EVENTS CALENDAR
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ABA ANNUAL MEETING
The State Regulation of Securities Committee is scheduled to meet at 9:30 AM on Tuesday, August 12, 2003, at the Fairmont Hotel, in conjunction with the 2003 Annual Meeting of the ABA, which will convene August 7 through August 13, 2003, in San Francisco.

NASAA ANNUAL FALL CONFERENCE
The State Regulation of Securities Committee will meet at 10:00 AM on Sunday, September 14, 2003, in conjunction with the 2003 NASAA Annual Fall Conference to be held September 14 through September 17, 2003, at the Chicago Marriott Downtown Hotel in Chicago, Illinois.

ABA BUSINESS LAW SECTION SPRING MEETING
The State Regulation of Securities Committee will meet in conjunction with the 2004 Spring Meeting of the Business Law Section to be held April 1 - 4, 2004, at the Westin Seattle and Sheraton Seattle Hotels, Seattle, Washington.

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PLAN FOR THE FUTURE
2004 Annual NASAA Fall Conference
September 30-October 3, 2004
Fairmont Scottsdale Princess
Phoenix, Arizona

2005 Annual NASAA Fall Conference
September 11 through September 14, 2005
Hilton Minneapolis
Minneapolis, Minnesota

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THE USA 2002 - HOW IT HAPPENED - WHERE IT STANDS - WHAT IT MEANS
By Philip Feigin*
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After four years of meetings and conference calls, and more paper than anyone would care to admit, the USA 2002 was adopted by NCCUSL in Tucson, Arizona in August of 2002. Subsequently, it has been formally endorsed or informally blessed in one way or another by NASAA, the ABA, the SIA, the New York Stock Exchange, the National Association of Securities Dealers (the "NASD"), the Investment Company Institute and the Investment Counsel Association of America. It has already been introduced as legislation in several states and adopted, for the most part intact, in Missouri and Oklahoma as of the date of this article.

E VOLUTION
Most practitioners of "blue sky" law either remember or have heard graying others relate the sorry tale that was the Revised Uniform Securities Act of 1985 ("RUSA"). Back then, I was a state securities regulator from Colorado, and became involved in the RUSA drafting process near its conclusion. In drafting the Colorado Securities Act of 1990, we borrowed RUSA's much improved format (over the Uniform Securities Act of 1956—"USA") and a provision here and there. Several states "cherry-picked" from RUSA, and a few other states actually adopted it with some modifications. Generally speaking, however, RUSA was doomed to failure and now sits right up there on the shelf with the Federal Securities Code.

The securities world changed in 1996 with the adoption of the National Securities Markets Improvement Act ("NSMIA"). NSMIA imposed many sea changes in the fabric of state securities regulation, many of which, ironically, were foreseen in RUSA.

[*Author’s Disclaimer: I worked on the drafting of the Uniform Securities Act of 2002 both as Executive Director of the North American Securities Administrators Association and as counsel to the Association. Even so, for purposes of this article, the opinions, facts and impressions are solely my own, and even I may disavow them if any get me in trouble.]
State securities registration regulation was preempted for securities listed for trading on a recognized exchange, traded on the NASDAQ National Market System or issued by registered investment companies, and most securities and many transactions exempt under the Securities Act of 1933. The states' regulation of broker-dealers and agents was left relatively unscathed, except that the states had to live with the books and records requirements imposed by the Securities and Exchange Commission (the "SEC"). The regulation of investment advisers was revolutionized, with the larger advisory firms ($>25 million under management) left exclusively to the SEC, most smaller firms and financial planners ($<25 million under management) left exclusively to the states where they have a place of business. Regulation of the individuals who work for either federal or states IAs is left to those states where they maintain a place of business.

The states and the North American Securities Administrators Association ("NASAA") had been adopting (unofficial) amendments to the USA for years, without the aegis of, objection or any reaction from the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), the outfit whose mission it is to promulgate uniform state laws. NCCUSL is generally unaccustomed to dealing in laws that are administered on an ongoing basis by state regulators, and even less so an act that is part of a complex regulatory environment with numerous federal statutes, self-regulatory organizations and a host of different regulators. In response to NSMIA, the states and NASAA reacted with remarkable speed, and within the next two years or so, most states had revised their laws, rules and regulations to conform to the new regulatory regime.

Those who championed NSMIA in 1996 were not done yet. By 1999, then Senator Phil Gramm, Chairman of the Senate Banking Committee, was working on the Securities Markets Enhancement Act ("SMEA"), holding discussions with various interested groups to gather ideas for what was to amount to NSMIA II. Many suggestions were forthcoming. By this time, I was the Executive Director of NASAA in Washington, D.C., and in this new capacity, I was forced to grapple with responses to each of them. In the face of SMEA and other legislative trial balloons, and in the midst of one of the most exuberant securities market run-ups in decades, NCCUSL announced it was launching an effort to draft a new Uniform Securities Act.

At first, there was much skepticism among those who were to participate in the drafting process. Several of the NCCUSL Commissioners involved in the RUSA drafting process returned to serve as members of the new Act drafting committee, as did several veterans from the states and the American Bar Association (the "ABA"). Despite their many scars from past battles, fortunately, there was a new camaraderie, born of the familiarity of working together on numerous issues over the intervening years as well as a significantly altered regulatory landscape. Unlike the RUSA experience, which dealt mostly with securities registration, investment company and investment adviser issues, brokerage regulation would be very much in play in the new USA ("USA 2002"), and the industry was well represented by the Securities Industry Association ("SIA"). Many other interested groups participated during the deliberations of the group as well. There can be no question that the reporter for the drafting effort, Joel Seligman, Dean of the Washington University School of Law in St. Louis, was a driving and crucial force in the process as was the persistent leadership, patience, acumen and judgment of Richard Smith, who chaired the committee's efforts, and Justin Vigdor, as vice chair.

For the private practitioner, the immediate question is "What's it mean to me?" Having participated in every session of the drafting committee and many sidebar and preparatory meetings, both as a state regulator and a private practitioner, I'll attempt to address the key points in the USA 2002 to watch out for, and how it is being received at the state level. Joel Seligman graced these pages in the December 2002 Blue Sky Bugle with an elegant review of the USA 2002, so I will attempt to avoid going over ground he covered.

Given that the USA 2002 was only adopted by NCCUSL in August of 2002, efforts to seek its introduction in and enactment by state legislatures were not slated to commence until the fall of 2003. Nonetheless, even without formal NCCUSL prodding, the USA 2002 was introduced and considered in Michigan, Missouri, Kansas and Oklahoma, and enacted in Missouri and Oklahoma. Particular provisions of the USA 2002 came into play in other legislation in North Dakota and Virginia. Groups in many other states around the country have been established to review the USA 2002 in the context of their own jurisdictions. It is likely that NCCUSL will act at its next full meeting to give the USA 2002 priority status as a "targeted act" so that all the efforts the organization can bring to bear to seek introduction and enactment of one of its products will be instituted commencing in the fall of 2003.

**WHAT'S NEW?**

In addressing what's new in the USA 2002, it must be stressed that the new version is more a commemoration of what has already occurred in most
securities state laws by natural evolution. The USA 2002 represents an attempt to make all those separate efforts uniform and to iron out the wrinkles that may remain. I think practitioners will find that the USA 2002 is a much more professional, sophisticated, intricate and precise state securities law than any in its wake. Much more has been set forth in black and white rather than be left to local rules or mere practice and lore. Surely, much has been left to the state administrator's rule making authority, but not often where a matter of national uniformity of process is at stake.

The securities registration provisions are little changed from the USA. NSMIA did most of the job on its own. The exemptions are greatly enhanced and enriched. In drafting the broker-dealer and investment adviser provisions, few stones accumulated over 50 years were left unturned. Practitioners and regulators both will find many previously unanswered questions addressed and answered. The core provisions regarding private civil liability were left alone, in compromise of otherwise irreconcilable positions. The changes to the federal statutes of limitation and repose in Sarbanes-Oxley in late July 2002 to two and five years were then reflected in the USA 2002 in August. Had they not been changed, it is my belief that many states would have raised them from the Lampf-directed one and three in any event. Enforcement powers and processes are also set forth much more precisely than before. In sum, this is an act with great depth, warranting careful study. (It should also be noted that in the months since promulgation, several minor errata have been noted and it is my understanding they will be corrected in an upcoming version. This is a living, breathing process.)

In the legislative experience to date, the inflammatory issues have proven to be (i) the question of banks as broker-dealers [USA 2002 section 102(4)(C)], (ii) the treatment of variable annuities as securities [USA 2002 section 102(28)(B)], (iii) the transactional securities registration exemption for offers and sales of securities from State A (where neither registered nor exempt) exclusively to investors in other states where the offer and sale is lawful (the so-called "Goldmen issue") [USA 2002 section 202(20)], (iv) the increased scope of the private offering exemption [USA 2002 section 202(14)], and (v) a provision that allows state administrators to adopt rules empowering them to grant requests for expungement of certain agent records from the Central Registration Depository ("CRD") [USA 2002 section 607(6)].

**BANKS AS BROKER-DEALERS**

The Gramm Leach Bliley Act of 1999 (the "GLBA") changed the way banks conduct securities and insurance business. Under the Securities Exchange Act of 1934 (the ‘’34 Act”) and most state securities laws, banks were excluded from the definition of "broker," "dealer" and "broker-dealer." Under the GLBA, the ‘’34 Act definition was pared back. If banks engaged in the business of effecting transactions in securities, they were now brokers and dealers, unless their activities were among a laundry list of specified forms and types of business. Among them was (i) the underwriting of direct participation programs (“DPPs”) and (ii) effecting no more than 500 securities transactions in a year.

In the USA 2002, a similar approach was taken to that of the GLBA. Banks are no longer given a blanket exclusion from broker-dealer registration. By operation of USA 2002 sections 102(4)(C) and 401, if a bank engages in the business of effecting transactions in securities for its own account or the accounts of others, the bank is a broker-dealer--but, not if it restricts that business to any of the exempt businesses noted in the GLBA and listed in the '34 Act--except the federal exemptions for underwriting DPPs and the 500 transaction de minimus exemption. The DPP underwriting exemption was rejected by NCCUSL given the bad experiences of the states in protecting their citizens with regard to private placements. The de minimus exemption was modified, restricted to unsolicited transactions.

These issues were debated long and hard during the NCCUSL deliberations, and the result was a resounding endorsement of the modifications to the GLBA model at both the Committee and full NCCUSL levels. Even so, the American Bankers Association has been unrelenting in its efforts since to reverse the departures from federal law with, in my view, much bluster and little justification or substantive argument. Missouri’s version of the USA 2002 was adopted with the NCCUSL model included. Many months ago, Virginia adopted what would become the USA 2002 model definition. Earlier this year, the North Dakota securities administrator succeeded in resisting efforts by some bankers to convince legislators to repeal the existing, more restrictive law in favor of the GLBA model. The same issue came up in Rhode Island. The latest version I have of the Oklahoma bill included the NCCUSL model. In sum, although the subject of debate wherever the question is raised, it would appear that the NCCUSL version has had the better of it to date.

**VARIABLE ANNUITIES**

Variable annuities constitute for me one of the true oddities of securities law. Generally, it has been my experience that federal law tends to be more conservative and less inclusive than state securities...
law. It is odd therefore to find an investment treated as a security under federal law but not state law, but that is the manner in which variable annuities are treated, at least in many states, for reasons more political than regulatory.

In any event, given their favorable treatment under tax laws and high agent payout, variable annuities became the favored product for many securities agents in the 1990s, too often without appropriate disclosure or suitable determinations. As complaints mounted, state securities regulators grew frustrated. They could not pursue securities actions against the abusing agents, and it was their perception that their insurance counterparts did not have the authority or expertise to do so.

The fix proposed by NASAA was to alter the USA securities definitional exclusion for insurance policies; to define variable annuities as securities for state law purposes. There was never any question that the variable annuity policies themselves were to be exempt from state securities registration requirements [USA 2002 section 201(4)]. In fact, state securities registration authority over variable annuities is preempted under NSMIA as they are “covered securities.” The goal of the NASAA proposal was to gain regulatory sales practice authority over the broker-dealers and agents selling them.

This amendment was also debated at great length during the Committee and the full NCCUSL deliberations. The American Council of Life Underwriters (the "ACLI") launched an all-fronts war against the change with thermonuclear fervor.

[Commentary--contrary to two bits of ACLI propaganda, the motivation for NASAA’s proposal was neither a backdoor attempt at substantive regulation of the products nor a grab for more registration revenue. In making the proposal, NASAA and its membership sought to join forces with the NASD and SEC in pursuing a mounting wave of investor abuse, and nothing more. There. Now I feel better.]

The ACLI succeeded at the NCCUSL conference in Tucson in having the treatment of variable annuities changed from one of presumption that variable annuities were securities to merely an option to treat them as such. Since that time, the ACLI has succeeded in preserving the status of variable annuities as excluded from the “securities” definition for state law purposes in each state where the question has arisen, harkening back to the very reason for the oddity in the first place, a matter of politics far more than regulatory reason.
THE PRIVATE OFFERING EXEMPTION

If there were any vestiges of the trials and tribulations of RUSA, they certainly emerged in our discussions of private offerings for the USA 2002. For sure, the level of contention was muted by NSMIA’s treatment of Rule 506 offerings, but some spirited discussion took place nonetheless. While coordination of state and federal law with regard to private offering exemptions may be an admirable goal, achieving it is quite another problem. For one thing, there is a broad body of federal rules and regulations addressing the subject. No one found it an appealing proposition to attempt to redefine all of that in the USA 2002, and cherry-picking one concept or another was equally problematic and fraught with peril.

In the end, and as was true for several contentious issues, the decision here was to leave well enough alone. Most private offerings are now conducted under Rule 506. For those few that might need a state statutory exemption to fall back upon, the USA model from 1956 was retained, with the one change to raise the number of investors permitted from 10 to 25 [see USA 2002 section 202(14)]. The ABA representatives sought to increase the number to an even higher level, and the NASAA representatives wanted to keep it at 10. Neither side was completely persuasive, and so the compromise was reached. Numeric aspects of any law are always the easiest to change. Those regulators and legislators for whom the increase to 25 is a problem can and will set the number wherever they feel comfortable, as they have always done. With NSMIA’s treatment of Rule 506 offerings, it really doesn’t matter anymore.

CRD EXPUNGEMENT

Of all the regulatory issues I had to confront during my 20-year tenure as a state regulator, none was more vexing than CRD record retention. The CRD is the database for the registration of every securities agent in the country. It is jointly owned by the states and the NASD and operated by the latter. While the NASD can make up its own rules for managing that system (with SEC oversight), fifty-two different open records laws each govern what is a matter of public record in a given jurisdiction. State broker-dealer and agent records are matters of public record in every state in the Union, and available to the public.

While the NASD may think a particular record should no longer be disclosed, one or more state laws might dictate otherwise, and those laws are not administered by the state securities authorities. Broker-dealers are required to report (most) written complaints lodged by customers against any of their registered people to the CRD. As a result, those complaints become a matter of public record under state law. If the complaint is spurious, extortive, mistaken or abandoned by inaction, it is perfectly understandable that the offended individual would want to purge the unfounded fact from his or her public record.

Although aggrieved agents can give their side of the story on the same CRD record, that is insufficient comfort for most aggrieved agents. At present, NASD rules provide for the removal of unadjudicated written complaints from the records they make available to the public after the passage of two years. There is no way to do that under most state laws, absent an order of a court. Even if such a court order is obtained, there remains a question as to whether a court in one state has the authority to remove or expunge another state's public record. So, what a member of the public might not be able to learn and obtain from the NASD’s version of the CRD can be obtained easily from the securities agency of any state. Therein lies the rub.

In recognition of the dilemma, the SIA urged changes in the USA 2002 to alter the manner in which state administrators interface with the CRD. Reflecting what we believed to be the sentiment of most state administrators, the NASAA representatives argued that state administrators could not allow themselves to be put in the position of determining on an ad hoc basis what would and would not be expunged from the state's public records. The State open records law is a highly volatile subject in many jurisdictions.

As a compromise, the drafting committee met the SIA halfway and provided to the administrator of a regulatory agency the authority to adopt rules and thereunder order a public record expunged at USA 2002 section 607(6). This has proven unpalatable to state securities regulators from both a political and practical sense. In contemplating my position on the proposal, I imagined I was still Colorado's Commissioner, and pictured myself sitting through hearing after hearing listening to arguments from agents as to why a particular record should be altered or expunged. I reacted as have most regulators to date. The provision was included in the Missouri and the Oklahoma acts, but was not included in the bill introduced in Kansas.

WHAT'S IN IT FOR THE PRACTITIONER?

By far and away, I believe the greatest prospect of the USA 2002 from the practitioner's perspective is what I call "up-front uniformity." The mechanical and classification differences in registration systems that abound to one extent or another among the states today will not be eliminated, but should be diminished considerably if states adopt the USA 2002 and its definitions, securities and professional registration provisions.
There is far greater certainty in the USA 2002. For example, the few lines that described “financial institutions and institutional investors” in the USA have been supplanted by an exhaustive and descriptive list that should give comfort to anyone struggling with the question of who's in and who's out [See, e.g., USA 2002 section 102(11)]. The paltry and outdated secondary offering exemptions of the USA have been refined, expanded and modernized to accommodate a host of transactions that were not contemplated in 1956. "Snowbird" exemptions are provided for agents for the first time. Notice filing provisions as a whole are set forth with clarity and precision. In sum, practitioners across the country ought to receive the USA 2002 with open arms from the perspective of trying to make blue sky filings and registrations an efficient, simplified and unified process.

On the subject of "back-end uniformity," a.k.a. "enforcement," arguments for uniformity generally seem less persuasive. Is it truly a public policy concern when one state has the authority to impose a civil penalty for fraud while another does not? Transactions are not planned on the basis of what the sentencing guidelines for fraud are in one state as opposed to another. Although considerable time was spent in crafting the broker-dealer, agent, investment adviser, investment adviser representative and anti-fraud regulation and enforcement provisions of the USA 2002, they will not be as attractive to the practitioner as we hope they are to the regulators. That is indeed the tradeoff. The NCCUSL calculation was that the cost of achieving much greater uniformity on the front-end, i.e., what the industry sought, was making the regulatory and enforcement features on the back-end more attractive to regulators.

CONCLUSION

I do not mean to undermine or downplay the many improvements and innovations contained in the USA 2002. It is by no means merely a photocopied and updated version of the 1956 Act. There are dozens of important new features. Many will resist adoption out of fear of the unknown, i.e., it is easier to deal with known confusion than learn a new and more orderly system. That is short-term thinking, and hopefully will not prevail.

We never calculated the total years of securities and blue sky experience that were brought to bear on the NCCUSL process, but collectively, it must be high in the hundreds. The hours spent on the project greatly exceeded that number. We'll see if it was worthy of and worth it all in the next few years. Hopefully, we have set the stage for the next era of state securities regulation.

NY PROPOSES ENHANCED FRAUD PROSECUTION POWERS FOR THE AG

By: Richard I. Alvarez
Law Offices of Richard I. Alvarez (New York)

A bill designed to enhance the authority of the New York Attorney General to investigate and prosecute securities fraud was introduced in the New York Senate on April 12, 2003, at the request of the Attorney General. The bill would amend the New York General Business Law (“GBL”) and the NY Penal Law in relation to the prevention of securities fraud. The text of the bill (Senate Bill S04820 – BALBONI and FUSCHILLO), as well as a summary of the proposal, a sponsor’s memorandum and the current status of the progress of the bill can be found at www.senate.state.ny.us, under the bill number.

GENERAL

The Securities Fraud Prevention bill is one of a number of initiatives sponsored by the Attorney General relating to his efforts to combat securities fraud and to promote corporate reform. In addition to other proposals relating to accounting reform, whistleblower protection and obstruction of justice legislation, the Securities Fraud Prevention bill seeks to protect the investing public against securities fraud, by improving the mechanisms for investigating frauds, expanding the powers of the Attorney General to investigate and prosecute securities fraud, and increasing the penalties for those who engage in securities fraud. The Attorney General believes that this bill will address what it considers to be significant flaws in the state’s securities laws – the Martin Act.

Currently, the Martin Act classifies certain fraudulent activities – such as stock price manipulation and issuing false statements about securities with the intent to deceive – as misdemeanors. Additionally, unlike the statutes of most other states (many of which are modeled on the Uniform Securities Act of 1956, or, in those states that have adopted it, the Revised Uniform Securities Act of 1985), the Martin Act does not grant the Attorney General to authority to suspend or revoke the license of a broker or dealer who engages in fraudulent activities. The bill, as currently being considered, would amend existing Martin Act provisions to expand the authority of the Attorney General in these areas, consistent with existing powers enjoyed by securities regulators in other states.

SUMMARY OF PROVISIONS

The bill seeks to amend certain existing Martin Act provisions to enhance the investigative authority of
the Attorney General, increase penalties for violations of the Martin Act, change the classification of certain acts that are currently misdemeanors to felonies and revise certain existing statutory definitions and dealer registration exemptions. Additionally, new sections are proposed to be added to the Martin Act covering, among other things, an increase in civil penalties for violations of the Martin Act, new authority to suspend or revoke state broker and dealer licenses and to issue cease-and-desist orders, the creation of an expedited mechanism for freezing accounts of brokers and dealers that contain potentially ill-gotten funds and authorizing notice filings for certain federal covered securities. Lastly, the bill proposes to amend existing Penal Law provisions to provide that felony violations under the Martin Act constitute “criminal acts” under the Penal Law.

Among the more significant sections of the Martin Act proposed for amendment are the following:

- amend Section 352 to add new subsection 7 allowing the Attorney General access to the premises of a “registered person” to conduct “on-site” inspections of such persons’ records and securities activities;
- amend Section 353 to increase the civil penalty for engaging in a “fraudulent practice” from $3,000 in the aggregate to the greater of $10,000 for each fraudulent practice engaged in by a defendant, or 10% of the total damages arising from such fraudulent practices;
- amend Section 359-g to increase the civil penalties for violation of any judgment, order or other penalty imposed upon a person who commits a fraudulent practice consistent with the higher proposed penalties contained in Section 353 (above); and
- amend Sections 339 through 339-f to make the crimes specified therein felonies rather than misdemeanors.

In addition to existing Martin Act provisions that are proposed for amendment, the bill would add the following new provisions to the GBL:

- new Section 353-b which would authorize the Attorney General to deny, suspend or revoke the registration of a broker or dealer (other than “...a notice filing on behalf of a federally exempt issuer...”) if the broker or dealer, or 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 an investment advisor is, among other things, subject to certain disqualifications, is not qualified on the basis of such factors as character, training, experience and knowledge of the securities business, or has failed to reasonably supervise its agents or employees;
- new Section 353-b would also authorize the Attorney General to summarily suspend or revoke the registration of a broker or dealer pending a final determination of any proceeding brought under the Act;
- new Section 353-c grants the Attorney General cease-and-desist authority for violations of the Act;
- new Section 354-a creates an interpleader mechanism in respect of monies received by a broker or dealer that may be the proceeds of criminal conduct or fraudulent activities; and
- new Section 359-d which creates a statutory notice filing requirement for Rule 506 offerings.

Lastly, the bill amends Penal Law Section 460.10(l)(b) to confirm that fraudulent transactions in securities that are felonies under the Martin Act are within the definition of “criminal act” under such section.

The bill will take effect ninety days after its enactment, with the exception of those sections of the bill relating to amendment of Sections 339 through 339-f and of Section 460.10(l)(b) of the Penal Law, which sections will take effect on the first day of November following enactment.

ANALYSIS

With the exception of recently enacted provisions covering the registration and regulation of investment advisers, the Martin Act stands alone among state securities statutes, bearing no meaningful resemblance to the model Uniform Securities Act of 1956 that is the basis for securities regulation at the state level in most all other jurisdictions. NY has consistently resisted efforts to conform its statutory scheme to the Uniform Act model, preferring to regulate persons offering and selling securities within or from NY, rather than regulating securities offerings themselves (with the notable exception of offerings of “real estate” securities, which are subject to the Real Estate Syndicate Act under the Martin Act). Despite this “fierce independence”, the recent adoption of the new Uniform Securities Act of 2002 by NASAA and its endorsement by NASAA and the bar as the new model for state securities regulation may have been one important factor behind the introduction of the Securities Fraud Prevention bill. However, a closer
reading of the bill makes it clear that NY has chosen to consider only certain portions of the new proposed model act. Moreover, NY has also publicly stated its belief that adoption of the entire new model act is not appropriate, deciding instead to propose enactment of certain sections of the model act together with its own proposals as a means of “providing substantial benefits to the members of the securities industry in NY.”

Consistent with certain provisions of the new model act, the bill contains provisions that seek to expand the authority of the Attorney General to investigate and prosecute fraud. For example, proposed subsection (6) of Section 352 of the bill corresponds to a similar provision under the new model act to provide for reciprocal enforcement of subpoenas issued by other states and the use of evidence, documents, records and testimony adduced pursuant thereto. This provision, as noted in the commentary to the new model act, finds support in Section 102(c) of the Securities Litigation Uniform Standards Act of 1998 under federal law. Similarly, new Martin Act Section 353-c allows the Attorney General to issue a cease-and-desist order if he believes a violation of the Martin Act has or is about to occur, which authority is found in the new model act but is not found in the 1956 model act (such authority is available under the 1985 model act, but only upon the application of a reasonableness standard). The remainder of the bill, however, seeks to expand the powers of the Attorney General outside the framework of a uniform securities law, again demonstrating the unique nature of NY’s blue sky statute.

The bill proposes to add authority to revoke or suspend broker and dealer registrations, a power enjoyed by all state securities administrators. However, because NY defines “dealer” to include issuers of securities, this new proposed authority would allow the Attorney General to suspend or revoke not only the registration of a “traditional” broker-dealer if such broker or dealer has violated or failed to comply with any provision of the Martin Act (or any rule or order authorized thereunder) but also to suspend or revoke the registration of an “issuer-dealer” for similar violations. Under this proposed new authority, the Attorney General would be permitted to suspend or revoke the “dealer” registration of an issuer if, for example, an issuer-dealer who has filed a Form M-11 Issuer Statement failed to file an amendment to its registration, on Form M-3, on a timely basis.

In the context of a traditional broker-dealer, the Attorney General could also suspend or revoke the registration of such a broker-dealer if a Further State Notice, required to be filed in connection with a public offering of securities, is not timely filed in connection with an offering of “non-covered” securities. While all states have the authority to suspend or revoke a broker-dealer’s registration for violations of a particular state’s statutory provisions, the new proposed authority to suspend or revoke sought by NY arguably extends far beyond the usual bases for suspension or revocation of a broker-dealer’s registration.

In addition to the foregoing, new proposed Section 352(7) would grant the Attorney General access for “on-site” inspections of “registered persons” and would invest the Attorney General with the authority to access the premises of registered issuer-dealers as well as “traditional” broker-dealers. It is important to note that the definition of “registered person” in the bill excludes any “…registered person who may be deemed to be a dealer by offering for sale or selling its own securities solely to, from or through any bank, dealer or broker…” which exclusion would not cover any issuer selling its own securities. While every other state has inspection authority over broker-dealers registered in their states, such authority generally does not extend the power to allow for inspections of issuers whose securities may be registered or otherwise sold in the state. New Section 354-a, which creates a form of interpleader action respecting customer funds of a broker-dealer that may be deemed by the broker-dealer to be the proceeds of some illegal activity, has no corollary in either existing model acts or the new model act. While this provision may have its genesis in new, enhanced federal Anti-Money Laundering regulations to which federally registered broker-dealers and investment advisers are currently subject, again, because of the unique nature of the martin Act, this new provision would apply not only to “traditional” broker-dealers, but to issuer-dealers registered in NY and effecting securities transactions in or from NY.

Beyond those provisions that seek to expand the Attorney General’s authority to investigate and prosecute fraud, the bill would create a statutory notice filing requirement for Rule 506 offerings. With the adoption, in June, 1997, of Form 99, NY has already sought to impose a notice filing requirement for such offerings, which are transactions in covered securities under Section 18(b)(4)(D) of the Securities Act of 1933, as amended. NY has stated that the Form 99 (together with a Form D, Consent to Service of Process, fee and a copy of any offering materials) “must” be filed prior to the offer or sale of certain covered securities (principally, securities offered or sold in Rule 506 private offerings) in or from NY, which “requirement” is inconsistent with the provisions of NSMIA. Moreover, the “requirement” to file a Form 99 and related materials ignores the statutory exclusion from the definition of “dealer” found in current Section
359-e of the Martin Act for persons engaging in offerings which are not offered or sold from or to “the public”.

The new proposed notice filing requirement at best ignores or at worst contradicts the plain statutory language of Section 359-e that excludes issuers offering or selling securities in non-public offerings from the requirement to register as a “dealer”. It would appear, then, that issuers offering securities in Rule 506 private offerings would be required to make filings in NY in connection with such transactions, despite the fact that such offerings are not made “…to the public…”, which is the basis for requiring registration as a dealer under Section 359-e. Further, the requirement in new Section 359-d that the Attorney General may require the filing of additional information in connection with a Rule 506 private offering is contrary to NSMIA, but may be meant to codify the requirement to continue to file Form 99, which requires issuers to provide information in addition to that requested in Form D. It must be remembered that NSMIA only authorizes states to collect a fee, and require a notice filing, consisting of a Form D and Consent to Service of Process, in connection with Rule 506 offerings.

UNANSWERED QUESTIONS

Does new Section 359-d relieve issuers of the requirement to file Form 99 in connection with a Rule 506 offering? If not, will the failure to file the Form 99 result in the Attorney General imposing a civil penalty (under new Section 359-g(4)) of up to $10,000 (for each violation) or 10% of the total damages arising from the violation (presumably based on the size of the offering)? Also, does the notice filing provision apply to Rule 506 offerings of real estate securities under Section 352-e? It appears that the notice filing provision “exempts” an issuer from the dealer registration provisions of Section 359-e but fails to similarly “exempt” the securities in a Rule 506 real estate offerings from the provisions of the Real Estate Syndicate Act.

CONCLUSION

The Securities Fraud Prevention Bill seeks to enhance the authority of the NY Attorney General to investigate and prosecute securities fraud committed in or from NY. The proposed bill, however, eschews the concept of uniformity of state securities regulation, as most recently promoted by the new model act, and instead, seeks to create a statutory structure that is again at odds with the regulatory scheme embraced by its fellow state regulators and the federal government. While the new model act may not necessarily be the answer to state regulation in the most important state for financial markets, NY’s efforts must be consistent with a national regulatory scheme that addresses the concerns of the investing public while offering those in the industry a clearer and more uniform set of rules regulating their conduct.

BLUE SKY BITS AND PIECES
By Ellen Lieberman
Debevoise & Plimpton (New York)

William H. Mohr, formerly New York Assistant Attorney General, became Director of the Regulatory Group of the Compliance Department of Citigroup Salomon Smith Barney on December 9, 2002. The unit he manages is responsible for (i) representing the firm in examinations by SROs and regulator and preparing SRO reports and responses to member surveys, (ii) counseling and shepherding compliance driven systems projects, (iii) privacy/security and (iv) continuing education.

William Hanner, Senior Examiner with the Illinois Securities Department for many years, has retired.

Bradley Skolnik resigned as of January 1, 2003 as Indiana Commissioner of Securities and is now in private practice in Indianapolis at the firm of Stewart & Irwin. He was succeeded in office as of February 1, 2003 by James Joven, previously a litigator in the Indiana Office of the Attorney General. Paul Lawson is Deputy Securities Commissioner in Charge of Enforcement and Kathleen Blackman, previously head of Enforcement, has left the Division.

Patricia D. Struck was re-appointed Administrator of the Wisconsin Securities Division by newly elected Governor James Doyle.

Martin A. Hewitt has moved his blue sky practice from Simpson Thacher & Bartlett LLP to Sidley Austin Brown & Wood LLP.

Susan Donovan, who was a Corporate Financing Specialist in the NASD Corporate Financing Department, passed away May 15, 2003, after a year's struggle with cancer.

NEW LIAISON LIST LAWYER TO COVER IOWA AND MINNESOTA

Matthew L. Fornshell, of Kohrman Jackson & Krantz P.L.L. of Cleveland, Ohio, has agreed to serve as Committee Liaison with securities administrators in Iowa and Minnesota. Mr. Fornshell can be addressed
at his firm, at One Cleveland Center, 20th Floor, 1375 East Ninth Street, Cleveland, OH 44114-1793.

Committee Liaisons for the various jurisdictions track developments in blue sky laws and regulations and report to members of the Committee three times a year, for publication in the Committee’s Report. This requires contact and conversation with state administrators on a regular basis. In addition, most Liaisons are available for short consultations with Committee members on issues or questions arising under the securities laws of the Liaison’s respective jurisdiction.

The Chair position for the Subcommittee on eCommerce remains open and any Committee member interested in serving is invited to contact Committee Chair Marty Miller at (212) 728-8690, or by e-mail at mmillers@willkie.com.

NEW YORK INVESTMENT ADVISER REGULATIONS NOW ON INTERNET

The recently adopted New York regulations for investment advisers have been posted on the Attorney General's web site. The exact web address is http://www.oag.state.ny.us/investors/iaregs_2003.pdf

WE GET LETTERS . . . .

DOES NEW YORK DEFINE “SECURITY”?

I noted with interest Mr. Ken MacRitchie’s article on notes as "securities" in the December, 2002, "Blue Sky Bugle." While I've only been able to skim it, I did read through the NY section on page 16, and noted the statement that the so-called "Martin Act" (NY General Business Law Art.23-A) does not define the term "security." There is, in fact, a definition of the term "security" in GBL Sec. 352(1) [CCH Blue Sky L. Rep. par. 42.101], albeit buried in a provision regarding the investigative powers of the Attorney General, which definition specifically includes "... bonds, notes, evidences of ... indebtedness ..." Further, since this definition doesn't include the standard preamble of "unless the context otherwise requires," there's a possibility of a court taking a literal approach that all notes are securities, regardless of the Reves decision (I confess that I'm not familiar with the Metropolitan Savings Bank case referred to in fnn. 172-173, although, since a number of provisions in the Martin Act are conditioned on the securities being offered to the "public," the result doesn't surprise me). Finally, it should be noted that the NY courts will apply the Howey test in evaluating whether a particular instrument or arrangement entails a "security," even though the definition in Sec. 352(1) doesn't include the term "investment contract"; see, e.g., People v. First Meridian Corp., 86 NY2d 608 at 618-622 (1995).

Alan Parness, Cadwalader, Wickersham & Taft

MR. MACRITCHIE RESPONDS

Following a reading of my article in the December, 2002, edition of The Blue Sky Bugle regarding notes as “securities” under state law, Alan Parness of New York pointed out that New York does have a definition of “security” in General Business Law section 352(1), buried in a provision regarding the investigative powers of the Attorney General, and that this definition of “security” does not include a “context” clause. Mr. Parness also commented that New York courts apply the Howey test in determining whether a particular instrument or arrangement is a “security,” even though the definition in section 352(1) does not include the term “investment contract.” I appreciate these thoughtful comments from a distinguished member of the Bar.

Ken MacRitchie, New Jersey Bureau of Securities

ONE MORE COMMENT

I would take issue with Mr. MacRitchie's characterization of New York’s Martin Act as an antifraud statute “without any general requirement for securities to be registered....” I'm not sure that I understand what the term "general" means here. Real estate offering registration under Section 352-e or theatrical syndication registration or intrastate offering registration coexist independently with dealer registration under Section 359-e. I wouldn't characterize those provisions as being any less "important" than the Section 359-e dealer registration requirement. To the contrary, I think that characterization of the Martin Act as just an “antifraud” statute may be misleading to a anyone who is not familiar with the Martin Act.

David Katz, Sidley Austin Brown & Wood

PROPOSED PROVISION WOULD SET CALIFORNIA PENALTY GUIDELINES

Factors to be considered when determining the amount of an administrative penalty imposed by the California Commissioner of Corporations for violation of any statute, rule or order under the Commissioner’s jurisdiction have been proposed for adoption. The proposal would add new Rule 250.70 that would set forth eight non-exclusive factors that will influence the determination of the penalty amount levied pursuant to authority provided the Commissioner in Section 25252 of the Corporations Code.
Criteria to be considered will include:

(1) The nature and seriousness of the violations including actual or potential harm to the public or consumer.

(2) The number and persistence of violations and the length of time over which they occurred.

(3) The person's history of violations or complaints with the Department, other agencies or regulators.

(4) Whether the person's conduct was negligent, willful, or knowing, and the extent to which it was negligent, willful, or knowing.

(5) The person's financial condition including net worth and revenue.

(6) The nature and extent to which the person cooperated with the Department's investigation.

(7) Whether the person aggravated or mitigated any injury or damage caused by the violations.

(8) The nature and extent to which the person has taken corrective action to ensure that violations will not reoccur.

DID YOU KNOW?

THE BLUE SKY BUGLE can be accessed online at http://www.abanet.org/buslaw/statesec/bsb.html and is generally available online about 30 days prior to delivery of the paper version.
Watch for it.

The Committee’s listserv is available to committee members for posting comments, arguments, updates, news relating to Blue Sky Law, the people who practice Blue Sky Law, and the people who administer Blue Sky Law
bl-stateregs@mail.abanet.org

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YOU are invited to Contribute!
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THE BLUE SKY BUGLE

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