervise his agents or employees if he is a broker-dealer, or his adviser representatives or employees if he is an investment adviser to assure their compliance with this act;
- (K) has failed to pay the proper filing fee; but the [Administrator] may enter only a denial order under this clause, and (he) shall vacate any such order when the deficiency has been corrected.

The [Administrator] may not institute a suspension or revocation proceeding solely on the basis of a final judicial or administrative order made known to (him) by the applicant prior to the effective date of the registration unless the proceeding is instituted within the next ninety days following registration. For the purpose of this provision, a “final judicial or administrative order” shall not include an order that is stayed or subject to further review or appeal. This provision shall not apply to renewal registrations.

- (b) The following provisions govern the application of section 204(a)(2)(I):
 - (1) The [Administrator] may not enter an order against a broker-dealer on the basis of the lack of qualification of any person other than (A) the broker-dealer himself if he is an individual or (B) an agent of the broker-dealer.
 - (2) The [Administrator] may not enter an order against any investment adviser on the basis of the lack of qualification of any person other than (A) the investment adviser himself if he is an individual or (B) any other person who represents the investment adviser in doing any of the acts which make him an investment adviser, an investment adviser representative.
 - (3) The [Administrator] may not enter an order solely on the basis of lack of experience if the applicant or registrant is qualified by training or knowledge or both.
 - (4) The (Administrator) shall consider that an agent who will work under the supervision of a registered broker-dealer need not have the same qualifications as a broker-dealer and that an investment adviser representative who will work under the supervision of a registered investment adviser need not have the same qualifications as an investment adviser.
 - (5) The [Administrator] shall consider that an investment adviser is not necessarily qualified solely on the basis of experience as a broker-dealer or agent. When he finds that an applicant for initial or renewal registration as a broker-dealer is not qualified as an investment adviser, he may by order condition the applicant's registration as a broker-dealer upon his not transacting business in this state as an investment adviser.
 - (6) The (Administrator) may by rule provide for an examination, including an examination developed or approved by an organization of securities administrators, which examination may be written or oral or both, to be taken by any class of or all applicants. The (Administrator) may by rule or order waive the examination requirement as to a

person or class of persons if the (Administrator) determines that the examination is not necessary for the protection of advisory clients.

(c) The [Administrator] may by order summarily postpone or suspend registration pending final determination of any proceeding under this Section. Upon the entry of the order, the [Administrator] shall promptly notify the applicant or registrant, as well as the employer or prospective employer if the applicant or registrant is an agent or investment adviser representative, that it has been entered and of the reasons therefor and that within fifteen days after the receipt of a written request, the matter will be set down for hearing. If no hearing is requested and none is ordered by the [Administrator], the order will remain in effect until it is modified or vacated by the [Administrator]. If a hearing is requested or ordered, the [Administrator], after notice of and opportunity for hearing, may modify or vacate the order or extend it until final determination.

(d) If the [Administrator] finds that any registrant or applicant for registration is no longer in existence or has ceased to do business as a broker-dealer, agent, or investment adviser or investment adviser representative, or is subject to an adjudication of mental incompetence or to the control of a committee, conservator, or guardian, or cannot be located after reasonable search, the [Administrator] may by order cancel the registration or application.

(e) Withdrawal from registration as a broker-dealer, agent, or investment adviser or investment adviser representative becomes effective thirty days after receipt of an application to withdraw or within such shorter period of time as the [Administrator] may determine, unless a revocation or suspension proceeding is pending when the application is filed or a proceeding to revoke or suspend or to impose conditions upon the withdrawal is instituted within thirty days after the application is filed. If a proceeding is pending or instituted, withdrawal becomes effective at such time and upon such conditions as the [Administrator] by order determines. If no proceeding is pending or instituted and withdrawal automatically becomes effective, the [Administrator] may nevertheless institute a revocation or suspension proceeding under section 204(a)(2)(B) within one year after withdrawal became effective and enter a revocation or suspension order as of the last date on which registration was effective.

(f) No order may be entered under any part of this section except the first sentence of subsection (c) without (1) appropriate prior notice to the applicant or registrant (as well as the employer or prospective employer if the applicant or registrant is an agent), or investment adviser representative), (2) opportunity for hearing, and (3) written findings of fact and conclusions of law.

[Sec. 204 amended 10-14-81 (NASAA), 11-20-86 (NASAA), 4-11-87 (NASAA), 4-17-94 (NASAA), 10-09-94 (NASAA)]

Official Code Comment

.01 [Sec. 204(a)—Grounds for denial, revocation or suspension of registration.]—First Clause (1): This clause authorizes the Administrator to proceed against an entire firm merely because an individual partner, officer, director or controlling person is disqualified under one of the specific clauses, but it requires a finding that such action is in the public interest. The disqualification of any other agent, or of an employee of an investment adviser, may not automatically be used against the broker-dealer or the investment adviser. But, when the

agent's or employee's disqualification is due to lack of reasonable supervision, the Administrator may proceed against the broker-dealer or the investment adviser under Clause (J). The Administrator's finding on "public interest" will presumably not be judicially reviewable except upon a showing of abuse of discretion. But the requirement that such a finding be made in all cases emphasizes that not every minor or technical infraction is meant to result in a denial, suspension or revocation order.

Clause (A): The completeness and accuracy of the application for registration are to be tested as of its effective date in a suspension or revocation proceeding. That is to say, the fact that an application for registration has become misleading by virtue of developments occurring after its effective date is not a ground for action under Clause (A). Action in such a case would have to be predicated under Clause (B) upon violation of § 203(c). On the other hand, in a proceeding to deny effectiveness to a pending application for registration, the completeness and accuracy of the application cannot be tested as of the effective date. This explains the first “or” clause in Clause (A).

Clause (B): As the federal courts and the SEC have construed the term “willfully” in § 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b): all that is required is proof that the person acted intentionally in the sense that he was aware of what he was doing. Proof of evil motive or intent to violate the law, or knowledge that the law was being violated, is not required. The principal function of the word “willfully” is thus to serve as a legislative hint of self-restraint to the Administrator.

Clause (D): The present tense of the word “is” means that an injunction which has expired or been vacated is no longer a ground for action under Clause (D).

Clause (E): This clause is designed to make it clear that, when a person who has had his registration revoked applies for a new registration after an interval, the Administrator does not have to establish again the ground which led to the earlier denial or revocation order.

Clause (F): As in Clause (E), the opening word “is” means that a suspension order which has expired by its terms or an order of any kind which has been vacated is not a ground for action under Clause (F).

Clause (H): The “but” clause makes it clear that a broker-dealer's or investment adviser's insolvency may be used against the broker-dealer or investment adviser, and that an agent's insolvency may be used against the agent, but that an order may not be entered against a broker-dealer or investment adviser on the basis of the insolvency of a partner, officer, director or controlling person under Clause (2).

Clause (J): This clause represents a codification of the view held by a number of Administrators, as well as the SEC, to the effect that a registrant must be held responsible for violations resulting from inadequate supervision of subordinates. This Act, unlike § 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b), does not authorize the Administrator to proceed against the registration of a broker-dealer merely because one of his agents has violated the

statute (unless the agent happens to be a director, officer or partner). But, when an agent's violation is found to be due to a violation of the broker-dealer's duty of reasonable supervision, and when the Administrator finds that it is in the public interest to proceed against the broker-dealer's registration, he may do so under Clause (J). This is not to say that proof of a violation by the agent is essential to an order under clause (J).

[Sec. 204(b)—Qualifications of registrants.]—Clauses (1)-(2): These clauses are a limitation upon Clause (2) of § 204(a). Some firms have limited partners or directors who simply supply capital without taking an active role in the firm's business. There is no need for such persons to be qualified.

Clause (5): This is essential in order to avoid double registration by people who act both as broker-dealers and as investment advisers. See the comment under § 201(c)(2).

Clause (6): Examinations may be required of any reasonably defined class of applicants. For example, the Administrator may want to examine only applicants for registration as investment advisers, in which event he will wish to examine also those applicants for broker-dealer registration who intend to perform advisory services for special compensation, so that he may properly administer § 204(b)(5).

[Sec. 204(d)—Cancellation of registration of inactive registrants.]—This provision is modeled on § 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b). It is designed to regularize the procedure for getting rid of “dead-wood” in the files.

[Sec. 204(e)—Withdrawal from registration.]—This provision is modeled on § 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(b). It is Rule X-15B-6, 17 Code Fed. Regs. § 240.15b-6, although the last sentence goes somewhat further. This provision does not affect an applicant's privilege of withdrawing his application for registration before it becomes effective. It is simply designed to make it possible to prevent withdrawal of an effective registration under fire. The last sentence is designed to take care of the case where the Administrator does not know of any reason to object to the withdrawal application until after it has become effective; but it is limited to situations where the Administrator can prove a willful violation under § 204(a)(2)(B).

[Sec. 204(f)—State Administrative Procedure Act applicable.]—Here, as in other procedural provisions of the statute, the administrator will also have to consider the requirements of any local Administrative Procedure Act, and these provisions may have to be varied depending upon the language of any such legislation.

1986 NASAA Comment

.15 Comment to Sec. 204, as amended on 11-20-86 (bold text deleted):

The amendment to section 204(a)(2)(B) establishes a cause for administrative action against an applicant or registrant who willfully violates any provision of federal acts named in the amendment including the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Investment Company Act of 1940, or the Commodity Exchange Act.

The changes made to section 204(a)(2)(J) will permit the [Administrator] to sanction not only broker-dealers and investment advisers for failure to supervise but also

individuals who are not registered and who have supervisory responsibilities.

New section 204(c) gives Administrators the authority to take action against investment adviser representatives, including barring such persons from being employed by an investment adviser, for any of the causes listed in section 204(a)(2)(A)-(K).

The amendment to section 204(d) gives Administrators the authority to summarily suspend or bar any person from acting as an investment adviser representative pending the final outcome of any proceeding commenced under that section.

Part III Registration and Notice Filing Procedures of Securities

Sec. 301. [REGISTRATION REQUIREMENT.] It is unlawful for any person to offer or sell any security in this state unless (1) it is registered under this act or (2) the security or transaction is exempted under section 402; or (3) it is a federal covered security.

[Sec. 301 amended 4-27-97 (NASAA).]

Official Code Comment

.01 [Sec. 301—Registration requirement for securities.]—This section forbids offers as well as sales prior to the effectiveness of a registration statement. “Offer” and “sale” are defined in § 401(j). The 1954 amendment of the Securities Act of 1933 to permit certain types of offers during the waiting period between

the filing and the effectiveness of the registration statement is recognized in a special exemption for securities which are in process of registration under both the federal and state statutes. See the comment under § 402(b)(12). “Security” is defined in § 401(1). The scope of § 301 with respect to the phrase “in this state” is specified in § 414(a), (c), (d) and (e).

Sec. 302. [REGISTRATION BY FILING.] (a) The following securities may be registered by filing, whether or not they are also eligible for registration under Section 303 or 304:

- (1) Securities for which a registration statement has been filed under the Securities Act of 1933 in connection with the offering of the securities if the following conditions are satisfied:
 - (A) the issuer is organized under the laws of the United States or a state or, if the issuer is not organized under the laws of the United States or a state, it has appointed a duly authorized agent in the United States for service of process;
 - (B) the issuer has actively engaged in business operations in the United States for a period of at least 36 consecutive calendar months immediately before the filing of the federal registration statement;
 - (C) the issuer has registered a class of equity securities under Sections 12(b) or 12(g) of the Securities Exchange Act of 1934, which class of securities is held of record by 500 or more persons;
 - (D) the issuer has:

- (i)
 - (a) a total net worth of \$4,000,000; or
 - (b) a total net worth of \$2,000,000 and net pretax income from operations before allowances for extraordinary items, for at least 2 of the 3 preceding fiscal years;
 - (ii) not less than 400,000 units of the class of securities registered under Section 12 of the Securities Exchange Act of 1934 held by the public, excluding securities held by officers and directors of the issuer, underwriters and persons beneficially owning 10% or more of that class of securities; and
 - (iii) outstanding warrants and options held by the underwriters and executive officers and directors of the issuer in an amount not exceeding 10% of the total number of shares to be outstanding after completion of the offering of the securities being registered;
- (E) the issuer has been subject to the requirements of Section 12 of the Securities Exchange Act of 1934 and has filed all the material required to be filed under Sections 13 and 14 of that act for at least 36 calendar months immediately before the filing of the federal registration statement;
- (F) for a period of at least 30 days during the 3 months preceding the offering of the securities registered there have been at least 4 market makers for the class of equity securities registered under Section 12 of the Securities Exchange Act of 1934;
- (G) each of the underwriters participating in the offering of the security, and each broker-dealer who will offer the security in this state, is a member of, or is subject to the rules of fair practice of, a national association of securities dealers with respect to the offering and the underwriters have contracted to purchase the securities offered in a principal capacity;
- (H) the aggregate commissions or discounts to be received by the underwriters will not exceed 10% of the aggregate price at which the securities being registered are offered to the public;
- (I) neither the issuer nor any of its subsidiaries, since the end of the last fiscal year preceding the filing of the registration statement, have:
- (i) failed to pay a dividend or sinking fund installment on preferred stock;
 - (ii) defaulted on indebtedness for borrowed money; or
 - (iii) defaulted on the rental on one or more longterm leases; which defaults in the aggregate are material to the financial position of the issuer and its subsidiaries, taken as a whole; and
- (J) in the case of an equity security, the price at which the security will be offered to the public is not less than \$5 per share.

- (2) Securities of an open-end investment company or unit investment trust for which a registration statement has been filed under the Securities Act of 1933 in connection with the offering of the securities if the following conditions are satisfied.
 - (A) the applicant has within the preceding 24 months previously qualified the sale of its securities pursuant to Section 303 or 304 or this paragraph or, in the case of a unit investment trust, its sponsor has previously registered the security of a substantially identical unit investment trust under Section 303 or 304 or this paragraph; and
 - (B) the applicant, or such previously qualified unit investment trusts, are in compliance with the material terms of such prior registrations.
 - (C) that since the registration under Section 303 or 304 there has been no material change in:
 - (i) the terms of its securities;
 - (ii) the method of selling or distributing its securities;
 - (iii) its investment practices, objectives or restrictions, or
 - (iv) in the terms of sale of its securities (including changes affecting the net proceeds of the sale to the applicant and the method of computing the selling price of its securities.)

(b) A registration statement under this section must contain the following information and be accompanied by the following documents in addition to the information specified in Section 305(c) and the consent to service of process required by Section 414(g):

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

(c)

- (1) If the information and documents required to be filed by subsection (b) have been on file with the [Administrator] for at least [5] business days, or any shorter period as the [Administrator], by rule or order, allows and the applicable registration fee has been paid before the effectiveness of the federal registration statement, a registration statement under this section automatically becomes effective concurrently with the effectiveness of the federal registration statement if no stop order is pending and no

proceeding is pending under Section 306. If the federal registration statement becomes effective before the conditions in this subsection are satisfied and they are not waived, the registration statement becomes effective when the conditions are satisfied. The registrant shall promptly notify the [Administrator] by telephone or telegram of the date and time when the federal registration statement became effective and the content of the price amendment, if any, and shall file promptly a post-effective amendment containing the information and documents in the price amendment. The [Administrator] shall promptly acknowledge receipt of notification and effectiveness of the registration statement as of the date and time the registration statement became effective with the Securities and Exchange Commission, or when all conditions have been met.

- (2) In the case of a registration filed under subdivision (a)(2), if the information and documents required to be filed by subsection (b) have been filed with the [Administrator] and the applicable registration fee has been paid, a registration under subsection (a)(2) becomes effective on the business day of filing or upon the expiration of its existing registration, whichever last occurs, unless the [Administrator] by order specifies an earlier effective date, if no stop order is in effect and no proceeding is pending under Section 306.

[Sec. 302 amended 4-11-87 (NASAA).]

Official Code Comment

.01 [Sec. 302(a)—Securities which may be registered by notification.]—In general: The introductory language of § 302(a) makes it clear that, when a particular security is eligible for registration by notification under § 302 as well as registration by coordination under § 303, it is discretionary with the person filing the registration statement to decide which procedure to use.

Clause (1): Section 302(a)(1) contains essentially a single earnings test, regardless of the type of security being registered. It applies in substance to any security whose issuer has been in continuous operation for five years if (A) there has been no default during the past three full fiscal years on any senior security and (B) the issuer during the past three fiscal years has had average earnings of five percent on its common stock. If the issuer has no outstanding securities of the types specified in Clause (A), it is necessary to satisfy only Clause (B). Under Clause (i) the five-percent test is applied to all outstanding securities at the date the registration statement is filed, and those securities are measured by the offering price (when additional securities are being offered) or by the market price, whichever is higher. In order to permit the calculation to be made so as to determine whether the notification procedure is available, the parenthetical clause within Clause (i) permits the person filing the registration statement to use the market price on any day within thirty days before the date of filing. The phrase “maximum offering price” means the highest price at which any of the securities are offered when they are offered to different people at different prices, as when they are offered to existing stockholders at a lower price than to

the public generally. The phrase does not mean the maximum proposed offering price referred to in § 303(c)(3). See the comment under that section. But as a practical matter, since the market price and hence the offering price may go up while the registration statement is pending, it will not be safe to rely on the notification procedure unless the five-percent test is satisfied on the basis of the maximum proposed offering price. The five-percent test is applied to book value only when there is no readily determinable market price for the security being offered and there is no cash offering price either, as when the offering is made in exchange with security holders of another issuer, or with existing security holders of the same issuer under such circumstances that the exemption in § 402(b)(11) is not available.

Clause (1)(B)(iii): Clause (ii) is designed to take care of the case where a corporate registrant (or perhaps a business trust or a limited partnership) has succeeded within the past three years to a business previously conducted by a sole proprietor or a general partnership, so that the five-year requirement at the beginning of § 302(a)(1) would be satisfied but it would be impossible to satisfy the three-year earnings test for want of any outstanding securities during all of that period. Under Clause (ii) the five-percent earnings test is applied in such a case to all securities to be outstanding after the conclusion of the offering.

Clause (1) as applied to senior securities: Under Clause (B) the five-percent earnings test on common stock must be satisfied even though the security being offered is a preferred stock or a bond. This affords some margin of

safety beyond the requirement in Clause (A) that there shall have been no default.

Clause (2): Oil, gas and mineral interests are excluded because they have no “issuer” as that term is defined in § 401(g)(2) and hence all distributions of such securities would be eligible for notification if they were not excluded.

[Sec. 302(b)—Procedure for registration by notification.]—This section is designed to supply enough information to enable the Administrator to apply the stop-order standards which uniformly govern all registration statements, whether by notification, qualification or coordination. In the case of a primary offering being registered under § 302(a)(1), clause (1) requires basic financial information by way of demonstrating eligibility

for the notification procedure. Clause (6) assures a modicum of financial information in the case of a non-issuer distribution which is eligible for the notification procedure solely because of § 302(a)(2). With respect to non-issuer distributions, see the comment under § 305(i).

[Sec. 302(c)—Time registration becomes effective.]—States in other time zones should substitute “two o'clock Central Standard Time” or “one o'clock Mountain Standard Time” or “noon Pacific Standard Time.” Flexibility to take care of emergencies or unusual situations is afforded by authorizing the Administrator to accelerate the effective date. He may do this almost routinely as the SEC does, so as not to require a waiting period of two days after the filing of the price amendment.

Sec. 303. [REGISTRATION BY COORDINATION.] (a) Any security for which a registration statement has been filed under the Securities Act of 1933 in connection with the same offering may be registered by coordination.

(b) A registration statement under this section shall contain the following information and be accompanied by the following documents in addition to the information specified in section 305(c) and the consent to service of process required by section 414(g):

- (1) three copies of the latest form of prospectus filed under the Securities Act of 1933;
- (2) if the [Administrator] by rule or otherwise requires, a copy of the articles of incorporation and by-laws (or their substantial equivalents) currently in effect, a copy of any agreements with or among underwriters, a copy of any indenture or other instrument governing the issuance of the security to be registered, and a specimen or copy of the security;
- (3) if the [Administrator] requests, any other information, or copies of any other documents, filed under the Securities Act of 1933; and
- (4) an undertaking to forward all future amendments to the federal prospectus, other than an amendment which merely delays the effective date of the registration statement, promptly and in any event not later than the first business day after the day they are forwarded to or filed with the Securities and Exchange Commission, whichever first occurs.

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

- (1) no stop order is in effect and no proceeding is pending under section 306;
- (2) the registration statement has been on file with the [Administrator] for at least ten days; and
- (3) a statement of the maximum and minimum proposed offering prices and the maximum underwriting discounts and commissions has been on file for two full business days or

such shorter period as the [Administrator] permits by rule or otherwise and the offering is made within those limitations. The registrant shall promptly notify the [Administrator] by telephone or telegram of the date and time when the federal registration statement became effective and the content of the price amendment, if any, and shall promptly file a post-effective amendment containing the information and documents in the price amendment. "Price amendment" means the final federal amendment which includes a statement of the offering price, underwriting and selling discounts or commissions, amount of proceeds, conversion rates, call prices, and other matters dependent upon the offering price. Upon failure to receive the required notification and post-effective amendment with respect to the price amendment, the [Administrator] may enter a stop order, without notice or hearing, retroactively denying effectiveness to the registration statement or suspending its effectiveness until compliance with this subsection, if he promptly notifies the registrant by telephone or telegram (and promptly confirms by letter or telegram when he notifies by telephone) of the issuance of the order. If the registrant proves compliance with the requirements of this subsection as to notice and post-effective amendment, the stop order is void as of the time of its entry. The [Administrator] may by rule or otherwise waive either or both of the conditions specified in clauses (2) and (3). If the federal registration statement becomes effective before all the conditions in this subsection are satisfied and they are not waived, the registration statement automatically becomes effective as soon as all the conditions are satisfied. If the registrant advises the [Administrator] of the date when the federal registration statement is expected to become effective, the [Administrator] shall promptly advise the registrant by telephone or telegram, at the registrant's expense, whether all the conditions are satisfied and whether he then contemplates the institution of a proceeding under section 306; but this advice by the [Administrator] does not preclude the institution of such a proceeding at any time.

[Sec. 303 amended 8-23-58 (NCCUSL).]

Official Code Comment

.01 [Sec. 303—Registration by coordination.]—This section streamlines the content of the registration statement and the procedure by which it becomes effective, but not the substantive standards governing its effectiveness. The same stop-order standards specified in § 306 govern all three types of registration—notification, coordination and qualification.

The phrase "in connection with the same offering" does not require that the federal and state registration statements either be filed simultaneously or become effective simultaneously. Thus a registration statement by coordination might be filed in a particular state shortly after the effectiveness of the federal registration statement, although the Administrator would be free to decide that it was not "the same offering" if the interval was too great.

In the case of those investment companies which offer their securities continually by filing periodic amendments to their federal registration statements under the special procedure afforded by § 24(e) of the Investment Company Act of 1940 (see the comment under § 305(k)), conceptually each such amendment represents

a new "offering." That is to say, every amendment filed with the SEC under § 24(e) is in substance a new registration statement. Hence it is contemplated that securities so registered with the SEC may be registered under this Act by coordination so long as the interval between the filing of the SEC amendment and the filing under this Act is not too great. Any question as to the propriety of this construction may be readily resolved by the adoption of a definitional rule under § 412(a) providing, in substance, that the term "registration statement" as used in § 303(a) includes an amendment filed under § 24(e) of the Investment Company Act of 1940.

[Sec. 303(b)—Filing same as with SEC.]—This subsection limits the Administrator to requiring only such information as is filed with the SEC. Concerning § 303(b)(4), see the comment under § 303(c).

[Sec. 303(c)—Time when registration is effective.]—This subsection is designed to achieve simultaneous effectiveness at the federal and state levels without impinging upon the Administrator's duty to test the registration statement under the substantive standards imposed by § 306.

In order for the registration statement to become effective automatically when it becomes effective at the SEC, all the conditions specified in Clauses (1)-(3) must be satisfied unless the Administrator waives one or more of them.

Under § 303(b)(4) the registration statement when it is filed must be accompanied by an undertaking to forward all amendments to the federal registration statement. There is an exception for an amendment which merely delays the federal effective date. This refers to the practice whereby, if twenty days have expired since the filing of the last federal amendment and the registration statement has not yet been corrected to the satisfaction of the SEC, the registrant files an amendment merely changing the filing date, thus starting another twenty-day period running and avoiding the necessity of the Commission's instituting a proceeding to prevent automatic effectiveness. Sometimes amendments are mailed to the SEC and sometimes they are filed manually. When they are mailed they are not "filed" under § 413(a) until they are received, and in that event they will have to be forwarded to the Administrator not later than the first business day after they are sent to the SEC. Under § 306(a)(2)(H) failure to comply with the required undertaking is per se a basis for a stop order.

Clause (3) and the next three sentences are addressed to the problem of getting to the Administrator the content of the federal price amendment in the short interval (seldom more than twenty-four hours) which usually elapses between its filing and the effectiveness of the federal registration statement. Clause (3) enables the Administrator to apply the stop-order test in § 306(a)(2)(F) by comparing the maximum underwriting commissions with the minimum offering price, and to apply the test in § 306(a)(2)(E) by reference to the maximum proposed offering price. Section 410(a)(1) imposes an absolute civil liability upon any person who "offers or sells a security in violation of section * * * 301," and § 410(f) makes the contract unenforceable. But under the fourth and fifth sentences the validity of offers and sales in the state is not affected unless the registrant was at fault.

The last sentence makes it possible for counsel for the registrant or the underwriter to give a firm opinion to his client that all the conditions of § 303(c) have been satisfied, although it requires nothing further of the registrant.

Sec. 304. [REGISTRATION BY QUALIFICATION.] (a) Any security may be registered by qualification.

(b) A registration statement under this section shall contain the following information and be accompanied by the following documents in addition to the information specified in section 305(c) and the consent to service of process required by section 414(g):

- (1) with respect to the issuer and any significant subsidiary: its name, address, and form of organization; the state or foreign jurisdiction and date of its organization; the general character and location of its business; a description of its physical properties and equipment; and a statement of the general competitive conditions in the industry or business in which it is or will be engaged;
- (2) with respect to every director and officer of the issuer, or person occupying a similar status or performing similar functions: his name, address, and principal occupation for the past five years; the amount of securities of the issuer held by him as of a specified date within thirty days of the filing of the registration statement; the amount of the securities covered by the registration statement to which he has indicated his intention to subscribe; and a description of any material interest in any material transaction with the issuer or any significant subsidiary effected within the past three years or proposed to be effected;
- (3) with respect to persons covered by clause (2): the remuneration paid during the past twelve months and estimated to be paid during the next twelve months, directly or indirectly, by the issuer (together with all predecessors, parents, subsidiaries, and affiliates) to all those persons in the aggregate;

- (4) with respect to any person owning of record, or beneficially if known, ten percent or more of the outstanding shares of any class of equity security of the issuer: the information specified in clause (2) other than his occupation;
- (5) with respect to every promoter if the issuer was organized within the past three years: the information specified in clause (2), any amount paid to him within that period or intended to be paid to him, and the consideration for any such payment;
- (6) with respect to any person on whose behalf any part of the offering is to be made in a non-issuer distribution: his name and address; the amount of securities of the issuer held by him as of the date of the filing of the registration statement; a description of any material interest in any material transaction with the issuer or any significant subsidiary effected within the past three years or proposed to be effected; and a statement of his reasons for making the offering;
- (7) the capitalization and long-term debt (on both a current and pro forma basis) of the issuer and any significant subsidiary, including a description of each security outstanding or being registered or otherwise offered, and a statement of the amount and kind of consideration (whether in the form of cash, physical assets, services, patents, goodwill, or anything else) for which the issuer or any subsidiary has issued any of its securities within the past two years or is obligated to issue any of its securities;
- (8) the kind and amount of securities to be offered; the proposed offering price or the method by which it is to be computed; any variation therefrom at which any proportion of the offering is to be made to any person or class of persons other than the underwriters, with a specification of any such person or class; the basis upon which the offering is to be made if otherwise than for cash; the estimated aggregate underwriting and selling discounts or commissions and finders' fees (including separately cash, securities, contracts, or anything else of value to accrue to the underwriters or finders in connection with the offering) or, if the selling discounts or commissions are variable; the basis of determining them and their maximum and minimum amounts; the estimated amounts of other selling expenses, including legal, engineering, and accounting charges; the name and address of every underwriter and every recipient of a finder's fee; a copy of any underwriting or selling-group agreement pursuant to which the distribution is to be made, or the proposed form of any such agreement whose terms have not yet been determined; and a description of the plan of distribution of any securities which are to be offered otherwise than through an underwriter;
- (9) the estimated cash proceeds to be received by the issuer from the offering; the purposes for which the proceeds are to be used by the issuer; the amount to be used for each purpose; the order or priority in which the proceeds will be used for the purposes stated; the amounts of any funds to be raised from other sources to achieve the purposes stated; the sources of any such funds; and, if any part of the proceeds is to be used to acquire any property (including goodwill) otherwise than in the ordinary course of business, the names and addresses of the vendors, the purchase price, the names of any persons who have received commissions in connection with the acquisition, and the amounts of any such commissions and any other expense in connection with the acquisition (including the cost of borrowing money to finance the acquisition);

- (10) a description of any stock options or other security options outstanding, or to be created in connection with the offering, together with the amount of any such options held or to be held by every person required to be named in clause (2), (4), (5), (6), or (8) and by any person who holds or will hold ten percent or more in the aggregate of any such options;
- (11) the dates of, parties to, and general effect concisely stated of, every management or other material contract made or to be made otherwise than in the ordinary course of business if it is to be performed in whole or in part at or after the filing of the registration statement or was made within the past two years, together with a copy of every such contract; and a description of any pending litigation or proceeding to which the issuer is a party and which materially affects its business or assets (including any such litigation or proceeding known to be contemplated by governmental authorities);
- (12) a copy of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature intended as of the effective date to be used in with the offering;
- (13) a specimen or copy of the security being registered; a copy of the issuer's articles of incorporation and by-laws, or their substantial equivalents, as currently in effect; and a copy of any indenture or other instrument covering the security to be registered;
- (14) a signed or conformed copy of an opinion of counsel as to the legality of the security being registered (with an English translation if it is in a foreign language), which shall state whether the security when sold will be legally issued, fully paid, and non-assessable, and, if a debt security, a binding obligation of the issuer;
- (15) the written consent of any accountant, engineer, appraiser, or other person whose profession gives authority to a statement made by him, if any such person is named as having prepared or certified a report or valuation (other than a public and official document or statement) which is used in connection with the registration statement;
- (16) a balance sheet of the issuer as of a date within four months prior to the filing of the registration statement; a profit and loss statement and analysis of surplus for each of the three fiscal years preceding the date of the balance sheet and for any period between the close of the last fiscal year and the date of the balance sheet, or for the period of the issuer's and any predecessors' existence if less than three years; and, if any part of the proceeds of the offering is to be applied to the purchase of any business, the same financial statements which would be required if that business were the registrant; and
- (17) such additional information as the [Administrator] requires by rule or order.

(c) A registration statement under this section becomes effective when the [Administrator] so orders.

[Sec. 304 amended 4-23-58 (NCCUSL), 4-11-87 (NASAA).]

Official Code Comment

.01 [Sec. 304(b)—Procedure for registration by qualification.]—This subsection is modeled on Schedule A of the Securities Act of 1933, 15 U.S.C. § 77aa, SEC

Form S-1, which is the basic registration form under that act, and a number of the state statutes. Section 305 contains a number of provisions applicable to registration generally, including authority in § 305(e) to reduce the

content of the registration statement by rule or otherwise. And § 412(a) gives authority to classify, and adopt different forms for different types of, issues and issuers.

Administrator to require the use of a prospectus in those unusual cases where he deems it in the public interest. This Act, unlike the federal statute, is not primarily a disclosure act.

[Sec. 304(d)—Rule requirements with respect to prospectuses].—This subsection simply authorizes the

Sec. 305. [PROVISIONS APPLICABLE TO REGISTRATION GENERALLY.] (a) A registration statement may be filed by the issuer, any other person on whose behalf the offering is to be made, or a registered broker-dealer.

[(b) Every person filing a registration statement shall pay a filing fee of \$..... percent of the maximum aggregate offering price at which the registered securities are to be offered in this state, but the fee shall in no case be less than \$..... or more than \$..... When a registration statement is withdrawn before the effective date or a pre-effective stop order is entered under section 306, the [Administrator] shall retain \$..... of the fee.]

(c) Every registration statement shall specify (1) the amount of securities to be offered in this state; (2) the states in which a registration statement or similar document in connection with the offering has been or is to be filed; and (3) any adverse order, judgment, or decree entered in connection with the offering by the regulatory authorities in each state or by any court or the Securities and Exchange Commission.

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

(e) The [Administrator] may by rule or otherwise permit the omission of any item of information or document from any registration statement.

(f) In the case of a non-issuer distribution, information may not be required under section 304 or 305(j) unless it is known to the person filing the registration statement or to the persons on whose behalf the distribution is to be made, or can be furnished by them without unreasonable effort or expense.

(g) The [Administrator] may by rule or order require as a condition of registration by qualification or coordination (1) that any security issued within the past three years or to be issued to a promoter for a consideration substantially different from the public offering price, or to any person for a consideration other than cash, be deposited in escrow; and (2) that the proceeds from the sale of the registered security in this state be impounded until the issuer receives a specified amount from the sale of the security either in this state or elsewhere.

(h) The [Administrator] may by rule or order require as a condition of registration that any security registered by qualification or coordination be sold only on a specified form of subscription or sale contract, and that a signed or conformed copy of each contract be filed with the [Administrator] or preserved for any period up to three years specified in the rule or order.

(i) Every registration statement is effective for one year from its effective date, or any longer period during which the security is being offered or distributed in a non-exempted transaction by or for the account of the issuer or other person on whose behalf the offering is being made or by any underwriter or broker-dealer who is still offering part of an unsold allotment or subscription taken by him as a participant in the distribution, except during the time

a stop order is in effect under section 306. All outstanding securities of the same class as a registered security are considered to be registered for the purpose of any non-issuer transaction (1) so long as the registration statement is effective and (2) between the thirtieth day after the entry of any stop order suspending or revoking the effectiveness of the registration statement under section 306 (if the registration statement did not relate in whole or in part to a non-issuer distribution) and one year from the effective date of the registration statement. A registration statement may not be withdrawn for one year from its effective date if any securities of the same class are outstanding. A registration statement may be withdrawn otherwise only in the discretion of the [Administrator].

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

(k) a registration statement may be amended after its effective date so as to increase the securities specified to be offered and sold, if the public offering price and underwriters' discounts and commissions are not changed from the respective amounts of which the [Administrator] was informed. The amendment becomes effective when the [Administrator] so orders. Every person filing such an amendment shall pay a late registration fee of [\$25] and a filing fee, calculated in the manner specified in subsection (b), with respect to the additional securities proposed to be offered. The amendment relates back to the date of the sale of the additional securities being registered, provided that within six months of the date of such sale the amendment is filed and the additional filing fee and late registration fee are paid.

(l) The [Administrator] may by rule or order require as a condition of registration under Sections 302, 303 or 304 that a prospectus be sent or given to each person to whom an offer is made in accordance with the prospectus delivery requirements of the Securities Act of 1933.* The [Administrator] may require that a prospectus containing any part of the information specified in subsection 304(b) be sent or given to each person to whom an offer is made before the sale of the security.

*NOTE: While no specific provisions for remedies have been provided for violations of the above prospectus delivery requirements proposals regarding such remedies will be forthcoming from the NASAA Uniform Securities Act Committee.

[Sec. 305 amended 8-23-58 (NCCUSL), 4-11-87 (NASAA).]

Official Code Comment

.01 [Sec. 305(a)—Provisions applicable to registrations generally.]—This section contains a number of provisions which are equally applicable to all three types of registration, or in a few cases to two of the three types.

The reference here to “any other person on whose behalf the offering is to be made” is designed for non-issuer distributions. See the comment under § 305(i). This section makes it possible for a local broker-dealer to file a registration statement independently of the issuer or underwriters, especially in coordination cases, so that the issuer and underwriters will not be able to veto the

making of an offering and the establishment of a market in any state in which they do not choose to register.

[Sec. 305(b)—Fee for convertible securities and offerings by way of warrants or rights.]—On the fee problem with respect to convertible securities and offerings by way of warrants or rights, see the comment under § 401(j)(5).

[Sec. 305(c)—When registration statement must be amended.]—This subsection, like every other provision having to do with the content of the registration statement, must be read in the light of the fact that the accuracy and completeness of the registration statement

are judged under § 306(a)(2)(A) as of its effective date unless a proceeding to deny effectiveness is instituted before the effective date. That is to say, the registration statement must be kept current with changing developments until the effective date, but it need not be amended thereafter except to correct inaccuracies or deficiencies which existed as of the effective date. If the Administrator wants some or all registration statements to be brought up to date periodically, he may do so by requiring reports under § 305(j).

Clause (3) does not require that notice be given with respect to any order permitting withdrawal of a registration statement. The Administrator may nevertheless require such information in qualification cases under § 304(b)(17).

[Sec. 305(d)—Incorporation by reference.]—The language in brackets is included only because some states do not keep files indefinitely. If a particular state does not keep files for as long as five years, or if it keeps them longer, some other appropriate figure should be substituted for “five.” But if files are kept indefinitely, the bracketed language should be omitted.

[Sec. 305(f)—Non-issuer distribution cross-reference.]—See paragraph 10 of the comment under § 305(i).

[Sec. 305(g)—Rule with respect to state of escrow.]—The “but” clause at the end of the subsection is designed to break the impasse which arises when each of several Administrators imposes an escrow or impounding requirement and insists that the depository be in his state.

[Sec. 305(h)—Rule with respect to form of sale contract.]—This provision is included to take care of the few states in which this regulatory device is used. No implication is intended that this authority should be used by the Administrator in states in which it is not traditional.

[Secs. 305(i) and 305(j) and related sections referring to non-issuer distributions.]—The statutory scheme with respect to non-issuer distributions and the related question of how long a registration statement remains effective is as follows:

1. Section 301(a) applies broadly to any offer or sale by any person. Thus, it is literally unlawful for A to sell five shares of X Corp. to B unless there is registration or an exemption.

2. The term “non-issuer” is defined in § 401(h) to mean simply “not directly or indirectly for the benefit of the issuer.”

3. Section 402(b)(1) exempts from registration “any isolated non-issuer transaction, whether effected through a broker-dealer or not.”

4. When the non-issuer distribution is something more than an “isolated transaction,” however that phrase is construed, it may still be exempted under one of the following sections: 402(a)(8), 402(b)(3), 402(b)(6), 402(b)(7), 402(b)(8), or 402(b)(9). See the comments under those sections.

5. Apart from these exemptions of general applicability, § 402(b)(2) affords an exemption which is specifically designed for certain non-issuer distributions. An Administrator who chooses to do so may keep track of the securities sold under this exemption by requiring under § 203(a) that registered broker-dealers prepare and keep lists of those securities.

6. If no exemption is available for the non-issuer distribution, the security must be registered. Under the first sentence of § 305(i) every registration statement is effective for at least one year and for any longer period during which the security is being distributed, except while a stop order is in effect. Under Clause (1) of the second sentence all outstanding securities “of the same class” as the registered security are considered to be registered for the purpose of any non-issuer transaction so long as the registration statement remains effective. And § 305(j) gives the Administrator power by rule or order to require the registrant to file reports so long as the registration remains effective. With respect to the applicability of § 305(j) to convertible securities and rights offerings, see the comment under § 401(j)(5). The effect is that as long as a registration statement is effective, no matter who has filed it or how many units of the class have been registered, all securities of the same class can be legally traded by anybody as if they were registered.

7. Clause (2) of the second sentence of § 305(i) is designed to take care of the situation where the Administrator finds it necessary to enter a stop order during the year after the effective date. When the registration which thus becomes the subject of a stop order was itself filed in connection with the non-issuer distribution, it would substantially nullify the effect of the stop order to continue to permit a secondary market on the class registration theory of the first sentence of § 305(i). But, when the registration statement related entirely to a primary distribution by the issuer, and a substantial part of the offering was made in the state before the stop order was entered, Clause (2) avoids indefinitely locking the buyers in. Clause (2) stops all trading based on the class registration theory of the first sentence of § 304(i), as distinct from trading based on the “isolated transaction” exemption in § 402(b)(1) or some other exemption, for thirty days after the entry of the stop order, so that the public may become aware of the stop order and the reason for its entry. Thereafter such trading may resume until the year has expired.

8. If securities of the class being registered are outstanding when the registration statement becomes effective, or if some of the registered securities have

been sold, post-effective withdrawal of the registration statement would interfere with the privilege of persons generally to engage in non-issuer trading for a minimum period of one year after the effective date. Since sellers might not always know of the withdrawal, they might thus be subjected to civil liability through no fault of their own. For this reason § 305(i) provides that a registration statement may not be withdrawn for one year from its effective date if any securities of the same class are outstanding.

9. If no exemption is available for a non-issuer distribution and a registration statement for securities of the same class is not effective, there arises for the first time the necessity of filing a special registration statement to permit a non-issuer distribution. As in the case of a distribution for the account of the issuer, registration may be affected here by coordination, notification or qualification. Concerning the exclusion of oil, gas and mining interests from § 302(a)(2), see the comment under § 401(g)(2). A registration for a non-issuer distribution, like any other registration, is considered to register all outstanding securities of the same class, and thus to permit anybody to trade for a minimum of one year or however much longer it may take to complete the registered non-issuer distribution. It is thus immaterial whether the registration statement specifically covers 100 shares or 100,000 shares, because the Administrator may not permit the registration statement to become effective unless the statutory standards are satisfied.

10. Section 305(f) is designed only to take care of the case where the seller cannot obtain certified financial statements and other data normally required. The phrase "without unreasonable effort or expense" is borrowed from § 10(a)(3) of the Securities Act of 1933,

15 U.S.C. § 77j(a)(3). In the case of a non-issuer distribution by a person who is in a control relationship with the issuer or otherwise has access to required information, that phrase is not meant to apply to the expense which is merely incident to supplying the information required to register. Moreover, § 305(f) does not excuse the filing of the financial data required by § 302(b)(6) if a non-issuer distribution is registered by notification; for § 305(f) applies by its terms only to §§ 304 (registration by qualification) and 305(j) (reports). The person filing the registration statement can always register by qualification. Although he may not be able to obtain the financial data required by § 302(b)(6) to demonstrate eligibility for the notification procedure, he may be able to obtain other information which the Administrator might wish to require under § 304.

[Sec. 305(k)—Amendment procedure for investment companies continually offering securities.]—Investment companies of the types here specified are distinguished by the fact that they are continually offering their securities. Therefore, they do not lend themselves readily to the concept of registering a security in connection with a proposed distribution. For that reason Congress in 1954 added a new § 24(e) to the Investment Company Act of 1940, 15 U.S.C. § 80a-24(e), providing an amendment procedure for registration statements filed under the Securities Act of 1933 by investment companies of these types. Since these investment companies typically offer in many states, the same provision is incorporated in § 305(k). Normally the investment company will presumably wish to use the coordination procedure under § 303. See the last paragraph of the comment under § 303(a). But it will find § 305(k) useful when it runs out of locally registered securities in a particular state before it had to file an amendment to its federal registration statement.

Sec. 306. [DENIAL, SUSPENSION, AND REVOCATION OF REGISTRATION.] (a) The [Administrator] may issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, any registration statement if he finds

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

(2) that

- (A) the registration statement as of its effective date or as of any earlier date in the case of an order denying effectiveness, or any amendment under section 305(k) as of its effective date, or any report under section 305(j) is incomplete in any material respect or contains any statement which was, in the light of the circumstances under which it was made, false or misleading with respect to any material fact;
- (B) any provision of this act or any rule, order, or condition lawfully imposed under this act has been willfully violated, in connection with the offering, by (i) the person filing the registration statement, (ii) the issuer, any partner, officer, or director of the issuer, any person occupying a similar status or performing similar

functions, or any person directly or indirectly controlling or controlled by the issuer, but only if the person filing the registration statement is directly or indirectly controlled by or acting for the issuer, or (iii) any underwriter;

- (C) the security registered or sought to be registered is the subject of an administrative stop order or similar order or a permanent or temporary injunction of any court of competent jurisdiction entered under any other federal or state act applicable to the offering; but (i) the [Administrator] may not institute a proceeding against an effective registration statement under clause (C) more than one year from the date of the order or injunction relied on, and (ii) may not enter an order under clause (C) on the basis of an order or injunction entered under any other state act unless that order or injunction was based on facts which would currently constitute a ground for a stop order under this section;
- (D) the issuer's enterprise or method of business includes or would include activities which are illegal where performed;
- (E) the offering has worked or tended to work a fraud upon purchasers or would so operate;
- [(E)] [the offering is being made on terms that are unfair, unjust or inequitable.]
- (F) the offering has been or would be made with unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters' profits or participation, or unreasonable amounts or kinds of options;
- (G) when a security is sought to be registered by notification, it is not eligible for such registration;
- (H) when a security is sought to be registered by coordination, there has been a failure to comply with the undertaking required by section 303(b)(4); or
- (I) the applicant or registrant has failed to pay the proper filing fee; but the [Administrator] may enter only a denial order under this clause and he shall vacate any such order when the deficiency has been corrected.

The [Administrator] may not institute a stop order proceeding against an effective registration statement on the basis of a fact or transaction known to him when the registration statement became effective unless the proceeding is instituted within the next thirty days.

(b) The [Administrator] may by order summarily postpone or suspend the effectiveness of the registration statement pending final determination of any proceeding under this section. Upon the entry of the order, the [Administrator] shall promptly notify each person specified in subsection (c) that it has been entered and of the reasons therefor and that within fifteen days after the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the [Administrator], the order will remain in effect until it is modified or vacated by the [Administrator]. If a hearing is requested or ordered, the [Administrator], after notice of an opportunity for hearing to each person specified in subsection (c), may modify or vacate the order or extend it until final determination.

(c) No stop order may be entered under any part of this section except the first sentence of subsection (b) without (1) appropriate prior notice to the applicant or registrant, the issuer, and the person on whose behalf the securities are to be or have been offered, (2) opportunity for hearing, and (3) written findings of fact and conclusions of law.

(d) The [Administrator] may vacate or modify a stop order if he finds the conditions which prompted its entry have changed or that is otherwise in the public interest to do so.

[Sec. 306 amended 4-11-87 (NASAA).]

Official Code Comment

.01 [Sec. 306(a)—Stop orders.]—This subsection applies equally to all three types of registration.

Clause (A): The completeness and accuracy of the registration statement are to be tested as of its effective date in a suspension or revocation proceeding. That is to say, the fact that a registration statement has become misleading by virtue of developments occurring after its effective date is not a ground for the issuance of a stop order revoking its effectiveness under Clause (A). Post-effective amendments are not necessary except to reflect inaccuracies as of the effective date. If a particular Administrator wants the registration statement to be kept more or less currently accurate so long as it remains effective, he may require reports as often as quarterly by rule or order under § 305(j). In that event, filing a misleading report would be a basis for a stop order under Clause (A) and failure to file such a report would be a basis for a stop order under Clause (B). On the other hand, in a proceeding to deny effectiveness to a pending registration statement, its completeness and accuracy cannot be tested as of the effective date. This explains the first “or” clause in Clause (A).

Clause (B): Concerning the meaning of “willfully,” see the comment under § 204(a)(2)(B). Under Clause (ii) a violation by the issuer has the same consequences whether the issuer has filed the registration statement itself or has had a local broker-dealer file the registration statement for it. But, when the registration is filed by a local broker-dealer who is acting independently, a provision authorizing the issuance of a stop order for a violation by the issuer or somebody connected with the issuer would be inconsistent with the statutory purpose of permitting (particularly in cases of registration by coordination) the making of an offering and the establishment of a market in any state in which a

registered broker-dealer is willing to effect registration. See the comment under § 305(a).

Clause (C): The word “is” at the beginning of Clause (C) means that a stop order or injunction which has expired by its terms or been vacated is not a ground for action under this clause.

Clause (D): The reference here is to something like a racetrack or gambling casino which is conducted in a state where such an enterprise is illegal. The “public interest” standard in Clause (1) must always be considered. Thus the fact that a large department store had recently violated a statute on resale price maintenance or minimum wages would not justify action under Clause (D). Moreover, Clause (D) is not meant to apply to an enterprise which is lawful where conducted, although it would be illegal if conducted in the state where the registration statement is filed.

Clause (E): Section 401(d) provides that the term “fraud” is not limited to common-law deceit. But this clause is not designed to be as broad as the “sound business principles” standard or the “fair, just, and equitable” standard found in some statutes.

Clause (F): This clause is broad enough to cover the statement of policy on options which was adopted in 1946 by the National Association of Securities Administrators, as well as its 1955 statement of policy on so-called “cheap stock.” 29 Proceedings of NASA 84-90; 38 id. 113-15.

[Sec. 306(c)—Cross reference to applicability of State Administrative Procedure Act.]—This section is comparable to § 204(f) and the comment there is equally applicable here.

Sec. 307. [FEDERAL COVERED SECURITIES.] (a) The Administrator, by rule or order, may require the filing of any or all of the following documents with respect to a covered security under Section 18(b)(2) of the Securities Act of 1933:

- (1) Prior to the initial offer of such federal covered security in this state, all documents that are part of a federal registration statement filed with the US Securities and Exchange Commission under the Securities Act of 1933, together with a consent to service of

process signed by the issuer and with [Insert language here to provide for the fee to be paid specifically for these types of filings, similar to the inclusion of the fee payment in section 305 of the USA for securities that are registered. Alternatively, depending upon the state's method of acknowledging fee payments, a cross-reference to fee language included separately in your act or your regulations could be included here. It must be recognized, however, that such fee language likely will need to be revised to acknowledge that the fee is now tied only to a filing requirement and not a registration or exemption].

- (2) After the initial offer of such federal covered security in this state, all documents that are part of an amendment to a federal registration statement filed with the US Securities and Exchange Commission under the Securities Act of 1933., which shall be filed concurrently with the [Administrator].
- (3) A report of the value of such federal covered securities offered or sold in this state, together with [Insert language here to provide for the fee to be paid, whether by specifically including it or by a cross-reference as note.]

(b) With respect to any security that is a covered security under Section 18(b)(4)(D) of the Securities Act of 1933, the Administrator, by rule or order, may require the issuer to file a notice on SEC Form D and a consent to service of process signed by the issuer no later than 15 days after the first sale of such covered security in this state, together with [the state should reference here the fee to be paid, whether by specifically including it or by a cross-reference.

(c) The Administrator, by rule or otherwise, may require the filing of any document filed with the US Securities and Exchange Commission under the Securities Act of 1933, with respect to a covered security under Section 18(b)(3) or (4) of the Securities Act of 1933, together with [the state should reference here the fee to be paid, whether by specifically including it or by a cross-reference.

(d) The Administrator may issue a stop order suspending the offer and sale of a covered security, except a covered security under Section 18(b)(1) of the Securities Act of 1933, if it finds that

- (1) the order is in the public interest and
- (2) there is a failure to comply with any condition established under this section.

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

[Sec. 307 added 4-27-97 (NASAA).]

Part IV General Provisions

Sec. 401. [DEFINITIONS.] When used in this act, unless the context otherwise requires:

(a) “[Administrator]” [substitute any other appropriate term, such as “Commission,” “Commissioner,” “Secretary,” etc.] means the [official or agency designated in section 406(a)].

(b) “Agent” means any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect purchases or sales of securities. “Agent” does not include an individual who represents (1) an issuer in (A) effecting transactions in a security exempted by clause (1), (2), (3), (10), or (11) of section 402(a), (B) effecting transactions exempted by section 402(b), or (C) effecting transaction in a covered security as described in section 18(b)(3) and 18(b)(4)(D) of the Securities Act of 1933, or (D) effecting transactions with existing employees, partners or directors of the issuer if no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state; or (2) a broker-dealer in effecting transactions in this state limited to those transactions described in section 15(h)(2) of the Securities Exchange Act of 1934. A partner, officer, or director of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is an agent only if he otherwise comes within this definition.

(c) “Broker-dealer” means any person engaged in the business of effecting transactions in securities for the account of others or for his own account. “Broker-dealer” does not include (1) an agent, (2) an issuer, (3) a bank, savings institution, or trust company, or (4) a person who has no place of business in this state if (A) he effects transactions in this state exclusively with or through (i) the issuers of the securities involved in the transactions, (ii) other broker-dealers, or (iii) banks, savings institutions, trust companies, insurance companies, investment companies as defined in the Investment Company Act of 1940, pension or profit-sharing trusts, or other financial institutions or institutional buyers, whether acting for themselves or as trustees, or (B) the person is licensed under the securities act of a state in which the person maintains a place of business and the person offers and sells in this state to a person who is an existing customer of the person and whose residence is not in this state.

(c1) “Federal covered adviser” means a person who is registered under section 203 of the Investment Advisers Act of 1940, except that, until October 10, 1999, a federal covered adviser for which a nonpayment or underpayment of a fee has not been promptly remedied following written notification to the adviser of such nonpayment or underpayment shall not be a federal covered adviser.

(c2) “Federal covered security” means any security that is a covered security under section 18(b) of the Securities Act of 1933 or rules or regulations promulgated thereunder, except, up through October 10, 1999 or such other date as may be legally permissible, a federal covered security for which a fee has not been paid and promptly remedied following written notification from the Administrator to the issuer of the nonpayment or underpayment of such fees, as required by this Act, shall not be a federal covered security.

(d) “Fraud,” “deceit,” and “defraud” are not limited to common-law deceit.

(e) “Guaranteed” means guaranteed as to payment of principal, interest, or dividends.

(f) “Investment adviser” means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities. “Investment adviser” also includes financial planners and other persons who, as an integral component of other financially related services, provide the foregoing investment advisory services to others for compensation and as part of a business or who hold themselves out as providing the foregoing investment advisory services to others for compensation. “Investment adviser” does not include (1) an investment adviser representative;

(2) a bank, savings institution, or trust company; (3) a lawyer, accountant, engineer, or teacher whose performance of these services is solely incidental to the practice of his profession; (4) a broker-dealer or its agent whose performance of these services is solely incidental to the conduct of its business as a broker-dealer and who receives no special compensation for them; (5) a publisher of any bona fide newspaper, news column, newsletter, news magazine, or business or financial publication or service, whether communicated in hard copy form, or by electronic means, or otherwise, that does not consist of the rendering of advice on the basis of the specific investment situation of each client; (6) any person that is a federal covered adviser; or (7) such other persons not within the intent of this subsection as the [Administrator] may by rule or order designate.

(g) "Investment adviser representative" means any partner, officer, director of (or a person occupying a similar status or performing similar functions) or other individual employed by or associated with an investment adviser that is registered or required to be registered under this act, or who has a place of business located in this state and is employed by or associated with a federal covered adviser; and who does any of the following: (1) makes any recommendations or otherwise renders advice regarding securities, (2) manages accounts or portfolios of clients, (3) determines which recommendation or advice regarding securities should be given, (4) solicits, offers or negotiates for the sale of or sells investment advisory services, or (5) supervises employees who perform any of the foregoing.

(h) "Issuer" means any person who issues or proposes to issue any security, except that (1) with respect to certificates of deposit, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or persons performing similar functions or of the fixed, restricted management, or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which the security is issued; and (2) with respect to certificates of interest or participation in oil, gas, or mining titles or leases, or in payments out of production under such titles or leases, there is not considered to be any "issuer."

(i) "Non-issuer" means not directly or indirectly for the benefit of the issuer.

(j) "Person" means an individual, a corporation, a partnership, an association, a joint-stock company, a trust where the interests of the beneficiaries are evidenced by a security, an unincorporated organization, a government, or a political subdivision of a government.

(k)

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

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

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

(4) A purported gift of assessable stock is considered to involve an offer and sale.

- (5) Every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer, as well as every sale or offer of a security which gives the holder a present or future right or privilege to convert into another security of the same or another issuer, is considered to include an offer of the other security.
- (6) The terms defined in this subsection do not include (A) any bona fide pledge or loan; (B) any stock dividend, whether the corporation distributing the dividend is the issuer of the stock or not, if nothing of value is given by stockholders for the dividend other than the surrender of a right to a cash or property dividend when each stockholder may elect to take the dividend in cash or property or in stock; (C) any act incident to a class vote by stockholders, pursuant to the certificate of incorporation or the applicable corporation statute, on a merger, consolidation, reclassification of securities, or sale of corporate assets in consideration of the issuance of securities of another corporation; or (D) any act incident to a judicially approved reorganization in which a security is issued in exchange for one or more outstanding securities, claims, or property interests, or partly in such exchange and partly for cash.

(l) "Securities Act of 1933," "Securities Exchange Act of 1934," "Public Utility Holding Company Act of 1935," "Investment Advisers Act of 1940," and "Investment Company Act of 1940" mean the federal statutes of those names as amended before or after the effective date of this act.

(m) "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay [a fixed sum of] money either in a lump sum or periodically for life or for some other specified period.

(n) "State" means any state, territory, or possession of the United States, the District of Columbia and Puerto Rico.

[Sec. 401 amended 8-23-58 (NCCUSL), 10-14-81 (NASAA), 11-20-86 (NASAA), 4-11-87 (NASAA), 4-27-97 (NASAA).]

Official Code Comment

.01 [Sec. 401(b)—"Agent" as "broker-dealer."—Whether a particular individual who represents a broker-dealer or issuer is an "agent" or is himself a "broker-dealer" depends upon much the same factors which create an agency relationship at common law. That is to say, the question turns essentially on whether the individual has manifested a consent to the broker-dealer or issuer to act subject to his control. See Restatement of Agency § 1. The last sentence does not require every partner, officer or director to file a separate application for registration, because the last sentence of § 202(a) provides that registration of a broker-dealer automatically

constitutes registration of any agent who is a partner, officer or director. See the comment under § 202(a).

[Sec. 401(c)—Persons without a place of business.]—With respect to the distinction between a person who is "engaged in the business of effecting transactions * * * for his own account" and an ordinary investor who buys and sells with some frequency, see Loss, Securities Regulation (1951 with 1955 Supp.), pp. 720-22. Clause (4): See paragraph 12 of the comment under § 414(a)-(f). The reference in Clause (B) to fifteen offers during any period of twelve consecutive months in the case of

persons without a place of business in the state is not intended to carry any implication that a person who effects more than fifteen transactions for his own account in the course of ordinary investment during any period of twelve months is for that reason alone a “broker-dealer.”

[Sec. 401(d)—Fraud not limited to common-law deceit.]—Section 401(d) codifies the holdings that “fraud” as used in federal and state securities statutes, as well as the federal mail fraud statute, is not limited to common-law deceit. See the cases cited in Loss, Securities Regulation (1951 with 1955 Supp.), p. 817, notes 30-31.

[Sec. 401(f)—Scope of definition of “investment adviser.”]—In general: This subsection has been taken almost verbatim from the definition in § 202(a)(11) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(a)(11). On the administrative construction of the federal definition, see Loss, Securities Regulation (1951 with 1955 Supp.), pp. 788-92. Clause (6) has been added; see paragraph 12 of the comment under § 414(a)-(f).

Clause (3): The model of this clause in the federal act has been thus explained in an opinion of the SEC’s General Counsel (Investment Advisers Act Release No. 2):

“[This clause] amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business. On the other hand, that portion of clause [(3)] which refers to ‘special compensation’ amounts to an equally clear recognition that a broker or dealer who is specially compensated for the rendition of advice should be considered an investment adviser and not be excluded from the purview of the Act merely because he is also engaged in effecting market transactions in securities. It is well known that many brokers and dealers have investment advisory departments which furnish investment advice for compensation in the same manner as does an investment adviser who operates solely in an advisory capacity. The essential distinction to be borne in mind in considering borderline cases * * * is the distinction between compensation for advice itself and compensation for services of another character to which advice is merely incidental.”

Clause (4): The word “paid,” which does not appear in the federal definition, has been added to emphasize that a person who periodically distributes a “tipster sheet” free as a way to get paying clients is not excluded from the definition as a “publisher.”

[Sec. 401(g)—Source of definition of “issuer.”]—The phraseology is taken almost verbatim from § 2(4) of the

Securities Act of 1933, 15 U.S.C. § 77b(4). The peculiar types of securities other than those dealt with in Clause (1)—for example, equipment-trust certificates—may be handled under the rule-making power in § 412(a).

[Sec. 401(h)—Non-issuer distribution cross-reference.]—See the comment under § 305(i).

[Sec. 401(j)—Scope of definition of “sale” and “offer.”]—Clauses (1)-(2): The phraseology is borrowed substantially from § 2(3) of the Securities Act of 1933, 15 U.S.C. § 77b(3), as amended in 1954 to split the definitions of “sale” and “offer.” See the comment under § 402(b)(12).

Clause (5): This clause provides that there is always an “offer” of the security called for by a conversion privilege or the warrant. Hence that security must be registered (unless some exemption is available) before the convertible security or the warrants are offered. Even if the warrants are themselves distributed without consideration, so that the warrants are not “sold,” a gift of a warrant involves an offer to sell the stock called for by the warrant. Hence registration of the stock is necessary before the warrants may even be given away. Moreover, since the security called for is being continuously “offered” so long as the conversion privilege or the purchase right remains exercisable, the security called for remains registered all that time under § 305(i), and the person who files the registration statement is subject to the Administrator’s power to require the filing of reports under § 305(j).

Under certain conditions, however, § 402(b)(11) exempts offers to existing security holders, specifically including “persons who at the time of the transaction are holders of convertible securities, non-transferable warrants, or transferable warrants exercisable within not more than ninety days of their issuance.” That exemption does not excuse registration of the second security (that is, the security called for by the warrant or conversion privilege) unless the offering of the first security itself (that is, the warrants or the convertible security) comes within the exemption; for there is a present “offer” of the second security under § 401(j)(5) and the offerees are not yet existing security holders. But the exemption under § 402(b)(11) will normally be available when the conversion privilege or warrant is exercised. Hence, if the first security is not being offered or distributed more than one year from the effective date of the registration statement, the effectiveness of the registration statement terminates at the end of the one-year period under § 305(i) and the power to require reports terminates at the same time.

The registration fee in the case of warrants or rights should be based on the total offering price of the security called for by the warrants or rights, together with the offering price of the warrants or rights themselves if they are not given away. In the convertible security situation, since no consideration is given for the second security

except the surrender of the first, the fee should be based solely on the offering price of the convertible security and there should be no double fee.

[Sec. 401(l)—Scope of definition of “security.”]—This subsection is identical with § 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1), except for oil, gas and mineral interests and the addition of the last sentence. Section 2(1) was modeled on the definitions in some of the state statutes, and the federal definition has in turn influenced many of the new state statutes enacted since 1933. Moreover, substantially that definition—particularly the phrase “investment contract”—has been broadly construed by both state and federal courts. See, e.g., SEC v. W.J. Howey Co., 328 U.S. 293 (1946); for citations to other federal and state cases, as well as a discussion of the administrative construction of the several phrases in the definition, see Loss, Securities Regulation (1951 with 1955 Supp.), pp. 299-329.

Oil, gas and mineral interests: Section 2(1) of the Securities Act of 1933 uses the phrase “fractional undivided interest in oil, gas, or other mineral rights.” The phrase in this statute is modeled on the language in § 25008(a) of the California act—“certificate of interest in 1986 NASAA Comment

.15 The clarifying amendment [in Section 401(f)] which specifically includes within the definition of “investment adviser” financial planners and other persons who provide investment advisory services to others for compensation and as a part of a business or who hold themselves out as providing investment advisory services to others for compensation, was largely patterned after the language found in SEC Release No. IA-770 of August 13, 1981. The drafters feel that any person in the business of providing advice or issuing reports or analyses regarding securities for compensation is an investment adviser. Financial planners and others who hold themselves out as providing investment advisory services to others for compensation are necessarily in the business of doing so and therefore an express reference to a business standard was deemed unnecessary in the second part of the definition encompassing financial planners. The provision defining an “investment adviser” to include financial planners and others who hold themselves out as providing investment advisory services to others for compensation should not be construed to mean that all financial planners fall within the definition by virtue of their designation as “financial planners.” Financial planners rendering advice exclusively in such non-securities areas as insurance and budget management, for example, would not be covered by the definition. However, persons offering “total financial planning” would be holding themselves out as providing investment advisory services. For similar reasons, the drafters thought it inappropriate to define an “investment adviser” as “a person who holds himself out as a financial planner.” A definition so worded would cover persons who, while not rendering investment advice, sell

an oil, gas, or mining title or lease”—which may be slightly broader than the federal phrase and in any event is by far the most commonly found phrase in the state statutes. The words which have been added to the California language are intended to make it clear that so-called “oil payments” are securities whether or not they may be regarded as interests in a title or lease. Very few states go so far as to include entire leasehold interests. However, it is clear that even entire leasehold interests may be offered under such circumstances that a security is involved in the nature of an “investment contract.” SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943); for other cases, see Loss, Securities Regulation (1951 with 1955 Supp.), p. 312, n. 31.

Last sentence: The last sentence has been explicitly phrased so as not to exclude from the definition the so-called “variable annuities” which have recently been developed. See also the comment under § 402(a)(5). If it is desired to exclude variable annuities along with orthodox annuities on the ground that the former are sufficiently regulated by the insurance authorities in the particular state, the bracketed language should be deleted.

insurance and other non-securities financial products as “financial planners.” Extending the “investment adviser” definition to those persons would possibly involve an incursion on the regulatory jurisdiction of state regulators other than the state securities administrator. It should be noted, however, that use of the term “financial planner” by a person engaged in product sales only without disclosing that he or she is merely a salesperson may constitute a deceptive practice that should be addressed by state financial services and consumer protection agencies.

For purposes of the exclusions in Sections 401(f)(3) and 401(f)(4), financial planners and others who hold themselves out as providing investment advisory services for compensation may not claim that the services rendered are “solely incidental” to another activity. To the contrary, holding oneself out as providing investment advisory services for compensation strongly indicates that such services are being performed on a more than incidental basis.

The exclusion pertaining to securities advisory publishers is expanded to include newsletter publishers who do not give advice to subscribers on the subscriber's specific investment situation. Because of the general nature of publishers' services, and the fact that the anti-fraud provisions apply to publishers even if excluded from the definition, the exclusion was expanded.

The exclusion provided by former section 401(f)(5) pertaining to persons who only give advice about government securities was eliminated. The type of

security should not govern who is and is not subject to registration.

The exclusion for persons advising institutional accounts was removed from section 401(f) and reconstructed in the registration exemption provided by section 201(c). Persons servicing institutional accounts, whether or not they have an office in a state, will be exempted from registration. In addition, pension and profit-sharing trusts must now be employee benefit plans with assets of at least \$1,000,000 to be considered institutional.

Comment: NASAA recognizes that some administrators, based on their experience and specialized knowledge of the investment advisory business in their jurisdictions, desire flexibility concerning whether subdivision (4) dealing with "solicitors" should be included within the definition of "investment adviser representative" under Section 401(g), and whether a broker-dealer and its agents should be excluded from subdivision (4) under certain specified circumstances. Accordingly, the Committee recommends that the adoption of subdivision (4) be at the discretion of the administrator.

.25 [Section 401(g).]—Revise Section 401(g) as follows by adding the following material, effective 4-27-90:

Sec. 402. [EXEMPTIONS.] (a) The following securities are exempted from [Sections requiring registration and filing of advertising materials]:

- (1) any security (including a revenue obligation) issued or guaranteed by the United States, any state, any political subdivision of a state, or any agency or corporate or other instrumentality of one or more of the foregoing; or any certificate of deposit for any of the foregoing;
- (2) any security issued or guaranteed by Canada, any Canadian province, any political subdivision of any such province, any agency or corporate or other instrumentality of one or more of the foregoing, or any other foreign government with which the United States currently maintains diplomatic relations, if the security is recognized as a valid obligation by the issuer or guarantor;
- (3) any security issued by and representing an interest in or a debt of, or guaranteed by, any bank organized under the laws of the United States, or any bank, savings institution, or trust company organized and supervised under the laws of any state;
- (4) any security issued by and representing an interest in or a debt of, or guaranteed by, any federal savings and loan association, or any building and loan or similar association organized under the laws of any state and authorized to do business in this state;
- (5) any security issued by and representing an interest in or a debt of, or guaranteed by, any insurance company organized under the laws of any state and authorized to do business in this state; [but this exemption does not apply to an annuity contract, investment contract, or similar security under which the promised payments are not fixed in dollars but are substantially dependent upon the investment results of a segregated fund or account invested in securities;]
- (6) any security issued or guaranteed by any federal credit union or any credit union, industrial loan association, or similar association organized and supervised under the laws of this state;
- (7) any security issued or guaranteed by any railroad, other common carrier, public utility, or holding company which is (A) subject to the jurisdiction of the Interstate Commerce Commission; (B) a registered holding company under the Public Utility Holding Company Act of 1935 or a subsidiary of such a company within the meaning of that

act; (C) regulated in respect of its rates and charges by a governmental authority of the United States or any state; or (D) regulated in respect of the issuance or guarantee of the security by a governmental authority of the United States, any state, Canada, or any Canadian province;

- (8) any security listed or approved for listing upon notice of issuance on the New York Stock Exchange, the American Stock Exchange, or the Midwest Stock Exchange [, or listed on the (insert names of appropriate regional stock exchanges)]; any other security of the same issuer which is of senior or substantially equal rank; any security called for by subscription rights or warrants so listed or approved; or any warrant or right to purchase or subscribe to any of the foregoing;
- (9) any security issued by any person organized and operated not for private profit but exclusively for religious, educational, benevolent, charitable, fraternal, social, athletic, or reformatory purposes, or as a chamber of commerce or trade or professional association;
- (10) a promissory note, draft, bill of exchange or bankers' acceptance that evidences an obligation to pay cash within 9 months after the date of issuance, exclusive of days of grace, is issued in denominations of at least \$50,000, and receives a rating in one of the 3 highest rating categories from a nationally recognized statistical rating organization; or a renewal of such an obligation that is likewise limited, or a guarantee of such an obligation or of a renewal;
- (11) any investment contract issued in connection with an employees' stock purchase, savings, pension, profit-sharing, or similar benefit plan if the Administrator is notified in writing thirty days before the inception of the plan or, with respect to plans which are in effect on the effective date of this act, within sixty days thereafter (or within thirty days before they are reopened if they are closed on the effective date of this act);

[(12) insert any desired exemption for cooperatives.]

(b) The following transactions are exempted from sections 301 and 403:

- (1) any isolated non-issuer transaction, whether effected through a broker-dealer or not;
- (2) Any non-issuer transaction by a registered agent of a registered broker-dealer, and any resale transaction by a sponsor of a unit investment trust registered under the Investment Company Act of 1940, in a security of a class that has been outstanding in the hands of the public for at least 90 days provided, at the time of the transaction:
 - (A) The issuer of the security is actually engaged in business and not in the organizational stage or in bankruptcy or receivership and is not a blank check, blind pool or shell company whose primary plan of business is to engage in a merger or combination of the business with, or an acquisition of, an unidentified person or persons; and
 - (B) The security is sold at a price reasonably related to the current market price of the security;

- (C) The security does not constitute the whole or part of an unsold allotment to, or a subscription or participation by, the broker-dealer as an underwriter of the security;
 - (D) A nationally recognized securities manual designated by rule or order of the Administrator or a document filed with the U.S. Securities & Exchange Commission (SEC) which is publicly available through the SEC's Electronic Data Gathering and Retrieval System (EDGAR) and contains:
 - (i) A description of the business and operations of the issuer,
 - (ii) The names of the issuer's officers and the names of the issuer's directors, if any, or, in the case of a non-U.S. issuer, the corporate equivalents of such persons in the issuer's country of domicile,
 - (iii) An audited balance sheet of the issuer as of a date within 18 months, or in the case of a reorganization or merger where parties to the reorganization or merger had such audited balance sheet, a pro forma balance sheet, and
 - (iv) An audited income statement for each of the issuer's immediately preceding two fiscal years, or for the period of existence of the issuer, if in existence for less than two years or, in the case of a reorganization or merger where the parties to the reorganization or merger had such audited income statement, a pro forma income statement; and
 - (E) The issuer of the security has a class of equity securities listed on a national securities exchange registered under the Securities Exchange Act of 1934, or designated for trading on the National Association of Securities Dealers Automated Quotation System (NASDAQ), unless:
 - (i) The issuer of the security is a unit investment trust registered under the Investment Company Act of 1940, or
 - (ii) The issuer of the security has been engaged in continuous business (including predecessors) for at least three years, or
 - (iii) The issuer of the security has total assets of at least \$2,000,000 based on an audited balance sheet as of a date within 18 months or, in the case of a reorganization or merger where parties to the reorganization or merger had such audited balance sheet, a pro forma balance sheet.
- (2.1) Any non-issuer transaction in a security by a registered agent of a registered broker-dealer if:
- (A) The issuer of the security is actually engaged in business and not in the organizational stage or in bankruptcy or receivership and is not a blank check, blind pool or shell company whose primary plan of business is to engage in a merger or combination of the business with, or an acquisition of, an unidentified person or persons; and
 - (B) The security is senior in rank to the common stock of the issuer both as to payment of dividends or interest and upon dissolution or liquidation of the issuer

and such security has been outstanding at least three years and the issuer or any predecessors has not defaulted within the current fiscal year or the three immediately preceding fiscal years in the payment of any dividend, interest, principal, or sinking fund installment on the security when due and payable.

- (2.2) a non-issuer transaction in an outstanding security if the issuer of the security has a class of securities subject to registration under Section 12 of the Securities Exchange Act of 1934 and has been subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 for not less than 180 days before the transaction; or has a class of securities registered under the Investment Company Act of 1940; or has filed and maintained with the [Administrator] for not less than 180 days before the transaction information substantially comparable to the information which the issuer would be required to file under Section 12(b) or Section 12(g) of the Securities Exchange Act of 1934 were the issuer to have a class of its securities registered under Section 12 of the Securities Exchange Act of 1934, in such form as the [Administrator] by rule provides, and shall pay a fee upon filing of [].
- (3) any non-issuer transaction effected by or through a registered broker-dealer pursuant to an unsolicited order or offer to buy; but the [Administrator] may by rule require that the customer acknowledge upon a specified form that the sale was unsolicited, and that a signed copy of each such form be preserved by the broker-dealer for a specified period;
- (4) any transaction between the issuer or other person on whose behalf the offering is made and an underwriter, or among underwriters;
- (5) any transaction in a bond or other evidence of indebtedness secured by a real or chattel mortgage or deed of trust, or by an agreement for the sale of real estate or chattels, if the entire mortgage, deed of trust, or agreement, together with all the bonds or other evidences of indebtedness secured thereby, is offered and sold as a unit;
- (6) any transaction by an executor, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian, or conservator;
- (7) any transaction executed by a bona fide pledge without any purpose of evading this act;
- (8) any offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profit-sharing trust, or other financial institution or institutional buyer, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity;
- (9) any transaction pursuant to an offer directed by the offeror to not more than ten persons (other than those designated in paragraph (8)) in this state during any period of twelve consecutive months, whether or not the offeror or any of the offerees is then present in this state, if (A) the seller reasonably believes that all the buyers in this state (other than those designated in paragraph (8)) are purchasing for investment, and (B) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective buyer in this state (other than those designated in paragraph (8)); but the [Administrator] may by rule or order, as to any security or transaction or any type of security or transaction, withdraw or further condition this exemption, or increase or

decrease the number of offerees permitted, or waive the conditions in Clauses (A) and (B) with or without the substitution of a limitation on remuneration;

- (10) any offer or sale of a preorganization certificate or subscription if (A) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective subscriber, (B) the number of subscribers does not exceed ten, and (C) no payment is made by any subscriber;
- (11) any transaction pursuant to an offer to existing security holders of the issuer, including persons who at the time of the transaction are holders of convertible securities, non-transferable warrants, or transferable warrants exercisable within not more than ninety days of their issuance, if (A) no commission or other remuneration (other than a standby commission) is paid or given directly or indirectly for soliciting any security holder in this state, or (B) the issuer first files a notice specifying the terms of the offer and the [Administrator] does not by order disallow the exemption within the next five full business days;
- (12) any offer (but not a sale) of a security for which registration statements have been filed under both this act and the Securities Act of 1933 if no stop order or refusal order is in effect and no public proceeding or examination looking toward such an order is pending under either act.

(c) The [Administrator] may by order deny or revoke any exemption specified in clause (8), (9) or (11) of subsection (a) or in subsection (b) with respect to a specific security or transaction. No such order may be entered without appropriate prior notice to all interested parties, opportunity for hearing, and written findings of fact and conclusions of law, except that the [Administrator] may by order summarily deny or revoke any of the specified exemptions pending final determination of any proceeding under this subsection. Upon the entry of a summary order, the [Administrator] shall promptly notify all interested parties that it has been entered and of the reasons therefor and that within fifteen days of the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the [Administrator], the order will remain in effect until it is modified or vacated by the [Administrator]. If a hearing is requested or ordered, the [Administrator], after notice of and opportunity for hearing to all interested persons, may modify or vacate the order or extend it until final determination. No order under this subsection may operate retroactively. No person may be considered to have violated section 301 or 403 by reason of any offer or sale effected after the entry of an order under this subsection if he sustains the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the order.

(d) In any proceeding under this act, the burden of proving an exemption or an exception from a definition is upon the person claiming it.

[Sec. 402 amended 8-23-58 (NCCUSL), 4-11-87 (NASAA), 4-28-96 (NASAA).]

Official Code Comment

01 [Sec. 402(a)—“Exemption” and “exception” distinguished.]—The distinction between exemptions and exceptions from definitions is important in view of the fact that the exemptions enumerated in § 402 are not exemptions from the anti-fraud provisions of §§ 101 and 410(a)(2). See the exceptions from the definition of “agent” in § 401(b), the definition of “broker-dealer” in

§ 401(c), the definition of “investment adviser” in § 401(f), the definitions of “sale” and “offer” in § 401(j)(6), and the definition of “security” in the last sentence of § 401(l).

[Sec. 402(a)(3)—Banks—Security as an interest in, debt or guaranteed by the issuer.]—Each of the exemptions in

Clauses (3)-(5) applies only if the security represents an interest in or a debt of the particular issuer, or is guaranteed by the particular issuer. The purpose is to make it clear that these exemptions do not apply when, for example, a bank acting as depository for a protective committee in a reorganization issues certificates of deposit, which in no sense represent an interest in or a claim against the bank. The exemption for bank securities in Illinois was so construed before it was specifically limited as it now is. *Jaffe v. Goldner*, 251 Ill. App. 188 (1929); see also *Commissioner of Banks v. Chase Securities Corp.*, 298 Mass. 285, 301-05, 10 N.E.2d 472, 485-87 (1937), appeal dismissed, 302 U.S. 660. But it required an amendment in California [§ 25100(c)] to override a contrary interpretation. *Young v. Three for One Royalties*, 31 P.2d 789 (Cal. 1934), rehearing denied with opinion, 1 Cal. 2d 639, 36 P.2d 1065 (1934).

[Sec. 402(a)(4)—Savings and loan associations—Security as an interest in, debt or guaranteed by the issuer cross-reference.]—See the comment under § 402(a)(3).

[Sec. 402(a)(5)—Insurance companies—Insurance policies and annuities.]—See the comment under § 402(a)(3). With respect to the status of insurance policies and annuities, see the comment under the last sentence of § 401(l). By virtue of that section, the orthodox insurance policy or annuity is not a “security” and the blue sky law has no impact on it, whereas securities issued by insurance companies are exempted from registration under the conditions of § 402(a)(5) and hence are subject to the fraud provisions. The purpose of the “but” clause in § 402(a)(5) is to make it clear that the so-called “variable annuities” which have recently been developed, and which are securities under § 401(l), are not exempted. If the bracketed language in § 401(1) is deleted (see the Commissioners' Note under that section), the bracketed language in § 402(a)(5) should be deleted for the same reason.

[Sec. 402(a)(6)—Source of reference to federal credit unions.]—The reference to federal credit unions is to those organized under 12 U.S.C. § 1751 et seq.

[Sec. 402(a)(7)—Public utilities—Municipal regulation.]—Twelve of the forty statutes with some sort of public-utility exemption refer specifically to regulation by municipal as well as state authority. The others do not necessarily exclude the possibility of municipal regulation. The reference in § 402(a)(7) to “a governmental authority of * * * any state” is broad enough to include a municipal authority.

[Sec. 402(a)(10)—Commercial paper—“Current transaction” construed.]—This exemption is modeled on § 3(a)(3) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(3). On the SEC construction of the phrase “current transaction,” see *Loss, Securities Regulation* (1951 with 1955 Supp.), p. 356. See also § 402(b)(8),

which exempts an offer or sale of any security to banks and other institutional buyers. The two exemptions substantially overlap.

[Sec. 402(a)(11)—Employee's benefit plans.]—This exemption is designed to solve the problem which arises in those states whose Administrators take the position, also taken by the SEC, that employees' benefit plans of various kinds involve an offer of a security in the nature of an “investment contract,” at least if participation is voluntary with each employee and he must contribute under the plan in order to participate. See *Loss, Securities Regulation* (1951 with 1955 Supp.), pp. 326-29.

[Sec. 402(b)(1), (2)—Isolated transactions—Non-issuer distribution cross-reference.]—See the comment under § 305(i).

[Sec. 402(b)(3)—Transactions effected by registered broker-dealer—“Solicitation” defined.] If necessary, the Administrator may use his rule-making authority under § 412(a) to define the term “solicitation.” On the construction of the term in § 4(2) of the Securities Act of 1933, 15 U.S.C. § 77d(2), see *Loss, Securities Regulation* (1951 with 1955 Supp.), pp. 405-06. In one important respect § 402(b)(3) is broader than § 4(2) of the federal statute, which the SEC has always interpreted as exempting only the broker's part of the transaction. In the SEC's view, the selling customer must find his own exemption—normally the exemption in § 4(1) of the federal act which is comparable to the exemption in § 402(b)(1) of this Act for “any isolated non-issuer transaction.” Section 402(b)(3) is not intended to be so limited. Of course, the exemption can in no case be used by an issuer, since it is limited to any non-issuer transaction.”

[Sec. 402(b)(5)—Mortgage transactions—Unit requirement.]—This exemption is severely restricted by the requirement that everything be both offered and sold as a unit. But it permits a public offering as a unit.

[Sec. 402(b)(8)—Sales to institutions—“Institutional buyer” defined.]—The term “institutional buyer” is broad enough to cover, for example, a college purchasing for its endowment fund or perhaps a labor union investing its surplus funds on a substantial scale. The term may be either left to ad hoc interpretation or defined by an interpretative rule under § 412(a).

[Sec. 402(b)(9)—Sales to limited number of persons.]—The figure ten is in substance only a prima facie figure. An Administrator, for example, may want to reduce it for uranium stocks or oil royalties or increase it for a close corporation which wants to solicit twenty or thirty friends and relatives of the owners for additional capital. The section does not require a written representation by each buyer that he is taking for investment, but it would be prudent on the part of the seller to obtain something in writing. Moreover, one who in good faith buys for

investment can later change his mind and resell, although the shorter the interval the harder it will be to show that there was a bona fide change of mind. Clause (B) is not intended to preclude solicitation by directors or officers or employees of the issuer so long as it is only an incidental function of their regular duties and they receive no additional compensation. It is also relevant whether such persons are specially hired in connection with the offering, particularly if they have a background in the securities business either as professional promoters or otherwise.

[Sec. 402(b)(10)—Preorganization subscriptions.]—Subsections (b)(9) and (b)(10), though interrelated, serve different purposes. Since the purpose of § 402(b)(10) is to enable a new enterprise to obtain the minimum number of subscriptions required by the corporation law, the limitation is on the number of subscribers rather than the number of offerees. Hence there may be a publicly advertised offering of preorganization subscriptions. But there may be no payment until effective registration unless another exemption is available. One of the other exemptions which might be available is § 402(b)(9). In that event registration would not be required at all. But § 402(b)(10) itself simply postpones registration; it does not excuse registration altogether.

1996 NASAA Comment

15 Comments to Sec. 402(b)(2) added on 4/28/96:

1. Paragraph (2) (intro.) immediately limits the exemption to non-issuer transactions by registered agents of registered broker-dealers except in resale transactions by sponsors of unit investment trusts in issued and outstanding securities. Thus, the exemption is not available for any sale or distribution by or on behalf of the issuer or any control person, except a resale transaction by a unit investment trust, nor when sold by unregistered persons in the state. These provisions are more restrictive than those in the Uniform Act.

Paragraph (2) (intro.) also requires that the securities be in the hands of the public for not less than 90 days prior to the transaction, thus barring use of the exemption immediately after an initial public offering by an issuer which may or may not have been registered for sale in the state. This time period will also help to curb the hyping of a security immediately after an initial public offering. Currently Arizona, Florida, Maine, North Dakota and Rhode Island require a 90 day “waiting period.”

With respect to unit investment trusts, the term “issuer” as used in Paragraphs (A), (D), and (E) of the exemption refers to the unit investment trust, not the sponsor of the trust.

[Sec. 402(b)(11)—Offer to stockholders—Standby commissions.]—The reference to a “standby commission” in Clause (A) is designed to permit payment to an underwriter for his risk and services in connection with his commitment to take down any portion of the offering which is not taken down by the security holders. As to what constitutes the payment of remuneration otherwise, see the comment under § 402(b)(9). The specific authority to disallow by order under Clause (B) is not subject to the general procedure set out in § 402(c) for denying any of the exemptions specified in § 402(b).

[Sec. 402(b)(12)—Written offers before effective date.]—The Securities Act of 1933 and the SEC rules severely restrict the types of written offers that may be made before the effective date.

[Sec. 402(c)—Denial or revocation of exemption.]—This subsection permits the Administrator by order to deny or revoke the exemption for any of the exempted transactions, as well as two types of exempted securities, but only with respect to a specific case. He has no authority by rule or otherwise to revoke any statutory exemption generally.

[Sec. 402(d)—Burden of proof.]—This codifies existing law. See the cases cited in Loss, Securities Regulation (1951 with 1955 Supp.), p. 414, n. 365.

2. Paragraph (B) requires that securities are sold at prices related to real market prices, not those which may be arbitrarily or artificially set through manipulation or other fraudulent practices.

3. Paragraph (C) excludes the sale of securities which remained unsold for any reason by dealers who were underwriters of such securities, whether for the issuer or any other person. Dealers cannot use the exemption if the securities being sold constitute any part of an original distribution, thus further reinforcing and restricting the non-issuer transaction limitation in paragraph (2).

4. Paragraph (D) follows the format of the Uniform Act of 1956 and the Uniform Act of 1985, by using the language “nationally recognized securities manual” and not naming any specific publisher. Rather, the language “manual designated by rule or order of the administrator” is used because an administrator naming a specific publisher in the statute may be abdicating essential regulatory obligations to publishing organizations over which the administrator exerts no oversight or control. By providing for nationally recognized securities manuals designated by rule or order by the administrator, the administrator has the ability to review and designate specific manuals and the authority to remove individual manuals of publishers from the recognized list should problems arise with the listing criteria for particular manuals. The exemption recognizes that the information

required to appear in a nationally recognized securities manual also may be available in a document filed with the SEC (e.g., Form 10-Q) and readily retrievable from EDGAR through the SEC's site on the Internet's World Wide Web.

This exemption differs from the Uniform Act in that its availability is not governed solely by a listing in a securities manual. While all Standard and Poor's, and Moody's manuals include the information specified by paragraph D, the exemption remains unavailable unless all the other conditions have been met e.g., sales through registered persons, securities outstanding for 90 days, listing on a securities exchange, etc.

Sub-paragraphs (D)(i), (ii), (iii) and (iv) also specify the type of information which must be contained in a designated manual or available through EDGAR. The addition in paragraph (D)(ii) is suggested to accommodate foreign issuers in countries where management schemes may be different from the usual "officers" and "directors" found in U.S. companies. Sub-paragraphs (D)(iii) and (D)(iv) require that the financial information must be audited. Two years of income statements are required (instead of one year as in the Uniform Act) for comparison purposes. The addition of pro forma statements to sub-paragraphs (D)(iii) and (D)(iv) allow for pro forma financials to be included in the manual when there has been a business reorganization or merger where a predecessor has the required audited financial statements. With this degree of specificity, there should be no question as to which manuals are approved or what information must be available in order for the exemption to apply.

5. Sub-paragraph (E) is a new provision designed specifically to address the problem of penny stock fraud by requiring that the issuer have a class of equity securities that is either listed on a national securities exchange or is quoted on NASDAQ. SCOR issuers would be eligible to participate in secondary trading by being listed on the Pacific Stock Exchange. However, at this time, there are very few SCOR listings on the Pacific Stock Exchange, and the issuer would also have to meet the requirements of (2)(A) through (D). Only those securities of companies designated on the National Market System and Small Cap designations are included in the NASDAQ System. OTC Bulletin Board companies are not included in the NASDAQ System and are not eligible for (E). Because of the safeguards built into stocks listed on national stock exchanges and the NASDAQ System (by reason of the SEC's oversight of those securities and markets), such securities are not as susceptible to penny stock fraud.

6. Three exceptions from the exchange-listed or NASDAQ-quoted requirement in (E) are provided:

a. Sub-paragraph (E)(i) provides an exception if the issuer of the security is a unit investment trust registered under the Investment Company Act of 1940.

Such exception would provide eligibility of secondary trading for the securities of a unit investment trust with respect to which the information required by paragraph (D) is published in a securities manual or is publicly available through EDGAR.

b. Sub-paragraph (E)(ii) provides an exception for an issuer that is engaged in business continuously for three years. "Blind pool" issuers, because they are organization-stage companies will not be able to utilize the exception. Also, few, if any, of the issuers involved in the penny stock fraud problem will have survived the three year test and will not be able to utilize the exception.

c. Sub-paragraph (E)(iii) is provided for non-listed/non-unit investment trust issuers that have not been in business at least three years, but have assets sufficient to justify their eligibility for the manual exemption. The \$2,000,000 total asset level was chosen because it corresponds with the NASDAQ Small Cap Market Maintenance Requirements. Absent such an alternative, no other trading exemption would be available for these issuers for as long as three years, and registration for secondary trading purposes is just not feasible in most states.

7. The Committee has determined that the secondary trading exemption for senior securities, currently combined with the manual exemption in Section 402(b)(2)(B) of the Uniform Act of 1956, should be treated as a separate exemption as 402(b)(2.1).

.20 Comment to Sec. 402(b)(2.1) added on 4/28/96:

Section 402(b)(2.1) has been bifurcated from the original Uniform Act exemption and the exemption re-worded to better reflect its intended application, as well as to take into account certain types of senior securities that did not exist when the original Uniform Act was written.

The Committee believes the exemption was intended to apply to senior securities of issuers who have demonstrated the ability over a reasonable period of time to honor such obligations. It has never made sense that the exemption should be available for securities outstanding for say, only a month or two, if that was the issuer's period of existence. The changes specify that the securities must be outstanding and without default for at least three years.

In addition, the original Uniform Act exemption refers only to securities with "fixed" maturities or interest or dividend rates, which is now obsolete in that it fails to take into account such more modern, "non-fixed" products as variable rate, floating rate, zero coupon, extendible securities, etc. The suggested changes will remedy these deficiencies and make clear the exemption applies only to securities ranking senior to the common stock.

Sec. 403. [FILING OF SALES AND ADVERTISING LITERATURE.] The [Administrator] may by rule or order require the filing of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature or advertising communication addressed or intended for distribution to prospective investors, including clients or prospective clients of an investment adviser unless the security or transaction is exempted by Section 402 or is a federal covered security.

[Sec. 403 amended 8-23-58 (NCCUSL), 4-27-97 (NASAA).]

Official Code Comment

.01 [Sec. 403—Rule with respect to sales literature.]— Many statutes require advertising and sales literature to be approved by the Administrator before it is used. Some require merely filing prior to use. Some, particularly with respect to securities registered by notification, require sales literature to be filed either concurrently with or after its use. Section 403 affords the

necessary flexibility, in conjunction with the authority in § 412(a) to classify, so that the Administrator may by rule or order apply any or all of these formulas to certain types of securities. Consistently with the “unless” clause, any rules or orders under this section can apply only to the person filing a registration statement or his principal.

Sec. 404. [MISLEADING FILINGS.] It is unlawful for any person to make or cause to be made, in any document filed with the [Administrator] or in any proceeding under this act, any statement which is, at the time and in the light of the circumstances under which it is made, false or misleading in any material respect.

Sec. 405. [UNLAWFUL REPRESENTATIONS CONCERNING REGISTRATION OR EXEMPTION.] (a) Neither (1) the fact that an application for registration or notice filing under Part II or a registration statement or notice filing under Part III has been filed nor (2) the fact that a person or security is effectively registered constitutes a finding by the [Administrator] that any document filed under this act is true, complete, and not misleading. Neither any such fact nor the fact that an exemption or exception is available for a security or a transaction means that the [Administrator] has passed in any way upon the merits or qualifications of, or recommended or given approval to, any person, security, or transaction.

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

Sec. 406. [ADMINISTRATION OF ACT.] (a) This act shall be administered by the [insert name of local administrative agency and any related provisions on method of selection, salary, term of office, budget, selection and remuneration of personnel, annual reports to the legislature or governor, etc., which are appropriate to the particular state].

(b) It is unlawful for the [Administrator] or any of his officers or employees to use for personal benefit any information which is filed with or obtained by the [Administrator] and which is not made public. No provision of this act authorizes the [Administrator] or any of his officers or employees to disclose any such information except among themselves or when necessary or appropriate in a proceeding or investigation under this act. No provision of this act either creates or derogates from any privilege which exists at common law or otherwise when documentary or other evidence is sought under a subpoena directed to the Administrator or any of his officers or employees.

[(c) Insert a provision, if desired, covering fees for examinations, filings under section 403, and other miscellaneous filings for which no fees are specified elsewhere in this act.]

Official Code Comment

.01 [Sec. 406(b)—Disclosure of non-public information.]—The “except” clause in the second sentence takes care of cases in which the Administrator or a member of his staff is subpoenaed. The law of evidence is not clear in such cases whether and to what extent non-public information in the files of a governmental agency is privileged. The last sentence makes it clear that nothing in the Act affects the question

of evidentiary privilege one way or the other. That question is left to the general law in the particular state.

[Sec. 406(c)—Fees for special purposes.]—The only fees specifically provided for in this statute are the registration fees under §§ 202(b) and 305(b). Many statutes specify a wide variety of additional fees for certain filings, examinations, interpretative opinions and other special purposes.

Sec. 407. [INVESTIGATIONS AND SUBPOENAS.] (a) The [Administrator] in his discretion (1) may make such public or private investigations within or outside of this state as he deems necessary to determine whether any person has violated or is about to violate any provision of this act or any rule or order hereunder, or to aid in the enforcement of this act or in the prescribing of rules and forms hereunder, (2) may require or permit any person to file a statement in writing, under oath or otherwise as the [Administrator] determines, as to all the facts and circumstances concerning the matter to be investigated, and (3) may publish information concerning any violation of this act or any rule or order hereunder.

(b) For the purpose of any investigation or proceeding under this act, the [Administrator] or any officer designated by him may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, agreements, or other documents or records which the [Administrator] deems relevant or material to the inquiry.

(c) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the [insert name of appropriate court], upon application by the [Administrator], may issue to the person an order requiring him to appear before the [Administrator], or the officer designated by him, there to produce documentary evidence if so ordered or to give evidence touching the matter under investigation or in question. Failure to obey the order of the court may be punished by the court as a contempt of court.

(d) No person is excused from attending and testifying or from producing any document or record before the [Administrator], or in obedience to the subpoena of the [Administrator] or any officer designated by him, or in any proceeding instituted by the [Administrator], on the ground that the testimony or evidence (documentary or otherwise) required of him may tend to incriminate him or subject him to a penalty or forfeiture; but no individual may be prosecuted or subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he is compelled, after claiming his privilege against self-incrimination, to testify or produce evidence (documentary or otherwise), except that the individual testifying is not exempt from prosecution and punishment for perjury or contempt committed in testifying.

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

[Sec. 407 amended 4-11-87 (NASAA).]

Official Code Comment

.01 [Sec. 407—Investigations and subpoenas.]—This section 407 is modeled generally on § 21(a)-(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(a)-(d).

The immunity provision in subsection (d) is of the broader variety which forecloses subsequent prosecution and not merely the use of the compelled testimony. Compare *Counselman v. Hitchcock*, 142 U.S. 547 (1892), with *Ullmann v. United States*, 350 U.S. 422 (1956). The words “or contempt” in the “except” clause at the end do not appear in § 21(d) of the Securities Exchange Act of 1934, but they do appear in the 1954 revision of § 3486 of the United States Criminal Code [68 Stat. 745, 18 U.S.C. § 3486], the statute construed in the *Ullmann* case. The purpose is to assure against a witness' obtaining immunity, answering a few questions and then balking. See *United States v. Bryan*, 339 U.S. 323, 335 et seq. (1950).

The compulsion of testimony under state process does not grant immunity from federal prosecution so far as the Fifth Amendment is concerned. *Feldman v. United States*, 322 U.S. 487 (1944) (prosecution under mail fraud statute); *Dunham v. Ottinger*, 243 N.Y. 423, 438, 154 N.E. 298, 302 (1926), cert. dismissed for want of a substantial federal question, 276 U.S. 592 (the compulsory testimony provision of the New York blue sky law satisfies the Fifth Amendment so long as it guarantees against state prosecution). On the other hand, compulsion of testimony under state process may violate the self-incrimination clause of the state constitution if there is no guarantee against a resulting federal prosecution. *People v. Den Uyl*, 318 Mich. 645, 29 N.W.2d 284, 2 A.L.R. 2d 625 (1947); *State ex rel. Mitchell v. Kelly*, 71 So.2d 887, 895 et seq. (Fla. 1954).

Sec. 408. [PROHIBITORY ORDERS AND INJUNCTIONS.] Whenever it appears to the [Administrator] that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this act or any rule or order hereunder, he may in his discretion bring either or both of the following remedies:

(a) issue a cease and desist order, with or without a prior hearing against the person or persons engaged in the prohibited activities, directing them to cease and desist from further illegal activity; or

(b) bring an action in the [insert the name of appropriate court] to enjoin the acts or practices to enforce compliance with this act or any rule or order hereunder. Upon a proper showing a permanent or temporary injunction, restraining order, or writ of mandamus shall be granted and a receiver or conservator may be appointed for the defendant or the defendant's assets. In addition, upon a proper showing by the [Administrator] the court may enter an order of rescission, restitution or disgorgement directed to any person who has engaged in any act constituting a violation of any provision of this act or any rule or order hereunder. The court may not require the [Administrator] to post a bond.

NOTE: Constitutional due process considerations should be addressed by rulemaking or incorporation of the applicable administrative procedure act provisions of each jurisdiction.

[Sec. 408 amended 4-11-87 (NASAA).]

Official Code Comment

.01 [Sec. 408—Injunctions—Law source.]—This section 408 is modeled on §§ 21(e) and 21(f) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78u(e), 78u(f).

Sec. 409. [CRIMINAL PENALTIES.] (a) Any person who willfully violates any provision of this act except section 404, or who willfully violates any rule or order under this act, or who willfully violates section 404 knowing the statement made to be false or misleading in any material

respect, shall upon conviction be fined not more than \$5,000 or imprisoned not more than three years, or both; but no person may be imprisoned for the violation of any rule or order if he proves that he had no knowledge of the rule or order. [No indictment or information may be returned under this act more than five years after the alleged violation.]

(b) The [Administrator] may refer such evidence as is available concerning violations of this act or of any rule or order hereunder to the [attorney general or the proper district attorney], who may, with or without such a reference, institute the appropriate criminal proceedings under this act.

(c) Nothing in this act limits the power of the state to punish any person for any conduct which constitutes a crime by statute or at common law.

Official Code Comment

.01 [Sec. 409—Criminal penalties.]—On the meaning of “willfully,” see the comment under § 204(a)(2)(B). The

sentence in brackets in § 409(a) is an optional provision for any state which does not have a general criminal statute of limitations.

Sec. 410. [CIVIL LIABILITIES.] (a) Any person who (1) offers or sells a security in violation of section 201(a), 301, or 405(b), or of any rule or order under section 403 which requires the affirmative approval of sales literature before it is used, or of any condition imposed under section 304(d), 305(g), or 305(h), or (2) offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at (x) percent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security and any income received on it, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at six (x) percent per year from the date of disposition.

(b) Any person who

(1) engages in the business of advising others, for compensation, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as a part of a regular business, issues or promulgates analyses or reports concerning securities in violation of sections 102, 201(c) or (d), 405(b), or of any rule or order under section 403, or

(2) receives directly or indirectly any consideration from another person for advice as to the value of securities or their purchase or sale, whether through the issuance of analyses, reports or otherwise and employs any device, scheme, or artifice to defraud such other person or engages in any act, practice or course of business which operates or would operate as a fraud or deceit on such other person, is liable to that person who may sue either at law or in equity to recover the consideration paid for such advice and any loss due to such advice, together with interest at (x) percent per

year from the date of payment of the consideration plus costs and reasonable attorney's fees, less the amount of any income received from such advice.

(c) Every person who directly or indirectly controls a person liable under subsections (a) and (b), including every partner, officer, or director of such a person, every person occupying a similar status or performing similar functions, every employee of such a person who materially aids in the conduct giving rise to the liability, and every broker-dealer or agent who materially aids in such conduct is also liable jointly and severally with and to the same extent as such person, unless able to sustain the burden of proof that he did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

(d) Any tender specified in this section may be made at any time before entry of judgment.

(e) Every cause of action under this statute survives the death of any person who might have been a plaintiff or defendant.

(f) No person may sue under this section more than three years after the contract of sale, or the rendering of investment advice, or the expiration of two years after the discovery of the facts constituting the violation, whichever first occurs.

(g) No person may sue under this section (1) if the buyer received a written offer, before suit and at a time when he owned the security, to refund the consideration paid together with interest at (x) percent per year from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within thirty days of its receipt, or (2) if the buyer received such an offer before suit and at a time when he did not own the security, unless he rejected the offer in writing within thirty days of its receipt.

(h) No person who has made or engaged in the performance of any contract in violation of any provision of this act or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract.

(i) Any condition, stipulation, or provision binding any person acquiring any security or receiving any investment advice to waive compliance with any provision of this act or any rule or order hereunder is void.

(j) The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, but this act does not create any cause of action not specified in this section or section 202(e).

[Sec. 410 amended 8-23-58 (NCCUSL), 10-14-81 (NASAA), 11-20-86 (NASAA).]

Official Code Comment

.01 [Sec. 410(a)—Civil liabilities.]—For a detailed breakdown of the civil liabilities under the present statutes, with annotations of some of the leading cases, see Loss, Securities Regulation (1951 with 1955 Supp.), pp. 962-82.

Clause (1): Clause (1) imposes civil liability when the offer violates one of the specified provisions even though the sale does not. The making of a non-exempted offer before the effective date can create no civil rights in the offeree unless the offer results in a sale. But when it does, this language means that the buyer may recover

even though no contract was made until after the effective date.

Clause (2): This clause is almost identical with § 12(2) of the Securities Act of 1933, 15 U.S.C. § 771(2), which was also borrowed almost verbatim in § 451.116 of the Michigan statute and § 13.1-522(a)(2) of the new Virginia act. For a comparison of § 12(2) of the federal statute with equitable rescission, from which it was adapted, see Loss, Securities Regulation (1951 with 1955 Supp.), pp. 997-1001, 1003-11. Section 410(a)(2), like § 101, the general fraud provision, applies regardless of whether the security is registered, exempted, or sold in violation of the registration requirements.

Measure of damages: The measure of damages, when the plaintiff is not in a position to tender back the security, is the same under Clauses (1) and (2). It is designed to be the substantial equivalent of rescission.

[Sec. 410(b)—Lack of knowledge as a defense.]—The defense of lack of knowledge is modeled on § 15 of the Securities Act of 1933, 15 U.S.C. § 770, and § 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(a). The last sentence, with reference to contribution, is a safeguard to avoid the common-law rule which prohibits contribution among joint tortfeasors.

[Sec. 410(d)—Survivorship of causes of action.]—This section is designed to codify the majority view of the few cases which have ruled on the question of survivorship under the state and federal securities statutes. For the cases, see Loss, Securities Regulation (1951 with 1955 Supp.), pp. 1077-78. Although the question whether a statutory cause of action is assignable involves much the

1981 NASAA Comment

.07 Section 410(b) is created to establish civil liability for individuals who willfully violate section 102 dealing with fraudulent practices pertaining to advisory activities.

1986 NASAA Comment

Since a purpose of Section 410(b) is to deter a wrongdoer, the amount recoverable is offset only by

same considerations as whether it survives the death of either party, that question is left to the general law, whether decisional or under the general assignment statutes which exist in some states.

[Sec. 410(e)—Offers to rescind.]—The purpose of subsection (e)(2) is to take care of the case where the buyer has already disposed of the security before the rescission offer is made to him. In such a case the buyer is not foreclosed from bringing suit if he is not satisfied with the seller's computation of damages, but in order to do so he must reject the rescission offer within thirty days so that the seller may know where he stands.

[Sec. 410(f)—Illegal contracts.]—This result has been quite generally reached by the courts even in the absence of a specific provision. See the cases cited in Loss, Securities Regulation (1951 with 1955 Supp.), p. 967, n. 63.

[Sec. 410(h)—Other rights and remedies.]—The mere presence of certain specific liability provisions in a statute is no assurance that other liabilities will not be implied by the courts under the doctrine which creates a common-law tort action for violation of certain criminal statutes. Restatement of Torts §§ 286-88. Notwithstanding the presence of several specific liability provisions in each of the several SEC statutes, the federal courts have implied a civil cause of action by a defrauded seller against the buyer under SEC Rule X-10B-5. See Loss, Securities Regulation (1951 with 1955 Supp.), pp. 1052-66. The "but" clause in Section 410(h) is designed to assure that no comparable development is based on violation of § 101 of this Act.

income, such as dividends received, and not by any economic benefit resulting from tax consequences.

Sec. 411. [JUDICIAL REVIEW OF ORDERS.] (a) Any person aggrieved by a final order of the [Administrator] may obtain a review of the order in the [insert name of appropriate court] by filing in court, within sixty days after the entry of the order, a written petition praying that the order be modified or set aside in whole or in part. A copy of the petition shall be forthwith served upon the [Administrator], and there-upon the [Administrator] shall certify and file in court a copy of the filing and evidence upon which the order was entered. When these have been filed, the court has exclusive jurisdiction to affirm, modify, enforce, or set aside the order, in whole or in part. The findings of the [Administrator] as to the facts, if supported by competent, material and substantial evidence, are conclusive. If either party applies to the court for leave to adduce additional material evidence, and shows to the satisfaction of the court that there were reasonable grounds for failure to adduce the evidence in the hearing before the [Administrator], the court may order the additional evidence to be taken before the [Administrator] and to be

adduced upon the hearing in such manner and upon such conditions as the court considers proper. The [Administrator] may modify his findings and order by reason of the additional evidence and shall file in court the additional evidence together with any modified or new findings or order. [The judgment of the court is final, subject to review by the (insert name of appropriate court).]

(b) The commencement of proceedings under subsection (a) does not, unless specifically ordered by the court, operate as a stay of the [Administrator's] order.

Official Code Comment

.01 [Sec. 411—Judicial review of orders.]—This section is modeled partly on § 12 of the Model Administrative Procedure Act, 54 Handbook of National Conference of

Commissioners on Uniform State Laws 334 (1944), and partly on § 25 of the Securities Exchange Act of 1934, 15 U.S.C. § 78y.

Sec. 412. [RULES, FORMS, ORDERS, AND HEARINGS.] (a) The [Administrator] may from time to time make, amend, and rescind such rules, forms, and orders as are necessary to carry out the provisions of this act, including rules and forms governing registration statements, applications, and reports, and defining any terms, whether or not used in this act, insofar as the definitions are not inconsistent with the provisions of this act. For the purpose of rules and forms, the [Administrator] may classify securities, persons, and matters within his jurisdiction, and prescribe different requirements for different classes. The [Administrator] may by rule adopt exemptions from the registration requirements of Sections 201 and 301 where such exemptions are consistent with the public interest and with the purposes fairly intended by the policy and provisions of this act.

(b) No rule, form, or order may be made, amended, or rescinded unless the [Administrator] finds that the action is necessary or appropriate in the public interest or for the protection of investors and consistent with the purposes fairly intended by the policy and provisions of this act. In prescribing rules and forms the [Administrator] may cooperate with the securities administrators of the other states and the Securities and Exchange Commission with a view to effectuating the policy of this statute to achieve maximum uniformity in the form and content of registration statements, applications, and reports wherever practicable.

(c) The [Administrator] may by rule or order prescribe (1) the form and content of financial statements required under this act, (2) the circumstances under which consolidated financial statements shall be filed, and (3) whether any required financial statements shall be certified by independent or certified public accountants. All financial statements shall be prepared in accordance with generally accepted accounting practices.

(d) All rules and forms of the [Administrator] shall be published.

(e) No provision of this act imposing any liability applies to any act done or omitted in good faith in conformity with any rule, form, or order of the [Administrator], notwithstanding that the rule, form, or order may later be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

(f) Every hearing in an administrative proceeding shall be public unless the [Administrator] in his discretion grants a request joined in by all the respondents that the hearing be conducted privately.

[Sec. 412 amended 4-11-87 (NASAA).

Official Code Comment

.01 [Sec. 412—Rules, forms and orders.]—(a) This subsection is largely modeled on the rule-making provisions of the SEC statutes. Some states have Administrative Procedure Acts which cut across this area. An order, of course, is directed to one or more particular persons, and a rule or form is of general applicability. Hence, when the Administrator is authorized to adopt rules or forms, he may not act by order and vice versa.

(d) Local Administrative Procedure Acts may provide specific procedures for publishing rules and forms. In the absence of any such statute, § 412(d) leaves the procedure of publication to each Administrator.

(e) Section 412(e) is modeled on the comparable provisions in the SEC acts and many other federal administrative statutes.

Sec. 413. [ADMINISTRATIVE FILES AND OPINIONS.] (a) A document is filed when it is received by the [Administrator].

(b) The [Administrator] shall keep a register of all applications for registration of securities and registration statements and all applications for broker-dealer, agent, investment adviser or investment adviser representative registration which are or have ever been effective under this act; all written notices of claim of exemption from registration requirements; all orders entered under this act; and all interpretative opinions or no-action determinations issued pursuant to subsection (e). All records may be maintained in computer or microfilm format or any other form of data storage. The register shall be available for public inspection.

(c) The information contained in or filed with any registration statement, application, or report may be made available to the public under such rules as the [Administrator] prescribes.

(d) Upon request and at such reasonable charges as he prescribes, the [Administrator] shall furnish to any person photostatic or other copies (certified under his seal of office if requested) of any entry in the register or any document which is a matter of public record. In any proceeding or prosecution under this act, any copy so certified is prima facie evidence of the contents of the entry or document certified.

(e) The [Administrator] in his discretion may honor requests from interested persons for interpretative opinions or may issue determinations that the [Administrator] will not institute enforcement proceedings against certain specified persons for engaging in certain specified activities where the determination is consistent with the purposes fairly intended by the policy and provisions of this act. The [Administrator] may charge a fee for interpretative opinions and no-action determinations.

[Sec. 413 amended 4-11-87 (NASAA).]

Official Code Comment

.01 [Sec. 413(a)—Administrative files.]—This subsection prescribes no particular method of filing, although the

Administrator is free to do so by rule under § 412(a). This subsection refers to a register of the applications and registration statements, not the physical documents.

Sec. 414. [SCOPE OF THE ACT AND SERVICE OF PROCESS.] (a) Sections 101, 201(a), 301, 307, 405, and 410 apply to persons who sell or offer to sell when (1) an offer to sell is made in this state, or (2) an offer to buy is made and accepted in this state.

(b) Sections 101, 201(a), and 405 apply to persons who buy or offer to buy when (1) an offer to buy is made in this state, or (2) an offer to sell is made and accepted in this state. [Subsection (b), as amended by the Conference, August 23, 1958.]

(c) For the purpose of this section, an offer to sell or to buy is made in this state, whether or not either party is then present in this state, when the offer (1) originates from this state or (2) is directed by the offeror to this state and received at the place to which it is directed (or at any post office in this state in the case of a mailed offer).

(d) For the purpose of this section, an offer to buy or to sell is accepted in this state when acceptance (1) is communicated to the offeror in this state and (2) has not previously been communicated to the offeror, orally or in writing, outside this state; and acceptance is communicated to the offeror in this state, whether or not either party is then present in this state, when the offeree directs it to the offeror in this state reasonably believing the offeror to be in this state and it is received at the place to which it is directed (or at any post office in this state in the case of a mailed acceptance).

(e) An offer to sell or to buy is not made in this state when (1) the publisher circulates or there is circulated on his behalf in this state any bona fide newspaper or other publication of general, regular, and paid circulation which is not published in this state, or which is published in this state but has had more than two-thirds of its circulation outside this state during the past twelve months, or (2) a radio or television program originating outside this state is received in this state.

(f) Sections 102 and 201(c), as well as section 405 so far as investment advisers and investment adviser representatives are concerned, apply when any act instrumental in effecting prohibited conduct is done in this state, whether or not either party is then present in this state.

(g) Every applicant for registration under this act and every issuer which proposes to offer a security in this state through any person acting on an agency basis in the common-law sense shall file with the [Administrator], in such form as he by rule prescribes, an irrevocable consent appointing the [Administrator] or his successor in office to be his attorney to receive service of any lawful process in any non-criminal suit, action, or proceeding against him or his successor executor or administrator which arises under this act or any rule or order hereunder after the consent has been filed, with the same force and validity as if served personally on the person filing the consent. A person who has filed such a consent in connection with a previous registration or notice filing need not file another. Service may be made by leaving a copy of the process in the office of the [Administrator], but it is not effective unless (1) the plaintiff, who may be the [Administrator] in a suit, action, or proceeding instituted by him, forthwith sends notice of the service and a copy of the process by registered mail to the defendant or respondent at his last address on file with the [Administrator], and (2) the plaintiff's affidavit of compliance with this subsection is filed in the case on or before the return day of the process, if any, or within such further time as the court allows.

(h) When any person, including any nonresident of this state, engages in conduct prohibited or made actionable by this act or any rule or order hereunder, and he has not filed a consent to service of process under subsection (g) and personal jurisdiction over him cannot otherwise be obtained in this state, that conduct shall be considered equivalent to his appointment of the [Administrator] or his successor in office to be his attorney to receive service of any lawful process in any non-criminal suit, action, or proceeding against him or his successor executor or administrator which grows out of that conduct and which is brought under

this act or any rule or order hereunder, with the same force and validity as if served on him personally. Service may be made by leaving a copy of the process in the office of the [Administrator], and it is not effective unless (1) the plaintiff, who may be the [Administrator] in a suit, action, or proceeding instituted by him, forthwith sends notice of the service and a copy of the process by registered mail to the defendant or respondent at his last known address or takes other steps which are reasonably calculated to give actual notice, and (2) the plaintiff's affidavit of compliance with this subsection is filed in the case on or before the return day of the process, if any, or within such further time as the court allows.

(i) When process is served under this section, the court, or the [Administrator] in a proceeding before him, shall order such continuance as may be necessary to afford the defendant or respondent reasonable opportunity to defend.

[Sec. 414 amended 8-23-58 (NCCUSL), 11-20-86 (NASAA), 4-27-97 (NASAA).]

Official Code Comment

.01 [Sec. 414(a)-(f)—Interstate transactions.]—This section defines and delimits the application of the Act in interstate or international transactions with only some of their elements in the state. It is not limited in its impact to the civil liability provisions of § 410. Section 414 and its appendages, §§ 401(c)(4) and 401(f)(6), determine the scope of the Act for all kinds of proceedings—civil, criminal, injunctive and administrative. It is quite clear that a person may violate the law of a given state, even criminally, without ever being within the state or performing within the state every act necessary to complete the offense. *Strassheim v. Daly*, 221 U.S. 280 (1911). So far as applying the Act in civil or injunctive or administrative proceedings is concerned, see the comment under §§ 414(g) and 414(h).

Section 414(a)-(f) can best be explained in the context of a civil action under § 410(a) by a buyer in State B against a selling broker-dealer in State S:

1. The basic approach of § 414(a)(1) is to apply the specified sections when "an offer to sell is made in this state."

2. Section 414(c) provides, in substance, that an offer which originates in State S and is directed to State B is made in both states. Hence the statute of State B applies under § 414(c)(2) in the hypothetical case.

3. By the same token, the statute of State S also applies to the offer under § 414(c)(1), on the theory that State S should not be used as a base of operations for defrauding persons in other states. It is thus quite possible for more than one statute to apply to a given transaction.

4. Section 414(e)(1) deals with the problem of offers in the form of newspaper and magazine advertisements. It provides, in substance that an advertisement in a regular newspaper or periodical is not an "offer" in any state other than the state of publication. Thus a seller

may insert an advertisement in the New York Times and have it circulated freely in other states.

5. A slight variation of this problem occurs in connection with magazines of national circulation. The place of publication of these magazines is purely fortuitous so far as the purposes of § 414 are concerned. Accordingly, § 414(e)(1) refers also to a publication which is published within the state but has more than two-thirds of its circulation outside the state.

6. Section 414(e)(2) treats radio and television programs originating outside the state in the same way as newspapers or magazines published outside the state. For purposes of this section a radio or television program is considered to originate in the state where the microphone or television camera is, not at any relay station.

7. The door left open in § 414(a) is then closed somewhat by § 414(a)(2), which provides in effect that a person in State B who makes an offer to buy as a result of an advertisement he sees in a paper published in State S (or a radio or television program originating in State S) may render the statute applicable if the seller then accepts the offer "in this state" (that is, State B). And § 414(d) specifies when an offer is "accepted in this state."

8. If the selling dealer in State S merely sends a confirmation or delivers the security into State B, or the buyer in State B sends a check in payment from within State B, the statute of State B does not apply except when under § 414(d) the confirmation or delivery constitutes the seller's acceptance of the buyer's offer to buy.

9. The parenthetical references in §§ 414(c) and 414(d) to "any post office in this state" are designed to make it clear that, when a person in State X directs an offer or acceptance to a person in State Y who has moved or gone temporarily to State Z, the act of State Y

does not apply and the act of State Z does not. This prevents entrapment of innocent persons who have no reason to believe that a communication will be forwarded into another state whose act has not been complied with.

10. The applicability of the statute to buyers as distinct from sellers is covered by § 414(b), which is precisely the converse of § 414(a). Here, of course, there is no civil liability.

11. Section 414(f) applies only to investment advisers.

12. Sections 401(c)(4) and 401(f)(6) exclude from the definitions of “broker-dealer” and “investment adviser” certain persons who have no place of business in the state. Clause (A) of each section has much the same rationale as the exemption in § 402(b)(8) for sales to institutional buyers or broker-dealers. Clause (A) of § 401(c)(4), insofar as it refers to issuers or other broker-dealers, has the additional purpose of making it unnecessary for an out-of-state underwriter to register as a broker-dealer before negotiating with an issuer in the state or setting up a selling group with local broker-dealers in it. Clause (B) of each section is designed to permit a New York broker-dealer or investment adviser, for example, to take care of a few customers who live in New Jersey or are vacationing in Florida without registering as a broker-dealer or investment adviser in those states, as he would otherwise have to do under § 414.

13. Nothing in the statute requires or permits one state to enforce the criminal provisions of another state's blue sky law.

[Sec. 414(g)—Consent to service—Issuers.]—The issuer does not have to file a consent to service unless it proposes to offer the security in the state through somebody acting on an agency basis in the common-law sense.

[Sec. 414(h)—Substituted service of process.]—The purpose of § 414(h) is to provide for substituted service of process when a seller in State S directs an offer into State B in violation of the registration provisions of State B or fraudulently. Under § 414(h) the buyer may sue the seller in State B and then bring suit on the judgment in State S. The section has been closely modeled on the type of nonresident motorist statute whose constitutionality was sustained in *Hess v. Pawlowski*, 274 U.S. 352 (1927). Recent cases indicate that it is due process of law for a court of State B to enter a judgment in the hypothetical case discussed in this paragraph if the person in State S effected only an isolated transaction in State B without ever entering the state. In addition to the nonresident motorist precedents, see *Travelers Health Ass'n v. Commonwealth of Virginia ex rel. State Corporation Commission*, 339 U.S. 643 (1950); *International Shoe Co. v. State of Washington*, 326 U.S. 310 (1945); *Parmalee v. Iowa State Traveling Mens Ass'n*, 206 F.2d 518 (5th Cir., 1953), cert. denied, 346 U.S. 877; *Schutt v. Commercial Travelers Mutual Accident Ass'n*, 206 F.2d 158 (2d Cir., 1956). If this is correct, a court in State S will have to give full faith and credit to the judgment of the court of State B.

Sec. 415. [STATUTORY POLICY.] This act shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this act with the related federal regulation.

Sec. 416. [SHORT TITLE.] This act may be cited as the Uniform Securities Act.

Sec. 417. [SEVERABILITY OF PROVISIONS.] If any provision of this act or the application thereof to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.

Sec. 418. [REPEAL AND SAVING PROVISIONS.] (a) The [identify the existing act or acts] is [are] repealed except as saved in this section.

(b) Prior law exclusively governs all suits, actions, prosecutions, or proceedings which are pending or may be initiated on the basis of facts or circumstances occurring before the effective date of this act, except that no civil suit or action may be maintained to enforce any liability under prior law unless brought within any period of limitation which applied when the cause of action accrued and in any event within two years after the effective date of this act.

(c) All effective registrations under prior law, all administrative orders relating to such registrations, and all conditions imposed upon such registrations remain in effect so long as

they would have remained in effect if this act had not been passed. They are considered to have been filed, entered, or imposed under this act, but are governed by prior law.

(d) Prior law applies in respect of any offer or sale made within one year after the effective date of this act pursuant to an offering begun in good faith before its effective date on the basis of an exemption available under prior law.

(e) Judicial review of all administrative orders as to which review proceedings have not been instituted by the effective date of this act are governed by section 411, except that no review proceeding may be instituted unless the petition is filed within any period of limitation which applied to a review proceeding when the order was entered and in any event within sixty days after the effective date of this act.

Sec. 419. [TIME OF TAKING EFFECT.] This act shall take effect on [insert date, which should be at least sixty or ninety days after enactment].

Sec. 420. [COOPERATION WITH OTHER AGENCIES.] (a) To encourage uniform interpretation and administration of this act and effective securities regulation and enforcement, the [Administrator] may cooperate with the securities agencies or administrators of one or more states, Canadian provinces or territories, or another country, the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Securities Investor Protection Corporation, any self-regulatory organization, any national or international organization of securities officials or agencies, and any governmental law enforcement or regulatory agency.

(b) The cooperation authorized by subsection (a) includes, but is not limited to, the following actions:

- (1) establishing a central depository for registration under this act and for documents or records required or allowed to be maintained under this act;
- (2) making a joint registration examination or investigation;
- (3) holding a joint administrative hearing;
- (4) filing and prosecuting a joint civil or administrative proceeding;
- (5) sharing and exchanging personnel;
- (6) sharing and exchanging information and documents subject to the restrictions of [insert applicable state law]; and
- (7) formulating, in accordance with the [administrative procedure act] of this state, rules or proposed rules on matters such as statements of policy, guidelines, and interpretative opinions and releases.

[Sec. 420 added 4-11-87 (NASAA).]