GUEST AUTHORS

We are pleased to have two guest columnists in this issue of the Bugle. Deborah Bortner, current President of the NASAA Board of Directors, shares her thoughts on the direction of state regulation of securities. Michel Gélinas, of the Montreal office of Stikeman Elliott, discusses the application of certain securities laws of the provinces.

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EVENTS SCHEDULE

ABA BUSINESS LAW SECTION

The State Regulation of Securities Committee will meet on Saturday, March 24 in conjunction with the Spring Meeting of the Business Law Section of the ABA at the Philadelphia Marriott Hotel, March 22-25, 2001, in Philadelphia, Pennsylvania.

NASAA SPRING CONFERENCE

The annual NASAA Spring Conference will be held April 29- May 1, 2001, at the Washington Court Hotel, Washington, D.C.

ABA ANNUAL MEETING

The State Regulation of Securities Committee will meet in conjunction with the 2001 Annual Meeting of the ABA, which will convene August 2 through August 8, 2001, in Chicago, Illinois.

NASAA ANNUAL FALL CONFERENCE

The State Regulation of Securities Committee will meet in conjunction with the 2001 Annual NASAA Conference, to be held Sept. 9 - 12, 2001, in San Francisco, California

Hyatt Regency Embarcadero

NASAA PRESIDENT BORTNER CALLS FOR EFFICIENT, EFFECTIVE AND UNIFORM REGULATION

By Deborah R. Bortner, President, NASAA Board of Directors, & Director of Securities, State of Washington

Over the last decade, millions of new investors have flocked to Wall Street. With some 80 million-plus Americans in the stock market, we are now a nation of shareholders. Of course more people in the market, many with little or no expertise in securities, has meant more fraud. Thus, role of state securities administrators as the “local cops on the beat” is more important than ever.

States realize, though, that no regulator is an island. In today’s global market, securities regulation at all levels -- state, federal and industry -- needs to be as efficient, effective and uniform as possible. In something as important as our securities market, we must make
sure that regulations complement, not restrain, innovation and economic growth.

During my tenure as NASAA president, a special task force has been looking at state licensing issues. Among other things, we are exploring ways to promote and increase uniformity wherever possible. We are also examining ways to reduce the cost and complexity of regulatory compliance related to multi-state licensing.

I believe people in this industry should be able to easily get licensed in different jurisdictions -- as long as they have clean records. Our task force is asking each state to evaluate whether the requirements in that state protect investors and add value to the whole process of regulating the marketplace.

We can increase uniformity by using the technology we already have. WebCRD, which is now a year-and-a-half old, can permit automatic licensing of new applicants who have no disciplinary history. Nearly 40 states have become automatic states. With some minor changes to the CRD, more states could do the same.

Here's one example of how it would work. Some states are required by law to check resident/applicants against a list of residents in that state who have failed to pay child support. If the CRD allowed states to keep resident/applicants in their manual queues, more states could provide for automatic licensing. This is a minor change but could yield a major benefit in terms of making states more uniform.

Most states require firms to file financial statements as part of their BD application. We've asked NASDR to share their FOCUS database so that each state will no longer have to ask each firm to produce that information. The NASD is actively reviewing that request.

Another important piece of technology is the Investment Adviser Registration Database. The IARD clearly has the potential to do for investment advisers what the CRD did for broker-dealers: create more uniformity and protect investors. States have different processes for licensing investment advisers. The IARD will change that. During our training sessions, NASAA will be working with our state examiners to share best practices on how to review the application of an IA or IA rep.

IARD also levels the playing field between IA reps and broker-dealer agents. Investors should be able to find out about an IA rep just as they do a BD agent. It hasn't been a level playing field until now because it's been hard to find an IA rep's disciplinary history.

That's why I decided that my state, Washington, will mandate filing over the IARD for our state-licensed advisers. Nearly three-quarters of the states agreed to mandate use of the IARD, and most others are considering such a move. I have made getting this system off to a successful start one of my highest priorities as NASAA president. We are making real progress, but much work remains to be done.

Another area of interest to the legitimate industry is the so-called vacationing client issue. I think this is extremely important. Our jobs and responsibilities frequently take us beyond our state borders. Our society is too mobile for us to require a firm or an agent to be registered in every
conceivable jurisdiction that a client could temporarily be visiting. As long as the broker-dealer and agent are registered where the investor resides, why shouldn't we allow that investor the freedom to transact business while temporarily away from home?

The corporate finance area has been a special interest of mine throughout my career. I am proud to say that in the early 80's my state, working with members of the industry, developed the idea of a fill-in-the-blank offering circular - an idea that was later developed into the Small Company Offering Registration. The program involving use of SCOR has helped hundreds of small businesses "go public" through the use of that intuitive document. SCOR, in turn, is the foundation for our programs of regional review of small company offerings.

I'm also committed to working hard to make coordinated review of small equity offerings a reality in every state during my tenure as NASAA president. We only have two states left before it is available in every applicable state.

My vision is to promote coordinated review of other types of offerings such as Direct Participation Programs and debt offerings. In fact, every filing that's made in more than one state is a candidate for coordinated review. Coordinated review is also a huge resource- and time-saver. It helps us leverage our expertise and staff. States with a particular expertise or states with larger staffs will be able to share their resources by acting as lead states in the coordinated review process.

During my year as president I have worked at the grass-roots level to spread the word about the success of coordinated review and SCOR and thereby increase the use of these programs. Further, I plan to reach out to economic development councils in each state, the Small Business Administration and incubators like ACE-Net. All of our governors are interested in jobs and helping small businesses and rural development. We should do all we can to help.

As we move into the 21st century I have urged my fellow regulators to consider what we do and ask some tough questions:

- Just because we can, should we?
- Just because our statutes give us the authority to take a certain action, should we?
- Just because we have the authority to ask for a certain document, should we-if it doesn't help us protect investors?

Despite all the changes in our markets and in the way we regulate and despite the changes yet to come, our core mission has not and will not change:

- to protect and educate investors,
- to prevent fraud and punish those who would commit fraud and
- to help legitimate businesses raise the money they need.

Our jobs as regulators have never been more important or more challenging and rewarding.
WORD FROM THE CHAIR
By Alan P. Baden
Vinson & Elkins (New York)
Chair, State Regulation of Securities Committee

NCCUSL Update. I have been attending the meetings of the drafting committee of NCCUSL on a new Uniform Securities Act as the ABA’s advisor. Recently, Chick Braisted, one of our committee members, also was appointed as a Business Law Section advisor to the drafting committee.

Joel Seligman, Dean of the Washington University School of Law, is the reporter on the project. After two years of work, the draft is rounding into shape. NASAA, the NASD, the SEC, the SIA and the ICI have been active participants in the process.

A fair summary of the proposed version would describe it as an amalgamation of the original Uniform Securities Act (“USA”) and the Revised USA (“RUSA”), with substantial modernization. Provisions have been included to recognize the existence of federal preemption from NSMIA, both in the securities registration and exemptive regime, as well as the investment adviser requirements. Also, the new act recognizes the fact that our world is changing from paper documents to electronic documents. Merit regulation has been included, but there is a broad exemptive scheme that should not alter the landscape of blue sky law.

The committee’s principal goal is to draft an act that will be attractive to all parties in interest. In addition, an effort has been undertaken to contact administrators in key states that have not adopted the USA, to seek their support in the process.

Recent discussions centered on the broker-dealer, investment adviser, enforcement and civil liability provisions. The discussions highlighted current regulatory issues and have been lively. For example, we met recently to discuss civil liability and the discussion included whether there should be civil liability for registration or licensing violations. Also, there has been discussion of both shortening and lengthening statutes of limitations.

NCCUSL posts drafts on its website www.law.upenn.edu/bll/ulc/ulc.htm and I encourage those who have comments or concerns to contact Chick Braisted or me. You should also feel free to direct comments to Dean Seligman. If you have comments it would help to have them before the drafting committee’s next meeting, which is March 23-25, 2001.

CALIFORNIA COMMISSIONER OF CORPORATIONS APPOINTED

Governor Gray Davis named his Legal Affairs Secretary and Chief Counsel, Demetrios A. Boutris, to the post of California Corporations Commissioner in late January, 2001. Mr. Boutris, 39, will also serve as Special Counsel to the Governor. He brings with him extensive experience in the laws that are under the jurisdiction of the Department of Corporations.

Prior to his position on the Governor’s staff, Mr. Boutris was Vice President and Special Counsel to the Chairman of MacAndrews & Forbes Holdings, which controls several public companies including CalFed Bank,
Panavision, Revlon, Sunbeam, Coleman and Meridian. He also served as Executive Director and Counsel to the U.S. Trade Representative in the Executive Office of the President. He also practiced securities, banking and corporation law with international law firms in Los Angeles and San Francisco.

JOIN THE BLUESKY LISTSERVE

To add your e-mail address to the Listserve, send an email message with your request to Mary Cornaby at “cornaby@law.villanova.edu”. The text of your message should read, “subscribe blue sky”, and include your first and last name.

HELP WANTED

Committee member to act as liaison and report to the Committee regarding securities laws of Puerto Rico. If interested contact Roger C. Fein, Chair of the Subcommittee on State Liaisons, at (312) 201 2536 or by e-mail at fein@wildmanharrold.com

IS IT RISKY TO RELY ON THE PRIVATE COMPANY EXEMPTION FOR SALES IN CANADA?

By Michel Gélinas
Stikeman Elliott (Montreal)

If a company in the United States does not constitute a “private company” in Canada, and proposes to issue securities to a person located in Canada, the company must be certain either that it complies with prospectus and dealer registration requirements or verifies that an exemption from those requirements is available.

What Constitutes a Private Company in Canada? A U.S. private company will sometimes assume that it also constitutes a private company in Canada, and that it is exempt from prospectus and registration requirements. This may not necessarily be the case. Although securities legislation in Canada is regulated at the provincial level, with each province having its separate securities commission or equivalent, the definition of "private company" is relatively uniform across Canada. A company will constitute a private company if its constating documents (i.e. its articles of incorporation) contain the following three restrictions:

The Right to Transfer its Shares is Restricted. The articles of incorporation will typically provide that each transfer of shares is subject to the prior approval of the company's board of directors.

The Number of Shareholders is Limited to No More Than 50. However, current and former employees are not included in this calculation. Hence, it is possible for a company with extensive employee ownership to exceed the 50 shareholder maximum while remaining a private company, provided that the two other conditions are also met.

Any Invitation to the Public to Subscribe for its Securities is Prohibited. The articles of incorporation only need to contain a simple statement to that effect to comply with this condition. Exactly what constitutes an invitation to the public is, however, a question of fact. It is worth noting that Canadian case law has applied tests developed in U.S. case law, such as the decision of the U.S. Supreme Court in SEC v. Ralston Purina, in determining what constitutes an invitation to the public. As a result, one would expect that the determination made by a Canadian court on this matter
would not be materially different from the determination made by a U.S. court.

Implications for U.S. Companies.
The articles of incorporation of a company that is a private company in the U.S. may not contain each of the three restrictions described above. If one or more of these restrictions are absent from its articles of incorporation, such a company would not be within the definition of “private company” in Canada and could not rely on the so-called private company exemption, pursuant to which a private company will generally not be subject to the securities legislation applicable in the relevant province.

We examine below the exemptions that may be available in respect of the three most likely scenarios under which a U.S. private company may issue securities in Canada:

Issuance to Employees. While, as a general principle, the securities legislation of each province provides for a statutory exemption for the issuance by a company of its securities to its employees or those of its subsidiary, its conditions of application can vary somewhat among the various provinces. For example, while consultants are generally covered by the statutory exemption in Ontario, it is not the case in Quebec. However, it could be possible in Quebec, depending on the factual situation, to obtain a discretionary order from the Quebec Securities Commission permitting the issuance of securities to consultants. The required filings and the fees also vary from one province to another.

Issuance to Friends or Family. Certain provinces provide for prospectus and dealer registration exemptions for the issuance of securities to family members or close business associates. However, these exemptions are generally not considered by a U.S. issuer because they involve the preparation of an offering memorandum or offering notice and require that offerees acquire securities for a minimum amount which is relatively important. As a result, the most practical route will be to seek a discretionary exemption from the relevant securities commission. The likelihood that a discretionary exemption will be granted will be a question of facts. For instance, it will be essential to demonstrate that the business associates are indeed what they are represented to be as opposed to passive investors.

Issuance to Other Investors. Securities may be issued in connection with an acquisition or an investment by venture capitalists. In these cases, the issuer will typically rely on the exemption that is based on the aggregate acquisition price paid by each Canadian investor. In both Ontario and Quebec, a prospectus exemption is available if the investor acquires securities for an aggregate consideration cost to such investor of at least C$150,000. Certain provinces have a lower threshold, such as British Columbia where the minimum amount is C$97,000. Certain other conditions must be met for the exemption to be available. This type of exemption requires filing a trade report (notice filing) within 10 days of the distribution and payment of prescribed filing fees.

Additional Considerations.
Certain provinces also have additional requirements which may further complicate the regulatory scheme. For instance, Ontario has a Universal Registration System which requires that broker-dealers must generally be
registered in Ontario when they deal on a prospectus-exempt basis with local investors. In Quebec, the $150,000 exemption is not available for a broker-dealer not registered in that province (although other exemptions are available for an unregistered broker-dealer).

Attorneys for an issuer should also note that even when securities have been issued pursuant to an exemption, the subsequent resale of such securities may nevertheless be subject to the prospectus filing and dealer registration requirements unless the subsequent resale qualifies as an exempt trade. While some provinces have adopted statutory exemptions permitting the resale (subject to certain conditions) of securities outside Canada on a recognized exchange or organized market, this type of exemption will not be available to a U.S. private company and it may therefore be necessary to obtain a discretionary ruling permitting resales from the relevant provincial securities commission. Such relief is routinely granted.

Conclusion. When representing a U.S. private company that intends to issue securities in Canada, first determine whether the company qualifies as a private company in Canada. You should also gather basic information from the company which will help identify the applicable issues. This would include confirming with the company the provinces in which securities would be issued and the identity (or at least, the categories) of the investors, as additional exemptions may be available based on the sophistication of the Canadian investors (such as banks, pension funds that meet certain size tests, etc.). Please note that to the extent discretionary relief must be obtained from a provincial securities commission, it may take three weeks or more (depending on the relief sought and the time of the year) before an exemption order may be issued. As a result, if the securities are to be issued, for instance, in connection with the closing of a transaction or the implementation of an incentive plan, the attorney should consider the impact of these timing constraints.

"NSMIA AND THE FLORIDA SECURITIES ACT - THEY FORGOT SOMETHING.....”

By Donald A. Rett
Collins & Truett (Tallahassee)

(Mr. Rett currently serves on the Board of Directors of the Florida Securities Dealers Association, and was Director of the Florida Division of Securities from 1975-1977. He has acted as the Florida Liaison to the Committee since the early 1980s.)

Beginning in 1977, the Florida Securities Dealers Association and the Comptroller’s Office engaged in a concentrated legislative effort, resulting in securities legislation which had a major impact on securities regulation in Florida. After the 1978 session of the legislature passed the initial measure, the Florida securities act no longer applied "merit review" standards to offerings which had been registered with the SEC. Private placements also received some attention, the legislature initially combining a few existing Florida transactional exemptions into one, and then utilizing as a template the SEC's Rule 146 as Florida's private placement model. The Florida private placement exemption - section 517.061(11) - exists today largely as originally passed, even though Rule 146 was abandoned by the
SEC over eighteen years ago, when the SEC promulgated its Regulation D.

A little later in the 1970's collaborative process came a significant clarification of what a securities "dealer" was not, at least in the context of a private placement. Relying on an SEC proposed rule (which was ultimately adopted by the SEC in 1985 as Regulation 240.3a4-1), the Florida legislature embraced the notion that an associated person in an issuer-sponsored, private placement was not a "dealer", and further, that such person could actually receive compensation for selling the issuer's securities, where such person is a "bona fide employee" of the issuer who hadn't participated in a distribution of securities in the last twelve months, and who performs, or will perform, "substantial duties" for the issuer when the distribution is concluded. (Having personally participated in this process, I can assure everyone that this language - in addition to following the SEC proposed rule - was specifically designed to preclude brokers from "selling away" for compensation.)

Hence, by 1979 unregistered persons could participate in, and even be compensated for, an issuer-sponsored private placement, courtesy of section 517.1-2(3) of the Florida securities act, which says that even if a person's selling activities might otherwise fit within Florida's definition of a "dealer", such person does not need a securities license if the transaction itself fits within the private placement exemption at section 517.061(11). (Note that section 517.171 of the Florida secure-ties act establishes that exemptions are "benefits", and requires that anyone enjoying such a benefit be able to affirmatively prove, if challenged, that the transaction is, indeed, exempt.)

Thus, for over a generation, privately placed deals in Florida have been exempted from securities registration and dealer registration (assuming the other tests are met) so long as any related compensation is paid either to Florida-registered dealers or to those bona fide employees (albeit, unregistered) of an issuer who could individually meet the other tests of "no recent participation" and "substantial duties".

But then Congress passed the National Securities Markets Improvement Act of 1996 ("NSMIA"). As part of this endeavor, Congress established a class of securities as "covered securities", and provided that such securities were not to be trifled with by any state's securities "...law, regulation, or order or other administrative action..." that would otherwise impose a state's securities registration requirements on covered securities. In NSMIA's definitional section, Congress specified that private placements under SEC rules or regulations issued under Section 4(2) of the Securities Act of 1933 (among other types of securities) would now be "covered securities". Section 4(2) is the statutory basis for federal Rule 506 of Regulation D.

In 1997, the Florida legislature, acknowledging the federal directive in NSMIA, amended the Florida securities act to say that a "federal covered security" does not have to be pre-registered in Florida prior to sale. However, it appears that this "free pass" provision wound up in the wrong part of the Florida securities act; instead of designating the sale of covered securities as some type of exempted transaction - and establishing a concomitant exemption from dealer registration (like
section 517.12(3), discussed above) for those unlicensed persons who sell covered securities - the legislature stopped by simply saying (in section 517.07 of the Florida securities act) that federal covered securities don't need to be registered. As a result, unlicensed Florida sellers of covered securities (in this case, Rule 506 offerings) face - in my opinion - a potentially enormous contingent liability for doing so because there exists no exemption from "dealer" registration for an issuer which directly sells securities through its own Rule 506 offering! The exposure is even more staggering when you recall that the Florida securities act contains criminal sanctions for even the most insignificant violations.

So, what's the remedy? Practitioners with whom I've spoken simply have had to ignore NSMIA (in this respect) and must continue to "dress" an issuer-distributed Rule 506/Regulation D offering as if it were a private placement under section 517.061(11) of the Florida securities act - and continue on as if it were "business as usual". This is an unfortunate "band aid" result since section 517.061(11) is based on a transactional exemption (SEC Rule 146) which disappeared from federal lore eighteen years ago. It appears to me that the only proper redress is an amendment to the Florida securities act, clarifying that issuers of federal covered securities need not register as dealers in Florida. An alternative would be to redefine the term "dealer" in the Florida act, to say that an issuer selling its own federal covered security need not register in Florida as a dealer.

BLUE SKY BITS AND PIECES
by Ellen Lieberman
Debevoise & Plimpton New York

Deborah Kubiak of Milbank, Tweed, Hadley & McCloy, New York, and Steven Cohen were married on January 21, 2001; the bride and groom honeymooned on Anguilla (without her children, much to their chagrin).

Michele A. Kulerman was named Counsel at Hogan & Hartson, L.L.P., Washington D.C.

Royce O. Griffin became General Counsel to NASAA on December 7, 2000. Royce was formerly Chief Deputy Attorney General of Arkansas, Senior House Counsel for the U.S. House of Representatives Telecommunications and Finance Subcommittee and Commissioner of the Colorado Securities Division.

Sandra Blitz has retired from Dewey Ballantine LLP to become a full-time soccer mom.

Roger G. Fein, of Wildman, Harrold, Allen & Dixon, was recently appointed an Associate National Commissioner of the Anti-Defamation League.

David Jonson, formerly the South Carolina Deputy Attorney General in charge of securities and a NASAA Board member, has joined Wyrick, Robbins, Yates & Ponton LLP, effective January 2, 2001, relocating to Raleigh, North Carolina from Columbia, South Carolina. David's replacement at the South Carolina Attorney General's Office is Roland Corning, who previously worked in another department in the South Carolina Attorney General's Office.
G. Philip Rutledge was appointed Chief Counsel, and Lynn D. Naefach was appointed Deputy Chief Counsel, by the Pennsylvania Securities Commission, effective January 1, 2001.

Jeff Gershon, formerly the Chief Deputy Commissioner of Securities for Indiana, joined Wryck, Robbins, Yates & Ponton LLP in the fall of 2000.

Doug Wilburn resigned as the Missouri Commissioner of Securities at the end of 2000, and has been replaced by Doug Ommen, who had been working for the Consumer Protection Section of the Missouri Attorney General's Office and, in the 1980's, for the Missouri Securities Division.

Bernard B. Polak retired as Principal Attorney of the New York Office of the Attorney General, Bureau of Real Estate Financing, after over 30 years of service.

CALIFORNIA OPTION EXEMPTION AMENDED
EFFECTIVE 1-1-2001

By Bruce Elwood Johnson
Morrison & Foerster LLP (San Francisco)

Effective January 1, 2001, the California exemption for securities issued pursuant to compensatory benefit plans, at Section 25102(o) of the Corporations Code, was extended to include securities issued under compensatory plans established by limited liability companies.

As a result of adoption of emergency regulations by the Commissioner, securities rules requiring certain provisions in compensatory plans were amended, also effective January 1, 2001, to make the rules compatible with compensatory plans adopted by limited liability companies as well as to plans adopted by corporations. The emergency regulations also clarify that the exemption is available for securities issued under compensatory benefit agreements as well as to those issued under benefit plans.

In addition, the emergency regulations amend Rule 260.102.19(a) to clarify that the notice required as a condition to the exemption must be filed not later than 30 days after the initial issuance of a security in California pursuant to the exemption. These changes allow the required notice to be filed prior to the initial issuance of a security, and make it clear that an initial issuance of securities under the compensatory plan by an out of state issuer, to persons not in California, does not trigger the notice filing requirement.

Currently, failure to file a Section 25102(o) notice may result in loss of the exemption for compensatory benefit plan securities. A proposal before the legislature in 2001 would clarify Section 25102(o) filing requirements and specifically provide that a failure to file the notice on time does not result in loss of the exemption, but would require only the payment of a penalty should the failure to file be discovered by the Commissioner.

If you are interested in learning about legislative proposals from the Business Law Section of the State Bar of California, visit the Bar’s website: http://www.calbar.org/buslaw/index.htm
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ABA STATE REGULATION OF SECURITIES COMMITTEE
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AND THE NASD

As of February 13, 2001
by Roger G. Fein, Chair

Committee members are invited to contact state liaison attorneys with questions or with
information regarding blue sky law and procedures in the relevant jurisdiction.

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