
THE BLUE SKY BUGLE

A Newsletter for Blue Sky Lawyers

Published by the ABA Committee on State Regulation of Securities

Volume 2007, Number 3, November, 2007

EVENTS CALENDAR

The Committee Will Have a Luncheon Event
December 14, 12:00 p.m. to 2:00 p.m.
Simpson Thacher & Bartlett LLP
425 Lexington Avenue
New York, New York 10017

The Committee will meet in conjunction with the 2008
Spring Meeting of the ABA Business Law Section
April 10 through April 13, 2008
at the Hilton Anatole Hotel, Dallas, Texas

Friday Evening, April 11, 2008
Committee Dinner

Saturday, April 12, 2008, 10:30 a.m. – 12:00 p.m.
Full Committee Meeting

Saturday, April 12, 2008, 9:30 a.m. – 10:30 a.m.
Subcommittee on Broker-Dealers And
Investment Advisers Meeting

Thursday April 10, 2008, 11:30 a.m. – 1:00 p.m.
MCLE Program Co-Sponsor
Navigating Safe Harbors and Blue Skies
The ABS's of a Private Offering of Securities

Friday, April 11, 2008, 10:30 a.m. – 12:30 p.m.
MCLE Program Co-Sponsor
Hot Securities Law Issues for Small Business II

Friday, April 11, 2008, 2:30 p.m. – 4:30 p.m.
MCLE Program Co-Sponsor
Ssh!! Privacy Laws – Basics, Bugaboos, and Beyond

The Committee will meet in conjunction with
the 2008 Annual Meeting of the ABA
August 2008
New York, New York

The Committee and its Subcommittees will meet at the
2008 Annual NASAA Fall Conference
September 15 through September 18, 2008
Las Vegas, Nevada

The Committee and its Subcommittees will meet in
conjunction with the 2009 Spring Meeting of ABA
Business Law Section
April 16, 2009 – April 19, 2009
at the Pan Pacific Vancouver Hotel
Vancouver, British Columbia

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BLUE SKY BITS AND PIECES

By Ellen Lieberman, Debevoise & Plimpton LLP

I am pleased to report that **Alan M. Parness**, who has ably served as the Committee's Vice Chair, has officially been named as Chair of the Committee, taking office after the conclusion of the ABA Annual Meeting in August 2008. Alan is Counsel to Cadwalader Wickersham & Taft LLP, and prior to joining that firm was a staff attorney and Special Deputy Attorney General with the New York Attorney General's Bureau of Securities and Public Financing. Alan's learned and always helpful contributions to discussions, to the listserv, to the Blue Sky Bugle, as a subcommittee chair, and as a friend and colleague, are well known to Committee members. As I go off into the sunset, I am pleased we will be in such capable hands.

R. Michael Underwood, Secretary to this Committee and Chair of our Enforcement Subcommittee, has joined Fowler White Boggs Banker in Tallahassee, Florida, as Counsel. We offer our best wishes to Mike and congratulate him on his new position.

Martin A. Hewitt, the Editor of the Blue Sky Bugle, has been appointed Special Counsel effective January 1, 2008, of Cadwalader, Wickersham & Taft LLP. His practice is concentrated in the areas of blue sky law and NASD Corporate Finance. We extend our heartiest congratulations!

In September 2007, **Roel Campos** stepped down as a member of the Securities and Exchange Commission, a position he held since August 2002. A Democrat, Campos was a proponent of better access to permit shareholders to nominate directors, enhancing corporate governance and issuer disclosure and eliminating conflicts of interest. A graduate of Harvard Law School, UCLA Graduate School of Business and the U.S. Air Force Academy, he was the first Hispanic member of the SEC, bringing diversity to the attention of the financial sector.

Annette L. Nazareth announced on October 2, 2007 that she will also depart from the SEC. She has asked not to be renominated as a Commissioner after her current term expires at the end of 2007, although her exact date of departure has not been announced. She has been a Commissioner since August 2005 and most recently prior to that was Director of the SEC's Division of Market Regulation. She began her career as an associate with the law firm of Davis Polk & Wardwell, and has indicated she will return to the private sector. She was a graduate of Columbia Law School where she was a Harlan Fiske Stone Scholar, and Brown University. A Democrat, she has been also been a proponent of proxy access for shareholders and has been concerned about protection of senior investors. She also played an important role in modernizing national market system rules.

News sources report that the Democratic Senate Majority Leader has recommended to fill the Campos and Nazareth seats on the SEC, **Luis Aguilar**, a partner at the law firm of McKenna, Long & Aldridge in Atlanta, and **Elisse B. Walter**, Senior Executive Vice President, Regulatory Policy & Programs, of the Financial Industry Regulatory Authority. Aguilar previously served as general counsel, executive vice president, and corporate secretary of INVESCO, and as its managing director for Latin America, and also did a

stint as an attorney at the SEC. Walter was previously General Counsel of the Commodity Futures Trading Commission, Deputy Director of the SEC's Division of Corporation Finance and in private practice.

Franklin L. Widmann, Chief of New Jersey's Bureau of Securities for a decade and President of the North American Securities Administrators Association (NASAA) from 2004-2005, left his state securities regulatory position as of October 15, 2007, for a position in the environmental section of the State Attorney General's Division of Law. During his tenure at the Bureau of Securities, he served as co-chair of the steering committee that reached a landmark settlement agreement in 2003 between securities regulators and ten top Wall Street investment firms with respect to their influence over research analysts. The settlement directed \$487 million dollars in civil penalties to the states, of which \$10 million was directed to New Jersey. Stepping into his shoes will be **Vincent Oliva**. Oliva, appointed by Attorney General Anne Milgram, was a former special agent for the FBI in Colorado in the 1980's, a former prosecutor in the Manhattan District Attorney's Office and the United States Attorney's Office in Denver and, most recently, senior associate general counsel of UBS Financial Services.

Wayne Davis, Indiana Securities Commissioner, has left that post and his successor is Chris Naylor, formerly a prosecutor in southern Indiana and head of the enforcement prosecutorial assistance section of the Securities Division.

Misty Gruber, until recently our Committee's Illinois liaison, is winding down her private practice at Dykema Gossett PLLC in Chicago as of August 31, 2007. She was a co-leader of the firm's biotechnology and life sciences team, and is now embarking on her own biotech venture. We wish her success as she begins this new chapter in her life.

Joseph P. Borg, Director of the Alabama Securities Commission since 1994, completed his second, nonconsecutive term as President of NASAA at the recent Annual Meeting in Seattle. Each of his terms presented real challenges—he took office in 2001 just as the events of 9/11 were occurring, and this year he presided amidst a flurry of releases, proposals and activity from the SEC. His successor is **Karen Tyler**, North Dakota Securities Commissioner since July 2001. During that time she served on NASAA's board of directors and chaired committees on investor education and 529 college savings plans. Before her tenure as North Dakota Securities Commissioner, she worked for

14 years in the banking and brokerage sectors of the financial services industry. Colorado Securities Commissioner **Fred Joseph** will serve as president-elect of NASAA.

We are delighted that **Daniel M. Baich** who practices at Sullivan & Cromwell LLP has agreed to serve as Assistant Editor of the Blue Sky Bugle. Dan practices in the area of financial institutions and was previously with the NASD (before it morphed into FINRA) in its New York Office. He is a graduate of SUNY Albany and Buffalo Law School.

Leigh F. Goldman, formerly with Tom Bolt & Associates, has opened his own office, Goldman Law Offices, Inc. in St. Thomas, U.S. Virgin Islands. His practice focuses on corporations, finance, banking and real estate.

I am delighted to announce that the ABA Business Law Section has appointed both a Business Law Fellow and a Business Law Ambassador to our Committee. The Section funds five Fellows each year for a two-year term, and **Kathleen F. Warner** of Austin, Texas, will be a Fellow working with our Committee for the next two years, including attendance at our meetings. Katie works at the Texas Office of the Attorney General Antitrust and Civil Medicaid Fraud Division, has been active in the ABA Young Lawyers Division and has agreed to undertake for us a research project on the treatment under state securities law of banks and similar institutions as broker-dealers. Similarly, the Section funds five Ambassadors each year for a two-year term, and **Melissa K. Brown** of San Francisco, Senior Associate at Bingham McCutchen LLP, will be an Ambassador to our Committee for the next two years and will attend our meetings. Because of her background in securities litigation and her interest in diversity, we've suggested that Melissa might take up her pen to do a series of columns on aspects of securities litigation for our newsletter, the Blue Sky Bugle, and might also work with **David C. Wang**, Holland & Knight LLP, our Liaison to the Section's Diversity Committee, on best practices and suggestions so the Committee can reach out to further diversify our ranks.

Keith Paul Bishop, a shareholder in Buchalter Nemer and our Committee's California liaison, has written a thoughtful article published in the Chapman Law Review, Spring 2007, "The McNulty Memo—Continuing the Disappointment," setting the McNulty Memorandum in its historical context and discussing its impact on attorney-client protected information. Keith is also an Adjunct Professor of Law at Chapman

University School of Law, and formerly California Commissioner of Corporations, Deputy Secretary and General Counsel of the California Business, Transportation and Housing Agency, and Interim Savings and Loan Commissioner.

New York Insurance Superintendent Eric Dinallo, who also chairs the New York Commission to Modernize the Regulation of Financial Services, has named **Scott H. Rothstein** as the Commission's executive director. Rothstein is currently Executive Director of the Legal and Compliance Division at Morgan Stanley and previously headed the legal advisory coverage group for Morgan Stanley's Global Wealth Management Group, served as Deputy General Counsel of American Skandia, was Counsel at Aetna, and before that was in private practice. A final report and recommendations to Governor Eliot Spitzer and the New York Legislature are anticipated in late 2008.

On November 14, the SEC announced that it had changed the name of its Division of Market Regulation to the **Division of Trading and Markets**, which was the name of the Division until 1972. This name change is intended to be a better reflection of the full range of the Division's responsibilities. SIFMA, FINRA and now the Division of Trading and Markets. A rose by any other name

FROM THE CHAIR – WHAT'S NEW IN THE BLUE SKY WORLD

By Ellen Lieberman Debevoise & Plimpton LLP

SEC Proposals on Regulation D. In the last issue of the Blue Sky Bugle, I noted that the Securities and Exchange Commission on May 23, 2007, had proposed a series of six measures largely geared to improving capital raising and reporting requirements. At the time that issue of the Bugle was published, we were still awaiting the final release published for comment on August 10, 2007. Release No. 33-8828 proposed a number of amendments to the limited offering exemptions in Regulation D.

Relying on its authority under Section 28 of the Securities Act of 1933, as amended, the SEC proposed a new Rule 507 creating a new securities registration exemption for offers and sales to "large accredited investors" that would permit publication of a limited announcement in a manner comparable to current state model accredited investor exemptions. "Large accredited investors" in Rule 507 transactions would be "qualified purchasers" under Section 18(b)(3) of the

Securities Act, hence the transaction would have “covered security” status and be preempted from state securities registration requirements, although state notice filings could still be required. Persons that are accredited without reference to dollar-amount thresholds, such as banks and insurance companies and executive officers of the issuer, would also qualify as large accredited investors. Entities accredited on account of \$5 million of assets would be required to have \$10 million in investments, and individuals qualified on the basis of income or net worth would be required to have \$400,000 income levels (\$600,000 with spouse) or \$2.5 million in investments

The SEC would also revise the definition of “accredited investor.” It would add an alternative “investments-owned” standard for those entities or individuals who might qualify based on their total assets (and define “investments” and “joint investments,” the latter to apply throughout Regulation D); adjust dollar amount thresholds periodically to take future inflation into account and add categories of entities to the list of investors in Rule 501(a)(3) that may be accredited. The SEC also sought additional comments on its prior proposals to define “accredited natural person” with respect to offerings by Section 3(c)(1) pooled investment vehicles.

Other parts of the proposal include reducing the Regulation D integration safe harbor from six months to 90 days and applying new “bad actor” disqualification provisions uniformly throughout Regulation D, and, with respect to Rule 504, solicited comment on whether securities sold pursuant to state model accredited investor exemptions should be deemed “restricted securities” for purposes of Rule 144.

The SEC has indeed been busy and, as a result, we will soon (perhaps as early as the end of this year) face a new regulatory landscape. I’m not sure what it will look like—but we continue to live in interesting times.

SEC Adopts Rules to Help Smaller Businesses. On November 15, 2007, the SEC voted to adopt three rules to improve capital-raising, reporting and disclosure requirements applicable to small businesses addressing some of the recommendations in the final report of its Advisory Committee on Smaller Public Companies. The final rules will expand the number of companies that can utilize scaled disclosure regulations by permitting scaled disclosure to be used by “smaller reporting companies” having less than \$75 million in public equity or (for those not able to calculate public float) revenues of less than \$50 million in the last fiscal year, and by all foreign

companies that file on domestic company forms and provide GAAP financials. SB forms will be eliminated and scaled disclosure will generally be moved into Regulations S-X and S-K with smaller reporting companies able to elect item-by-item whether or not to comply with scaled disclosure.

The final rules, among other things, will shorten holding periods for Rule 144 restricted securities of reporting companies to six months for non-affiliates (subject to the Rule 144(c) public information requirement until the securities have been held for one year); permit non-affiliates of non-reporting companies to freely resell after one year; eliminate manner of sale and loosen volume limitations for affiliate sales of debt securities; raise the threshold for required Form 144 filings for affiliate sales, and otherwise streamline, and codify interpretations of, Rule 144. The final rules will also amend Rule 145 and will create new exemptions from registration requirements under the Securities Exchange Act of 1934 that would otherwise be triggered by compensatory employee stock options.

Comment Letters. The Committee jointly submitted three comment letters with the Committee on Federal Regulation of Securities and, with respect to the Regulation D proposals, also with the Committee on Middle Market and Small Business. The comment letters to the SEC were on Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3, Release No. 33-8812, Electronic Filing and Simplification of Form D, Release No. 33-8814, and Revisions of Limited Offering Exemptions in Regulation D, Release No. 33-8828. In addition, the Committee submitted a comment letter to the California Department of Corporations in connection with a proposed rule change that would eliminate an exemption from state investment adviser licensing requirements for investment advisers that are not federally registered and have fewer than 15 clients and more than \$25 million of assets under management (exemptions would still be available for advisers to certain “venture capital companies” as defined in the rule, and for advisers with no place of business in California and fewer than six clients resident in the state in the preceding 12 months). These letters are all available on our Committee website [<http://www.abanet.org/dch/committee.cfm?com=CL680000>] and the letters to the SEC are also available on the SEC’s website.

Although not a comment letter, the Committee also recently sent a letter to Mark Connelly, Director of New Hampshire’s Bureau of Securities Regulation, in his role as new Chair of NASAA’s Corporate Finance Section.

This letter follows up on a conversation at the recent NASAA Annual Meeting and requests the Corporate Finance Section to urge the states to make their exemptions that coordinate with federal Rule 701 more uniform and more consistent with the federal exemption. While the 2002 Uniform Securities Act employee benefit plan exemption covers all of the entities (including parent and sister companies) and individuals (including certain advisors, consultants and insurance agents) covered by Rule 701 and also, like Rule 701, extends to securities issued under written compensatory contracts as well as written compensatory benefit plans, there are a number of states whose exemptions are not coterminous with Rule 701. Our letter has been posted on the Committee's website.

By submitting comments to federal and state regulators, we can alert them to the impact or issues in existing or proposed regulations that might otherwise not come to their attention. In particular with respect to federal regulation, our perspective is sometimes very different from that of NASAA or its constituent state regulators, and the SEC should be aware of and take into consideration these divergent views. I urge Committee members to take an active and dynamic role in our comment drafting process. Let us know if there are proposals we should comment upon and then volunteer to participate in or lead the drafting committee. We welcome and value your input.

Federal Legislation Removing Second Tier Exchanges from "Covered Security" Status. H.R. 2868, introduced by New York Representatives Gregory Meeks and Vito Fossella, would amend Section 18 of the Securities Act of 1933, as amended, to remove from covered security status securities issued by companies listed on second-tiers of U.S. exchanges. Without this amendment, NASAA was concerned that securities listed on any developmental listing tiers created by the major U.S. exchanges would be covered securities and state securities registration requirements would be preempted. The bill is intended to permit the creation of such tiers with the goal of reducing the number of U.S. initial public offerings gravitating from U.S. to foreign stock exchanges. The bill passed the House of Representatives by voice vote, and was referred on October 24, 2007, to the Senate Committee on Banking, Housing and Urban Affairs.

The Martin Act—New York's All Purpose Statute, and Is There a Preemption Issue? Eliot Spitzer as Attorney General, according to the media hype, "resurrected" the Martin Act (codified at Article 23-A of New York's General Business Law) and rode the

resulting publicity onto the front page of every newspaper and then into the New York Governor's mansion. In fact, the Martin Act, adopted in 1921 and amended a number of times including 1955 when criminal penalties were added, has been used responsibly and effectively by Attorneys General for decades. It authorizes the Attorney General under Section 352 to investigate "fraudulent practices" in connection with the issuance, exchange, purchase, sale, promotion, negotiation, advertisement, investment advice or distribution of securities within or from New York, and "fraudulent practices" are broadly defined and have been broadly interpreted in case law through the years. The Martin Act has been a productive enforcement tool because it permits broad administrative discovery and can result in harsh penalties. For example: the Attorney General, without judicial approval, may issue investigatory subpoenas; failure to comply with a subpoena is a crime; witnesses may not be entitled to counsel; and a person who refuses to answer questions may be permanently enjoined from the securities industry. During the Spitzer administration, his office and that of long time Manhattan District Attorney Robert Morgenthau, used the Martin Act as the basis for billions of dollars of settlements that also restructured how some in the brokerage and corporate world do business, involving, for example, research analyst conflicts of interest, spinning of shares in IPOs, mutual fund late trading and market timing.

More recently, Spitzer's successor as Attorney General, Andrew Cuomo, has stretched far beyond what usually constitutes securities regulation and is using the Martin Act in even more creative and unexpected ways. Demonstrating the elastic qualities of the Martin Act, it is currently being used to investigate environmental risks in a somewhat roundabout manner. Subpoenas were sent to five large energy companies based outside New York, which are being investigated to see if there was adequate disclosure to investors of future financial liabilities from the impact on global warming of carbon dioxide emissions from their coal-fired power plants.

Use of the Martin Act to oversee this kind of prospectus disclosure reminds me of a case noted in the Bugle earlier this year. In Capital Research & Management Co. v. Brown, 147 Cal. App. 4th 58, 53 Cal. Rptr. 3d 770, (Cal. Ct. App. 2d Dist. 2007), the California Court of Appeals held that, even though NSMIA expressly prohibits any state from imposing conditions on the use of offering documents for a covered security, through NSMIA's savings clause Congress intended to preserve the states' anti-fraud authority to control the conduct of brokers and dealers, and could require disclosure even if

that disclosure would likely be made in the prospectus. With reference to that case, SEC Commissioner Paul S. Atkins in a speech on April 20, 2007, said “some recent state enforcement cases involving several large mutual fund complexes and their in-house distributors are troubling. When the California Attorney General was asked by a Wall Street Journal reporter about whether he was seeking more disclosure than required by the Commission, his response was ‘that’s fine’ because he thought he should be “‘supplementing’ SEC regulations. The setting of disclosure standards for nationally-offered securities such as mutual funds is a function that Congress, through NSMIA, clearly left to the Commission.” What would he say about this latest use of the Martin Act to regulate the environment by way of prospectus disclosure?

Mr. Goldstein Goes to Court, Again. Philip Goldstein, co-founder of investment fund manager Bulldog Investors, brought suit against the Securities and Exchange Commission in 2006 which resulted in the D.C. Court of Appeals’ vacating an SEC rule that would have required hedge funds advisers to register federally as investment advisers. Goldstein v. SEC, F.3d 873 (D.C. Cir. 2006). In January 2007, Massachusetts Secretary of State William Galvin’s office filed suit against the Bulldog funds, Mr. Goldstein and related parties alleging the fund engaged in general advertising and public solicitation of non-accredited investors by sending information in response to an internet query from a Massachusetts resident and alleging the Bulldog website was not adequately password protected. Goldstein and Bulldog have now responded by suing Galvin, claiming, among other things, that the government was violating their First Amendment rights. A number of recent comment letters to the string of SEC proposals, including those submitted by this Committee and by Mr. Goldstein, have urged the SEC to remove the limitations on public advertising and general solicitation for some or all of the Regulation D exemptions.

Meetings and Events. San Francisco, California. We had a successful and productive few days in San Francisco in August 2007 in conjunction with the ABA Annual Meeting. California Commissioner of Securities Preston DuFauchard attended our Committee meeting, where we discussed various California initiatives already or about to be released, many of them intended to conform California requirements more closely to federal requirements, among others, broker-dealer and investment adviser regulations, compensatory benefit plan rules (effective July 9, 2007) and franchise rules. A general discussion of various blue sky issues followed—including private placement brokers, revisions to and

electronic filing of Form D and proposed amendments to Regulation D. (Subsequent to the San Francisco meeting, the California Department of Corporations issued a proposed rule that would require the registration of hedge fund advisers who are not federally registered although advisers with no place of business in California may continue to rely on a state exemption or the equivalent national *de minimus* exemption under Section 222(d) of the Investment Advisors Act of 1940 if they have five or fewer clients resident in California, or a state exemption for advisers to certain “venture capital companies” as defined in the California rule.)

The Committee also co-sponsored three MCLE events at the Annual Meeting—“The Regulatory Civil War Over Variable and Equity Indexed Annuity Sales and Supervision: Whose Side Are You On, Anyway?,” chaired by Peter J. Anderson, Sutherland Asbill & Brennan, LLP, and with NASAA President Joseph P. Borg participating; “Watch Those Speed Bumps! -- Quirky California Laws Often Surprise Lawyers Involved in California-Based Transactions,” led by Gerald Niesar of Niesar Curis Bartling & Whyte, LLP and with Commissioner DuFauchard participating; and “Insider Trading Revisited” chaired by Kenneth Bialkin of Skadden, Arps, Slate, Meagher & Flom LLP. Program materials from the first two programs are posted on our Committee website.

Seattle, Washington. The Committee next met in Seattle on September 30, 2007, in conjunction with the Annual Meeting of NASAA. A number of our subcommittees also had stand alone meetings. Gerald Laporte, Chief of the SEC’s Office of Small Business Policy, was a guest speaker and, while many topics were touched on, the main thrust of the discussion was the SEC’s proposals relating to Form D and Regulation D. A few Committee members who participated in the drafting committee for our comments on Electronic Filing and Simplification of Form D were able to meet, during the event, with SEC Commissioner Paul S. Atkins and his Chief Counsel, Mark Uyeda, to discuss in person the various SEC proposals. It was a unique and much appreciated opportunity to exchange views.

Dallas, Texas. Our next regularly scheduled meeting is scheduled to be held at the Spring Meeting of the ABA Section of Business Law on Saturday, April 12, 2008, at the Hilton Anatole Hotel in Dallas, Texas. We also intend to cosponsor three MCLE programs, Lee Liebolt’s reprise of last year’s successful event to be titled Hot Securities Law Issues for Small Business II; a somewhat more basic program to be cosponsored with the Middle Market and Small Business Committee and

the Young Lawyers Forum on Navigating Safe Harbors and Blue Skies - The abcDs of a Private Offering of Securities, chaired by Richard Leisner of Trenam Kemker with input from Carmen A. Gaspero, Jr. of Katten Muchin Rosenman LLP of our Committee, and Ssh! Privacy Laws -- Basics, Bugaboos, and Beyond being organized by Shane Hansen of Norcross & Judd LLP to be co-sponsored with the Committee on Banking Law. The programs are scheduled for Friday April 11 10.30-12.30, Thursday April 10 11.30-1, and Friday April 12 2.30-4.30, respectively.

Luncheon Event. Another in our series of luncheon meetings, with telephone conference call access, will be held on Friday, December 14, 2007. Mark Lab of Simpson Thacher & Bartlett LLP has graciously agreed to host the event. We have invited Karen Tyler, North Dakota Securities Commissioner and NASAA's new President, together with colleagues from NASAA, to be our special guest speakers. Information about this and other upcoming events is posted on the Committee's website.

Subcommittees and Social Event. Our Subcommittees are becoming more active. Their reports are now separately posted on individual Subcommittee websites, and Subcommittees now have their own listservs for posting information and discussing practice points that may not be of interest to the entire Committee membership. Make sure you are a member of each Subcommittee in which you may have an interest so you can participate in the dialogue. Go to the Committee website <http://www.abanet.org/dch/committee.cfm?com=CL680000>, and sign up (or let me know and we'll have the ABA staff assist).

At the Spring Meeting in Dallas, we are planning a first-time social event—a Committee dinner on Friday night April 11. Ben Nager of Sidley Austin LLP will be our dining guru and he will help organize the event and select an appropriate dining venue. Since this is a first for us, please send Ben or me an indication as early as possible if you might join us and how many are likely to be in your party so we can make this work.

Thanks and Appreciation. I'd like to take a moment to thank all those who participate in the efforts of the Committee – liaisons, subcommittee chairs, Bugle contributors, comment letter participants, luncheon hosts, folks who alert us to current items of interest or assist in responding to inquiries posted on the listserv, and those who come to our meetings in person or by conference call and participate in our ongoing dialogue. We are very much a community and we all benefit from

the community spirit and involvement. And a special word of thanks to our valuable blue sky colleagues – the paralegals – whose contributions in our workplace and within the ABA are very necessary, very helpful and very much appreciated.

AVOIDING INVESTMENT ADVISER DEATH TRAPS

By: R. Mark Field

The Bogatin Law Firm, PLC

Hiding in plain sight in the bowels of the investment adviser laws and regulations are a variety of traps for those winding down the business affairs of investment advisers who were engaged in solo practice at the time of their death. These traps can be easily tripped, and make it difficult for the investment adviser's estate or surviving business entity to assign or transition the business to other investment advisers for value without engaging in illegal conduct. Here's what you need to know to identify the traps and work around them.

When faced with this type of situation, you should first engage in a bit of expedited due diligence. Compile a due diligence notebook that consists of the following information related to your client's business: (i) regulatory compliance documents (including, at a minimum, your client's current Form U-4 and Form ADV); (ii) customer contact information; (iii) supervised person contact information; (iv) solicitor contact information; (v) advisory contracts; (vi) supervised person agreements; (vii) solicitor agreements; and (viii) any recent or pending regulatory matters. You may also want to gather other documents related to your client's business such as lease agreements and the like, but a discussion of these is beyond the scope of this article.

Once you've completed the due diligence stage, you'll know: (i) whether the deceased advisor was conducting his business individually or through an entity; (ii) whether he was registered under federal or state law; (iii) if he was practicing through an entity, whether his death prompted a dissolution of that entity; (iv) whether his advisory contracts terminated upon his death; (v) whether his advisory contracts can be assigned; and (vi) whether he had any unfinished regulatory compliance matters. When you are armed with this information, you are ready to really get started.

Here's the first "trap." Investment advisers are required by law to be, or be run by, individuals having appropriate licenses. By definition, when an investment adviser who is practicing solo dies, there isn't anyone

associated with his business who is properly licensed to run the business. Accordingly, the wind down process must be conducted without engaging in investment adviser activities.¹ This is problematic where the solo adviser practiced through an entity that survived his death. Where the surviving entity holds the investment adviser registration, the adviser's death often puts it in a Catch-22. If its advisory contracts don't terminate upon the death of the adviser, then it remains contractually obligated to provide advisory services, but doing so will cause it to violate applicable law unless it first hires a new Series 65-licensed adviser to operate the business. To minimize the consequences of the first trap, notify the SEC or state regulators, as appropriate, to inform them of the investment adviser's death, and your concern that all of the investment adviser's clients are smoothly transitioned to other licensed advisers who meet with their approval. You may also want to take this opportunity to share with them your plans to wind down the investment adviser's business by either assigning the investment advisers accounts for value, or promoting the establishment of new advisory relationships between the clients and a specified investment adviser by serving as a paid solicitor. The goal at this stage is to assure the regulators that every effort is being made to comply with applicable laws and to invite them into the process to ensure that any concerns they have are addressed.

The next trap arises from restrictions on the disclosure of client information that require prior consent by the affected clients. While neither the Investment Adviser's Act of 1940 (the "Act") nor the rules promulgated thereunder come out and say this directly, investment advisers are fiduciaries and thus have an obligation to preserve their client's confidential information.² In addition, state laws are often a little more direct in their prohibition of such disclosures. For example, to the extent permitted under Section 203A of the Act, in Tennessee the disclosure of a client's identity, affairs or investments is prohibited except as required by law or

consented to by the client.³ To avoid falling into the disclosure trap you'll need to inform the deceased adviser's customers of his death. In some circumstances this disclosure may also be mandated by the Act.⁴ Take this opportunity to introduce yourself to the deceased adviser's clients and to tell them about your desire to assign or transition their accounts to another adviser whom they deem acceptable. This introduction will also provide you with the opportunity to seek their consent to your effort and the disclosure (as required and in confidence) of information concerning their identity, affairs, or investments. If your plan is to hire a Series 65-licensed adviser to be the businesses registered investment adviser, then share this with them. The goal at this stage is to assure all concerned that the situation is under control.

Yet another trap is created by the "assignment" definition and the notice and consent requirements associated with assignments. If you poll business lawyers, most will tell you that a sale of ownership interests in a company doesn't effect an assignment of the company's contracts. The assignment trap arises in large part because the Act defines the term differently.⁵ Under the Act, an assignment includes traditional assignments and, with limited exceptions, transfers of ownership interests that effect changes in control.⁶ Further, as noted in the preceding paragraph, under the Act an investment advisory contract must contain language requiring the client's consent to any assignment of the contract, and notification of any change in control of investment advisers operating as a partnership. To the extent this trap will be tripped by death, the only real way to avoid tripping it is to include a client consent provision in each investment advisory contract that indicates who will take control of the company upon the investment adviser's death. If

³ Tenn. Admin. Comp. Rule 0780-4-3.02(c)(17)

⁴ Investment Advisers Act of 1940, Section 205(a)(3), 15 U.S.C. § 80b-5(a)(3)

⁵ Investment Advisers Act of 1940, Section 202(a)(1), 15 U.S.C. § 80b-2(a)(1) ("Assignment" 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 shall be deemed 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 such admission, shall be only a minority of the members and shall have only a minority interest in the business.")

⁶ *Id.* See also, 17 C.F.R. § 275.202(a)(1)-1 (2007)

¹ Investment adviser services are listed in the Act under the definition of "investment adviser," which states in pertinent part as follows: "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 part of a regular business, issues or promulgates analyses or reports concerning securities..." 15 U.S.C. § 80b-2(a)(11)

² Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 *et seq.*; and Rules and Regulations – Investment Advisers Act of 1940, 17 C.F.R. Part 275

consent was not obtained prior to the date of death, then the best that you will be able to do is to seek consent as soon as possible after the investment adviser's death -- and to seek it again prior to consummating any transaction that falls within the scope of the "assignment" definition.⁷

The last trap arises under state law in the context of the provision of "solicitation services." You may find that investment adviser firms who are interested in "acquiring" your client's customers aren't interested in having the accounts transferred to them through the "assignment" mechanism. If this is the case, your client may still be able to profit from its book of business by entering into one or more solicitation agreements. Under these agreements, your client would recommend to its clients that they enter into investment advisory agreements with the third party adviser. Your client would then receive a fee for its services. This process is sanctioned by the SEC in Rule 206(4)-3.⁸ Unfortunately, most states view solicitation as an investment adviser representative function and require solicitors to register as investment adviser representatives.⁹ This, in turn, means that they must meet certain prerequisites that your executor or remaining investment adviser staff members are unlikely to have.

The basis for this position is hidden in a common state law definition of "investment adviser representative" and the requirement that investment adviser representatives meet certain licensing requirements and register. Using Tennessee law as an example, an "investment adviser representative" is "any partner, officer, or director of (or person occupying a similar status or performing similar functions) an investment adviser, or other individual, except clerical or ministerial personnel, who is employed by or associated with an investment adviser and does any of the following: (A) Makes any recommendation or otherwise renders advice regarding securities; (B) Manages accounts or portfolios of clients; (C) Determines which recommendation or advice regarding securities should be given; (D) Solicits, offers or negotiates for sale of or sells investment advisory services; or (E) Supervises employees who perform any such actions; ... [but not] such other persons not within the intent of this subdivision (11) as the commissioner

may, by rule, exempt from this definition as not in the public interest and necessary for the protection of investors."¹⁰ While the Tennessee Department of Commerce and Insurance Division of Securities has not taken an official position regarding whether a solicitor is an investment advisor representative, the agencies responsible for enforcing the securities laws of Delaware, Iowa, and North Carolina have taken a position with respect to similarly-worded definitions. In each case, these states have decided that solicitors are investment advisor representatives, and therefore must be registered under applicable state law.¹¹ In view of these decisions you should proceed with caution if you are interested in pursuing the solicitation option for facilitating the transition of your client's advisory accounts to other advisers. With any luck, your state's regulators will officially, or at least unofficially, sanction the use of this method without registration where the other methods aren't workable, your client is engaging in solicitations solely in connection with the winding down of the deceased adviser's business, and the solicitation activity is limited to making introductions.¹²

As discussed above, many traps await well-intentioned, but unwary persons who seek to wind down the affairs

¹⁰ Tenn. Code Ann. § 48-2-102(11) (Emphasis added)

¹¹ See, Licensing Requirements Of Solicitors/Cash Solicitation Rule, Superintendent Of Securities Of Iowa, 2001 Ia. Sec. LEXIS 4, July 17, 2001; Re: Regulation of Investment Adviser Representatives Under the North Carolina Investment Advisers Act, State Of North Carolina Department Of The Secretary Of State, 2000 N. Car. Sec. LEXIS 7, July 21, 2000; and Re: Solicitors, State Of Delaware Department Of Justice Division Of Securities, 1997 Del. Sec. No-Act. LEXIS 24, December 22, 1997, October 10, 1997

¹² One final way to assist might be to take advantage of the exception to the "investment adviser" definition in 15 U.S.C. § 80b-2(a)(10) that allows attorneys to provide investment advice when doing so is incidental to their practice of law. The longstanding SEC practice is to treat investment advice as incidental to the practice of law when (1) the attorney doesn't hold himself out to the public as providing investment advisory services, (2) the advisory services are provided in connection with and reasonably related to the lawyer's provision of legal services, and (3) his fee for such services is based on the same factors that he uses to determine his fees for legal services. See, 1988 SEC No-Act. LEXIS 1731, Investment Advisers Act of 1940 -- Section 202(a)(11)(B), Dec 27, 1988, Jan L. Warner, Esq. citing Investment Advisers Act Release No. 1092 (Oct. 8, 1987). Unfortunately, I think this method is fatally flawed by the need to keep the deceased adviser's estate or surviving business in the loop for compensation purposes. Technically, it seems that it will remain the solicitor, and therefore will encounter issues in those states that require solicitors to register. It may also raise unacceptable professional liability risks. Attorneys interested in examining this option further should create a flow chart that depicts all of the parties to the proposed solicitor arrangement, the licenses each is required to maintain, and the flow of consideration.

⁷ Investment Advisers Act of 1940, *supra* note 5

⁸ 17 C.F.R. § 275-206(4)-3 (2007)

⁹ See, e.g., Tenn. Code Ann. § 48-2-109(c), and Tenn. Admin. Comp. Rule 0780-4-3-.01(9)

of deceased investment advisers in solo practice. These traps are best disarmed by opening lines of communication with the applicable regulators, regularly communicating with the clients to keep them apprised of developments and to seek their consent when required by law, and when feasible, by employing an investment adviser to wind down the deceased adviser's business. While the process can be frustrating, it helps to keep in mind that the laws and regulations were drafted to protect investment adviser clients. So long as the investment adviser's clients' interests are protected, you should be able to craft a solution that meets with the approval of the applicable regulators. The process takes time, however, so it is best treated like disaster recovery planning and done prior to the adviser's death.

CONSUMER PRIVACY AND INFORMATION SECURITY ISSUES

By: Patricia E.M. Covington
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When a lawyer utters the word privacy, most automatically think about the Gramm-Leach Bliley Act ("GLB"). While GLB is certainly a significant authority and source of regulation regarding consumer data privacy and data security, it is hardly the only relevant law on the subject. When approaching the subject of consumer information privacy, it's best to step back and take a panoramic view of the landscape.

Having a thorough understanding of the area of consumer privacy and data security is not only crucial for compliance, it's vital for developing an economical and resource efficient compliance program. Further, it's helpful in developing a robust one likely to realize the laws' intended goals.

There are three types of consumer privacy and data security laws: (1) those that restrict the sharing of consumer information and require the safeguarding of it (*i.e.*, confidentiality and security related); (2) those that restrict marketing to consumers (*i.e.*, marketing related); and (3) those that seek to prevent or redress the misuse of consumer information (*i.e.*, identity theft protection related).

When we discuss privacy laws, we have to start with the granddaddy of them all, the Fair Credit Reporting Act ("FCRA"). The FCRA was the first law to restrict how information could be shared and used. Specifically, the FCRA restricts the sharing of credit related information. Two definitions are central to the FCRA—"consumer report" and "consumer reporting agencies," A

"consumer report" is information about a consumer that bears on the consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living when used in connection with the consumer's eligibility for credit or insurance, for employment purposes, or for any other legitimate business need in connection with a transaction initiated by the consumer. "Consumer reporting agencies" are persons that regularly collect and/or evaluate consumer report information for the purpose of furnishing it to others for some type of remuneration. The FCRA restricts with whom and under what circumstances consumer reports may be shared. In addition, users of consumer reports have certain notice requirements to consumers for actions taken that are adverse to the consumer.

The FCRA also prohibits any person from sharing information that meets the definition of a consumer report with any third party, including an affiliate. An exception exists for information that solely relates to transactions or experiences between the consumer and the person making the report ("Transaction and Experience Information"). The FCRA provides affiliates with an additional exception. An affiliate may share information that meets the definition of a consumer report ("Credit Information") if it has provided consumers with an opportunity to opt out of its sharing with affiliates, and the opt out has not been exercised. This exception is not available to nonaffiliated persons.

Thus far, all of the FCRA provisions discussed are confidentiality and security related—restrictions on the sharing of consumer information. The FCRA also has marketing related provisions. The FCRA provides a process by which persons can obtain customer lists for marketing purposes—otherwise known as "prescreened lists" and "firm offers of credit." There are special rules regarding how these lists may be used. In addition, consumers have a right to be removed from these prescreening lists.

In 2003, the FCRA was amended by the Fair and Accurate Credit Transactions Act ("FACTA"). FACTA was intended to enhance the ability of consumers to combat identity theft, restrict the use of medical information in connection with credit eligibility, and grant consumers greater control over the solicitations they receive. Two of the FACTA privacy related laws most relevant to the securities law area are the Disposal Rule and the Affiliate Marketing Rule.

The Disposal Rule requires that companies properly dispose of consumer reports (or any derivatives or compilations of consumer reports). Its aim is to prevent the unauthorized access and use of consumer report information. Companies are required to have policies and procedures for the proper disposal of consumer report information. The policies and procedures must provide reasonable measures to protect against unauthorized access or use of consumer report information in connection with all phases of disposal—storage, transportation and actual destruction. This FACTA privacy law is of the confidentiality and security kind.

As of the writing of this article, the Securities and Exchange Commission’s Affiliate Marketing Rule has not yet been published in the Federal Register. The federal banking agencies¹³ and the Federal Trade Commission’s (“FTC”) rules have been published. The Affiliate Sharing Rule limits how information shared with affiliates can actually be used when it comes to marketing.¹⁴ The limitations of this rule apply to all information—Experience and Transaction Information, as well as Credit Information. The Affiliate Marketing Rule created a new term, “eligibility information,” as a substitute for the more complicated description of all Experience and Transaction Information and Credit Information. The Affiliate Marketing Rule restricts how eligibility information is used by affiliates for marketing purposes. If a person receives eligibility information from an affiliate, it may not use such information for marketing purposes unless it has provided consumers with notice and an opportunity to opt out of such use, and the opt out has not been exercised. Exceptions to this general rule are provided, such as if there is a pre-existing relationship between the affiliate and the consumer and if the marketing is in response to a communication initiated by the consumer. Note that the restrictions of the Affiliate Marketing Rule do not apply to the sharing of information, but to the *use* of such information. The Affiliate Marketing Rule provides marketing related privacy protections to consumers.

As previously mentioned, the most well-known privacy law is GLB. It has two general requirements, privacy

and safeguarding. The privacy provisions require that notices be provided to customers, and sometimes consumers, informing them about what information is being collected about them, how such information is shared and with whom it is shared. The privacy requirements also give customers and consumers an opportunity to opt out of certain types of sharing. The safeguard provision requires that written policies and procedures be adopted to protect customer records and information. The policies and procedures must include administrative, technical, and physical safeguards to insure the security and confidentiality of such information, to protect against anticipated security and integrity threats, and to protect against unauthorized access and use of the information. The GLB provisions are confidentiality and safeguarding related.

The federal Do Not Call laws (FTC’s Telemarketing Rule and FCC’s Telephone Consumer Protection Act), CAN SPAM, and Do Not Fax laws are also privacy laws. They are of the marketing related kind. These laws contain specific requirements regarding how and when a company may contact consumers via phone, email and fax.

In addition to the federal privacy laws, there are many on the state level. Some are mini-versions of the federal ones, and some are completely new, such as security breach notice laws. Security breach notice laws require that consumers be notified of security breaches when it affects such consumer’s sensitive personal information. Most states only have this requirement when the breach involves computerized data. Currently, 39 states and the District of Columbia have a security breach notice law.

Many states also have Social Security Number limitation laws. These laws limit how Social Security Numbers can be used, published, and transmitted. Some states prohibit Social Security Numbers from being printed on any materials that are mailed. There are some exceptions, such as for applications. 30 states have this type of law.

The states have also enacted laws regulating the disposal of consumer information. These laws are very similar to the FACTA Disposal Rule, except that they apply to all records and documents that contain sensitive consumer information. They generally require that companies have reasonable policies and procedures to dispose of sensitive customer information to prevent any unauthorized acquisition and use. There are 18 states with this type of law.

Many states have mini-GLB or safeguarding laws. These laws require that companies implement a safeguarding

¹³ The federal banking agencies are the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.

¹⁴ The Affiliate Marketing Rule discussion is based on the Affiliate Marketing provision in FACTA (Section 214) and the FTC’s published rule.

program to protect the confidentiality, security and integrity of consumer information. Approximately 6 states have this law.

Lastly—at least for now—there are credit or security freeze laws in many states. These laws give consumers the right to lock down their consumer reports. If the consumer has placed a security freeze, creditors or other users of consumer reports cannot gain access to them. Currently, 40 states have this law.

It's important to know and understand the requirements of all privacy laws so that a cohesive compliance program can be created and maintained. For example, the effort invested and extended to comply with the FACTA Disposal Rule can be expanded to comply with a state's disposal law. Further, this effort can be included as a component of the GLB safeguards program. However, to do so, it must be documented in the written description of the program.

Many compliance efforts can perform double duty. However, to enable this, a company must understand all of the privacy related requirements applicable to it. Not only will a company prevent the duplication of efforts, it will have a stronger overall program. It will also be better prepared for when a new privacy law requires yet another compliance program.

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TEXAS' EXPERIMENT WITH FINDER REGULATIONS

By: *Nelson S. Ebaugh*
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Although not defined under federal statutes or rules, finders have long been recognized by the SEC and the courts. Generally speaking, finders "find" investors for companies. However, pursuant to SEC no-action letters and case law, finders must step aside immediately after making an introduction between an investor and a company. If the finder performs any of the hallmarks of broker activity, such as negotiating on behalf of a party or receiving transaction based compensation, the finder runs the risk of being prosecuted as an unlicensed broker. These and other restrictions characterize finders under federal law (hereinafter, "Federal Finders").

Over the past few years, there has been a call for the SEC to expand the role of Federal Finders to allow them to perform more activities in the private placement setting. For instance, in 2005, a Task Force selected from the Business Law Section of the American Bar Association issued a report recommending that the SEC create a registration category for Private Placement Broker-Dealers ("PPBDs").¹⁵ The ABA Task Force envisioned that PPBDs would be similar to Federal Finders but different in several key respects.

Although Federal Finders and PPBDs can introduce investors to a company, neither can participate in a transaction to the extent that a broker can. This is the principal similarity between a Federal Finder and a PPBD. The differences between Federal Finders and PPBDs are more numerous. For starters, Federal Finders are not required to register in any capacity. The ABA Task Force, however, has recommended that PPBDs be required to register as such.¹⁶ A Federal Finder is generally limited to participating in only one transaction over a lifetime.¹⁷ On the other hand, a PPBD, as contemplated by the ABA Task Force, would be able to participate in an unlimited number of transactions. These are just a few, of many, differences between Federal Finders and PPBDs.

Texas' Novel Approach

Apparently inspired by the ABA Task Force's report, the Texas State Securities Board created a special category for "finders."¹⁸ Texas' finder regulations took effect on September 1, 2006. In adopting these regulations, Texas became the first state in the nation to require the registration of so called "finders." As mentioned above, not even the SEC requires finders to register as such.

However, a person registered as a finder under Texas law (hereinafter, a "Texas Finder") is more akin to a PPBD than what has traditionally been considered a Federal Finder. As a consequence, although Texas Finders may be complying with Texas law, they are likely violating the federal law because the SEC has not yet recognized PPBDs.

¹⁵ Mary M. Sjoquist, et al., *Task Force on Private Placement Broker-Dealers*, ABA Section of Business Law, "Report and Recommendations of the Task Force on Private Placement Broker-Dealers," 60 Bus. Lawyer 959 (May 2005) (hereinafter, "ABA Report").

¹⁶ *Id.* at 961.

¹⁷ *Id.* at 960.

¹⁸ 7 Tex. Admin. Code § 115.1(a)(9); 7 Tex. Admin. Code § 115.11.

Significant Differences Between Texas Finders and Federal Finders

Texas Finders are permitted to facilitate as many transactions as they desire. In fact, a Texas Finder can make a career out of introducing investors to companies without ever registering as a broker with the Texas Securities Commissioner. In this sense, Texas Finders are quite similar to PPBDs. As contemplated by the ABA Task Force, PPBDs could likewise make a career out of introducing investors to companies without ever registering as a broker.

As noted above, however, a Federal Finder cannot facilitate securities transactions on a regular basis. If a Federal Finder does, the SEC would consider him to be “engaged in the business of selling securities for compensation” and therefore an unlicensed broker.¹⁹

Texas Finders are required to register in their capacity with a regulatory authority and keep certain books and records.²⁰ The ABA Task Force has recommended the same requirements for PPBDs.²¹ In contrast, Federal Finders are not required to register as such nor are they required to keep any books or records.

Another distinction between Texas Finders and Federal Finders arises out of the type of compensation that each is permitted to receive. A Texas Finder may contract to receive transaction based compensation upon making an introduction that results in an investment.²² Transaction based compensation typically involves “commissions, for bringing capital to a third party securities issuer.”²³ Although the ABA Task Force did not expressly recommend that PPBDs should be entitled to transaction based compensation, the Task Force left this possibility open.²⁴

A Federal Finder, however, is rarely, if ever, entitled to receive transaction based compensation.²⁵ Instead, Federal Finders may only contract for a flat fee; in other words, a fee that is not dependent upon the completion of a transaction. The SEC has rationalized that transaction based compensation gives a finder an

inappropriate “salesman’s stake” in the transaction.²⁶ As a consequence, a Texas Finder receiving transaction based compensation could be prosecuted as an unlicensed broker by the SEC.

The above-described differences and others are summarized in the following chart:

Federal Finder	Texas Finder
Can deal with any investors.	Limited to dealing with accredited investors.
Can act as a finder probably only once in lifetime.	Can act as a finder as many times as desired.
Rarely (if ever) can accept transaction based compensation.	Can always accept transaction based compensation.
No disclosure requirement.	Mandatory disclosure to each investor.
No registration requirement.	Must file a Form BD to register as a finder.
No record maintenance requirement.	Must maintain records for five years.

The Exclusively Intrastate Exemption

There is at least one scenario under which a Texas Finder could operate in a manner that does not subject him to the federal constraints imposed upon finders. Brokers and finders “whose business is exclusively intrastate” are not subject to federal registration requirements.²⁷ The odds, however, of a finder operating a business that is exclusively intrastate are rather slim.

According to the SEC, “the intrastate exemption from broker-dealer registration is highly restricted.”²⁸ Similarly, the NASD has remarked that the intrastate exemption is “narrowly and literally construed.”²⁹

²⁶ *Id.* at 976.

²⁷ 15 U.S.C. § 780(a)(1).

²⁸ Marc H. Morgenstern, *The Real Estate Syndicator as a Securities Broker-Dealer*, 6:2 REAL ESTATE SEC. J. 7, 8 (1985) (citing SEC legislation, 1963, hearings before Subcommittee of Senate Committee on Banking and Commerce on S. 1642, 88th Cong., First Sess. (1963) 388; S. Rep. No. 379, 88th Cong., First Sess. (1963) 47.)).

²⁹ NASD Notice to Members 05-18, n.10 (March 2005). See also Guide to Broker-Dealer Registration: Intrastate Broker-Dealers (December 2005; accessed October 25, 2007), <<http://www.sec.gov/divisions/marketreg/bdguide.htm>>.

¹⁹ ABA Report at 960.

²⁰ 7 Tex. Admin. Code § 115.11.

²¹ ABA Report at 961-62.

²² Tex. Rev. Civ. Stat. art. 581- 34.

²³ ABA Report at 959-60.

²⁴ *Id.* at 963-64.

²⁵ *Id.* at 975-78.

A few examples will highlight the difficulty of relying upon the intrastate exemption. Assume, for instance, that a finder has conducted business as such in Michigan. After doing so, he cannot move to another state and employ the intrastate exemption, no matter how long he lives in the subsequent state.³⁰ In other words, to fall within the intrastate exemption, the broker or finder seeking its protection may never leave the state wherein he began participating in the securities industry.³¹ In addition, if a finder or broker initiated his business in one state, but participated in just one transaction that included an out of state party, that finder could fall outside of the intrastate exemption forever.³²

There are other examples demonstrating how difficult it is to meet the requirements of the intrastate exemption. For instance, if a finder facilitated a transaction in one state, but received payment in another state, the intrastate exemption may be lost.³³ Last but not least, as noted by the SEC in one of its web pages, “information posted on the Internet that is accessible by persons in another state would be considered an interstate offer of securities or investment services that would require Federal broker-dealer registration.”³⁴ These are just some of many examples illustrating why the intrastate exemption is so difficult to satisfy.

Because the intrastate exemption has been so narrowly and literally construed, it is unlikely that even a handful of Texas Finders will be able to satisfy the exemption. Consequently, a large number of Texas Finders run the risk of being prosecuted as unlicensed brokers by the SEC.

Conclusion

Due to the conflicts between the new finder rules in Texas and the treatment of finders under federal law, it could be risky to operate as a Texas Finder. For this reason, before registering as a Texas Finder, it may be

advisable to wait until the SEC has decided whether to adopt a similar registration category.

If one does register as a Texas Finder, he will have the unenviable choice of deciding whether to satisfy the intrastate exemption, a very difficult endeavor, or to register as a broker-dealer at the federal level. Of course, if a Texas Finder decided to go through all of the trouble to register as a broker-dealer at the federal level, he might as well register as a broker in Texas too. But those who seek registration as a Texas Finder will likely do so to avoid the trouble and expense of becoming a broker at either the state or federal level. In sum, it is highly unlikely that any Texas Finders will concurrently register as a broker-dealer at the federal level.

In April 2006, the SEC’s Advisory Committee on Smaller Public Companies delivered a report to the SEC echoing the ABA Task Force’s recommendation to create a registration category for PPBDs.³⁵ Perhaps, with enough public support, the SEC will adopt a registration category similar to the new finder rules in Texas, such as the PPBD category. Until then, registration as a Texas Finder may not be a practical option.

SEC PROPOSES EXEMPTIVE RELIEF FOR TICS.

By: Deborah S. Froling, Arent Fox LLP, Washington, D.C.

Notice of Application of the National Association of Realtors For Exemptive Relief Under Sections 15 and 36 of the Exchange Act and Request for Comment. On November 9, 2007, the Securities and Exchange Commission (the “SEC”) released a “Notice of Application of the National Association of Realtors for Exemptive Relief Under Sections 15 and 36 of the Exchange Act and Request for Comment” (the “Exemption”). Release No. 34-56779; File No. S7-26-07), <http://www.sec.gov/rules/other/2007/34-56779.pdf>. Generally, the Exemption would allow a licensed real estate agent to receive compensation in connection with providing real estate advisory services to an investor in a securitized tenant in common transaction (a “TIC transaction”). Historically, a non-securities licensed person was prohibited from receiving compensation in connection with a securities transaction. If the Exemption is adopted by the SEC, the real estate versus

30 Morgenstern, *supra* note 14, at 9 (citing SEC No Action Letter, National Educators Group, Inc. (November 17, 1977)).

31 *Id.*

32 Winchester Securities, SEC No-Action Letter, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,119 (April 1, 1971).

33 *Guon v. United States*, 285 F.2d 140, 144 (8th Cir. 1960).

34 Guide to Broker-Dealer Registration: Intrastate Broker-Dealers (December 2005; accessed October 25, 2007), <<http://www.sec.gov/divisions/marketreg/bdguide.htm>>. See also Howard M. Friedman, *Securities Regulation in Cyberspace*, § 16.02 (2004 Supplement).

35 Herbert S. Wander, et al., *Advisory Committee on Smaller Public Companies to the U.S. Securities and Exchange Commission, Final Report*, 81 (Apr. 2006).

securities argument swirling around the TIC industry could, for the most part, become a moot point.

The Exemption, in summary, would allow any licensed real estate agent or broker, who is predominately engaged in and has substantial experience in the sale of commercial real estate, to receive a real estate advisory fee from a purchase of a tenant in common interest in real property that is offered and sold in a securities transaction. The real estate advisory fee can be paid either directly by the client or on behalf of the client by the sponsor or issuer of the TIC transaction. The general conditions include the following:

- The real estate agent must be “predominantly engaged in sales of real estate other than TIC Securities,” is appropriately licensed in compliance with state real estate laws, and is identified in a buyer’s agent agreement with the investor. (Emphasis added).
- Each investor must receive a deed at closing (*i.e.*, the Exemption appears not to apply to a Delaware Statutory Trust TIC arrangement where an investor receives a trust certificate rather than a deed at closing) and the transaction must be structured so that the TIC transaction would qualify as like-kind property for Section 1031 purposes, presumably meeting the requirements of Revenue Procedure 2002-22.
- The TIC transaction must be effected through a registered securities broker-dealer.

Comments are due to the SEC by December 17, 2007.

FROM THE OTHER SIDE OF THE DESK

*By Sue Noble, Paralegal Specialist -- Blue Sky/Securities
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*The answer, my friend, is blowin in the wind ...
-- Bob Dylan*

For a year now, I’ve been indulging myself, thanks to our editor, in musings on the general condition of being a blue sky practitioner. The time has come -- likely it’s past due -- for me to give you an indication that in fact I do pay attention to the state of the law, and actually know (or at least am learning) a little something about it. This demonstration is, of course, going to take place in the context of federal law rather than blue sky law, in view of the extensive proposals by the Securities and

Exchange Commission to amend Regulation D and to revise Form D and require it to be filed electronically.

There’s just no use pretending that these proposals will not have an effect on the blue sky process, however much one might wish to have “the devil one knows.” It’s no longer possible (if it ever was) to be a conscientious practitioner, especially in the area of private placements, and avoid the Gordian knot of federal and state regulation. Not only must the tension between the federal “hands off but tell all” approach and the state “it better be good no matter how much you tell” approach be resolved, there are also the legitimate concerns of all the other players in the industry: issuers, ranging from the entrepreneurial start-up company to hedge funds and other private investment companies to reporting companies; broker-dealers; investment advisers; and of course the blue sky bar.

For those of you who may not have read the proposing releases and comments, here is a very abbreviated chronology with links to recommended reading. In May, at an open meeting the SEC discussed the topic of revisions to Regulation D. Following that meeting, Press Release 2007-102 (<http://www.sec.gov/news/press/2007/2007-102.htm>) summarized several proposals, including a reference to electronic filing of Form D. That press release was followed in late June by **Release 33-8814** (<http://www.sec.gov/rules/proposed.shtml>) detailing the proposed changes to Form D. These proposals included provision for changes to Regulation D that were not in fact proposed until August 3 in **Release 33-8828**, which may be found at the same link. For convenience, the latter link leads to the “proposed rules” page on the SEC web site, so that you may access Federal Register versions of both proposals and the comment letters to date.

The proposals are extremely wide-ranging, and it would take a book to analyze all of the content along with the implications of the proposals. What’s more, action might well be taken on some or all of the proposals before anyone could write and publish such a book. What follows is a purely arbitrary and personal overview of a few items, and the reader is left to infer much of the substance of the respective proposals from the responses summarized.

Release 33-8814

SEC: The agency hopes that states would permit one-stop filing and rely on SEC filings as satisfying state law filing requirements. It believes one-stop filing would reduce significantly the costs and burdens of preparing

and filing Form D and could represent substantial savings to small businesses filing Form D. Many items have been revised, instructions regarding when amendments need to be made have been added, and several items have been eliminated.

Regulators: One-stop filing will necessitate a mechanism for collecting and disbursing state filing fees. In general, state regulators view Form D as an enforcement tool, and object to any change that might reduce that function such as the proposal to eliminate disclosure of 10% beneficial owners. Regulators believe the filing of Form D should be a condition to the availability of the exemptions in Regulation D, that all free writing should be prohibited, all fields should require answers (including the estimated use of proceeds and identification of beneficial owners, both proposed for elimination), and additional information regarding persons selling. The proposal to require annual amendments is endorsed.

Blue Sky Practitioners: One-stop filing may be ineffective if not swiftly adopted by state regulators, and is likely to increase legal costs due to parallel but unequal filing requirements, *i.e.*, electronic filing with the SEC but paper filing with states, or the need to send filing fees directly to states regardless of the method of filing. The proposed date of first sale requirement in the revised form is unclear, and the definition of sale needs revision. The instructions regarding amendments are too broad, and are inconsistent in some cases. Elimination of free writing is likely to result in misleading responses; some items require explanation. Because of specific technical requirements, entrepreneurial issuers (an estimated 95% of filers) are extremely unlikely to make their own filings. Issuers should not be required to undertake to provide offering materials to the SEC and the states.

Industry: Federal-state coordination is a necessity. For pooled asset funds, disclosure of revenue range should be modified to reflect assets under management. The amendment requirements are overbroad and should be confined to material mistakes of fact or material changes of information. The undertaking to provide offering materials may invite states to request the offering documents and create confusion as to the issuer's obligation.

Box Score: All of the 23 respondents seem to be in favor of electronic filing. But as with any wide-ranging proposal, the devil is in the details. In this case, it appears that there are also a considerable number of ogres, imps, gremlins and other troublemakers.

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SEC: The proposals would provide additional flexibility to issuers, clarify and improve application of the rules, add a new exemption for sales to "large accredited investors," and permit limited advertising in offerings where each purchaser meets the definition of large accredited investor. Several revisions would be made to the definition of accredited investor, in addition to the new definition of "accredited natural person." "Bad actor" disqualifications would apply to every offering pursuant to the revised Regulation D. The integration safe harbor period would be reduced to 90 days, but the time for filing would remain no later than 15 calendar days after the first sale.

Regulators: Proposed inflation adjustments of accredited investor standards will enhance investor protection, but current thresholds should also be adjusted. The disqualification provisions are strongly supported and should be broadened. Inclusion of an "investments-owned" test in the accredited investor definition requires refinement in several respects, as does the limited advertising proposal. Securities sold in Rule 504 offerings should be subject to resale restrictions, and the integration period should not be shortened.

Blue Sky Practitioners: Multiple definitions of accredited investor are confusing and complicate the exempt offering process. The standards and tests to be applied need to be harmonized, particularly in light of the differing standards under the Investment Company Act of 1940 and Rule 144A. The proposed disqualification provisions are too broad and would create significant complications in completion of a Form D. The due diligence required to determine whether the disqualifications are applicable may well result in decisions to rely on the 4(2) exemption, rather than on Regulation D, with attendant complications and limitations. In at least some cases, the restrictions on advertising should be relaxed, if not eliminated entirely. Reduction in the integration safe harbor is supported, but the proposed new Rule 507 should be excluded from integration with Rule 506 transactions. The time for filing should be extended.

Industry: Rather than adopt Rule 507 and the "Accredited Natural Person" definition, adopt a tiered approach based on the type of offering. With the growth of hedge funds and other pooled investment vehicles, Regulation D should be harmonized with provisions of the 1940 Act. If accreditation standards are inflation-adjusted, investors who were compliant at the time of

initial purchase should not be barred from future investments in the same offering. Disqualification provisions are overbroad and imprecise. Public companies should be exempted from Regulation D filing requirements. Industry's answers mostly come, not surprisingly, from trade associations, such as the National Venture Capital Association and the Managed Funds Association. The SEC estimates that 95% of Form D filers are private companies, who are less likely to be familiar with Regulation D than these industry professionals.

Box Score: The 61 respondents all seem to agree that Regulation D should be revised. But the devil here has not only the company mentioned above, but assorted fiends, demons and goblins, at least if one looks at the disparities of responses.

So where does all of this leave us? At least for the time being, with the devil we know (which I personally have generally found to be better than the devil we don't know). What will it lead to? *The answer, my friend, is blowin' in the wind ...*

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SMART CHARTS™ ENHANCE CCH BLUE SKY LAW REPORTER

By John M. Jascob

Editor, CCH NASAA Reports
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EDITORIAL

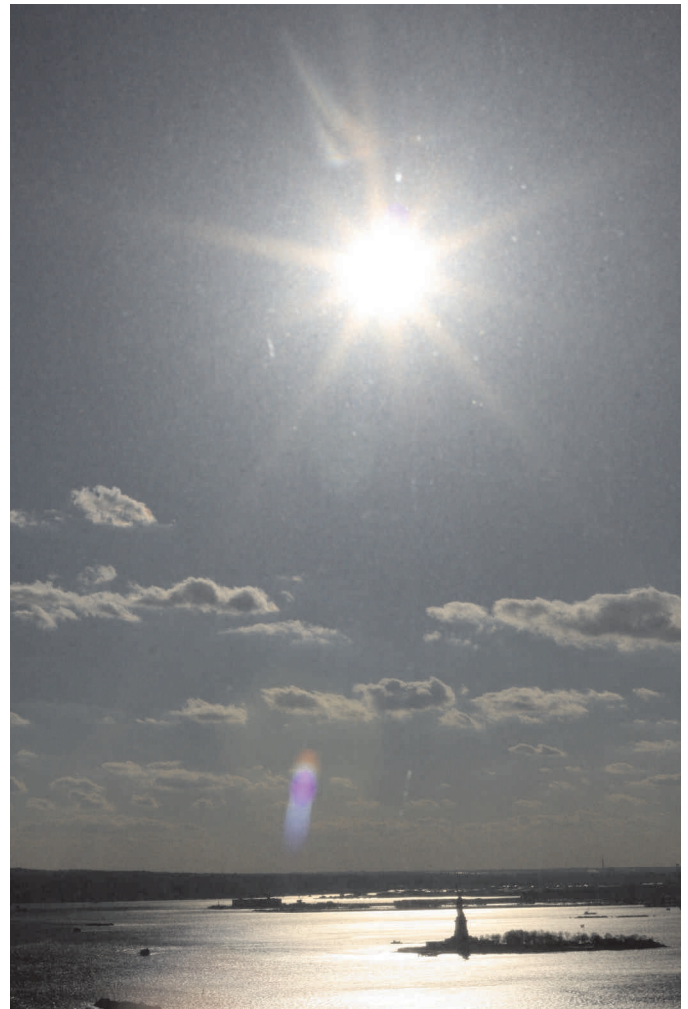
By Martin A. Hewitt

Cadwalader, Wickersham & Taft LLP

As another year draws to a close I can't help but notice that this has been a year in which the Blue Sky Bugle has grown substantially in readership. This could not have been accomplished without the help of our many and varied contributors. As the issues we face become more complex, the ability of more practitioners, regulators, and paralegals to contribute with their unique expertise, wit, and wisdom is that which will make the Blue Sky Bugle continue to grow as a useful tool to add perspective to all the commotion in our varied but related practice areas.

Please see an anonymous photograph in keeping with our blue sky theme. My many thanks for this contribution of what is definitely a clear blue sky.

On behalf of the Blue Sky Bugle (and as a way of not having to send as many individual holiday greetings cards this year!) please accept the editorial staff's best holiday wishes to you and your families.



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