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# THE BLUE SKY BUGLE

A Newsletter for Blue Sky Lawyers

Published by the ABA Committee on State Regulation of Securities

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## EVENTS CALENDAR

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### ABA BUSINESS LAW SPRING MEETING

The Committee and its Subcommittees will meet in conjunction with the 2009 Spring Meeting of the ABA Business Law Section at the Pan Pacific Vancouver Hotel Vancouver, British Columbia April 16-18, 2009

### ABA ANNUAL MEETING

The Committee and its Subcommittees will meet in conjunction with the ABA Annual Meeting Hyatt Regency Hotel Chicago, Illinois July 30, 2009 – August 4, 2009

### NASAA 2009 FALL CONFERENCE

The Committee and its Subcommittees will meet in conjunction with the Annual Meeting of the North American Securities Administrators Association Adams Mark Hotel Denver, Colorado September 13-16, 2009

### ABA BUSINESS LAW SPRING MEETING

The Committee and its Subcommittees will meet in conjunction with the 2010 Spring Meeting of the ABA Business Law Section Denver, Colorado April 22-24, 2010

### NASAA 2010 FALL CONFERENCE

The Committee and its Subcommittees will meet in conjunction with the Annual Meeting of the North American Securities Administrators Association Hawaii September 2010

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## BLUE SKY BITS AND PIECES

By: *Ellen Lieberman*  
Debevoise & Plimpton LLP

**Mark T. Uyeda** was named Assistant Director, Division of Investment Management, at the Securities and Exchange Commission. Many of us met Mark when he served as Chief Advisor to the California Corporations Commissioner, after which he served for two years as counsel to SEC Commissioner Paul Atkins, and then for a very brief period worked with Commissioner Troy Paredes.

**Lori L. Hovanec** took office as Director of the Alaska Division of Banking and Securities. She is an attorney and formerly served as trust officer for a national banking association.

As previously reported, **Timothy L. Le Bas**, who had been Deputy California Corporations Commissioner and General Counsel, Office of Law and Legislation, left the California Department of Corporations as of February 29, 2008, to move to the California Department of Managed Health Care which regulates California HMOs. His successor is **Colleen Monahan**, who had served as an Attorney with the California Department of Corporations. Also appointed as a new Deputy Commissioner, for the Securities Regulation Division, is **Robert Van der Volgen**.

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**Don B. Saxon**, Florida Commissioner, resigned his position effective September 30, 2008. He has served as NASAA's Ombudsman. **Alex Hager** is serving as Acting Commissioner of the Office of Financial Regulation. **Richard A. White**, Florida's Director of the Division of Securities, also stepped down from his position as of December 5, 2008. **Michael Gross** is serving as Acting Director. The new NASAA Ombudsman will be **Joseph P. Borg**, Director of the Alabama Securities Commission and two-time president of NASAA.

Effective October 13, 2008, **James L. Eastman** was named Chief Counsel and Associate Director in the Division of Trading and Markets at the SEC. Previously he was counsel to SEC Chairman Christopher Cox, Assistant General Counsel at FINRA, Senior Counsel in the SEC's Office of the General Counsel, and counsel to the late Commissioner Paul Carey. He was also in private practice at Schiff Hardin and Covington & Burling.

**Delbert Hosemann, Jr.**, Mississippi Secretary of State replacing **Eric Clark**, has appointed **Dave Scott** as Assistant Secretary of State for the Business Regulation and Enforcement Division, a position previously held by **James O. Nelson, II**, and **Michael Huggs** as Division Director

**Edwin J. Apenbrink** retired as Nevada's Chief of Licensing and Registration effective October 2008. He helped make the recent NASAA Annual Meeting in his hometown of Las Vegas, a successful event.

**Bonnie E. Russell** retired in November 2008 as Maine's Securities Administrator. She was succeeded by **Judith Shaw**, former Deputy Superintendent of Insurance and Assistant Attorney General.

**Leslie Van Buskirk** replaced **David A. Cohen** as Supervising Attorney in Wisconsin's Securities Division, Bureau of Registration and Enforcement.

**Karen Wheeler**, formerly Financial Analyst Supervisor of the Wyoming Securities Division, has been named as Director the reconstituted Division now called the Compliance Division.

**Ken Ross** has been named as Commissioner of Michigan's Office of Financial and Insurance Regulation, previously the Office of Financial and

Insurance Services, replacing the former Commissioner, **Linda Watters**. Previously he served as Acting Commissioner and as Deputy Commissioner of Policy for that Office, with the Michigan Credit Union League and as Assistant Attorney General. He also appointed **Stephen Hilker** as the Office's Chief Deputy Commissioner, **Jean Boven** as Deputy Commissioner of the Regulatory Compliance Division and **Jenita Moore** as Deputy Commissioner for Policy.

**Fred J. Joseph**, Securities Commissioner for the State of Colorado, assumed the office of President of NASAA at NASAA's annual meeting in Las Vegas. He follows **Karen Tyler**, North Dakota Securities Commissioner. **Denise Voigt Crawford**, Commissioner of the Texas State Securities Board and a former NASAA President, became President-Elect. **David Massey**, Deputy Securities Administrator of the North Carolina Securities Division, is the new Treasurer, **Glenda Campbell**, Vice Chair of the Alberta Securities Commission, the new Secretary, and members of the Board of Directors include **Joseph P. Borg**, Director of the Alabama Securities Commission., **Chris Biggs**, Commissioner of the Kansas Office of the Securities Commissioner, **Melanie Senter Lubin**, Maryland Securities Commissioner, and **Michael Stevenson**, Director of Securities with the Washington Securities Division.

**John W. White**, Director of the Division of Corporation Finance at the Securities and Exchange Commission will rejoin Cravath, Swaine & Moore at the beginning of 2009. He was a partner at that firm for more than 25 years before taking on the SEC post in February 2006.

**Erik Christiansen**, shareholder of Parsons Beale & Latimer in Salt Lake City, Utah, has accepted the position of Utah Liaison for the Committee on State Regulation of Securities. Erik practices in Utah and California and is chair of his firm's Securities Litigation Practice Group. He joined the firm in 1996 and before that practiced with Milbank Tweed, Hadley & McCoy and with Stroock & Stroock & Lavan. He is an active participant within the civic and legal communities, and has been a frequent speaker on legal issues.

**Christine A. Bruenn**, a partner in the Portland, Maine, office of Bingham McCutchen LLP, has accepted the position of Maine Liaison for the Committee on State Regulation of Securities. Chris

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previously served as Maine's Securities Administrator and NASAA President and was awarded a Blue Sky Cube (one cubic foot of Kansas blue sky) by NASAA at the September 2006 NASAA Annual Meeting.

**John R Fahy**, of Whitaker Chalk Swindle & Sawyer LLP in Fort Worth, Texas, is pleased as punch to announce the birth on December 9 in Dallas of Eric Henry Fahy who arrived first at 6 lb. 7 oz. and with more hair, and John Richard Fahy, Jr. (to be called Jack), who arrived second at 6 lb. 15 oz.. Dad John, Sr., and Mom Liz (Carmen) are thrilled, as are older sisters Anna (age 3) and Mary Margaret (age 2). Congratulations on the new double tax deduction! John, Sr., was previously General Counsel for two NASD-registered securities broker-dealers, Staff Enforcement Attorney for the Securities and Exchange Commission and Managing Attorney for the Texas State Securities Board's Houston Office, and ran the meeting of our Subcommittee on Broker-Dealers and Investment Advisers in Dallas last Spring.

The biggest item to report of course is the election of **Barack Obama** as 44th President of the United States. The week after his election he named a 17-member board to advise him on economic matters -- which is likely to include how to restructure regulatory agencies. The members of this advisory panel are David Bonior, a former House member (D-Mich.); Warren Buffett, chairman-CEO, Berkshire Hathaway; Roel Campos, former SEC commissioner; William Daley, chairman, Midwest, JP Morgan Chase; former commerce secretary; William Donaldson, former SEC chairman; Roger Ferguson, president-CEO, TIAA-CREF, former vice chairman, Board of Governors of the Federal Reserve; Jennifer Granholm, governor, State of Michigan; Anne Mulcahy, chairman-CEO, Xerox; Richard Parsons, chairman, Time Warner; Penny Pritzker, CEO, Classic Residence by Hyatt; Robert Reich, former labor secretary; Robert Rubin, chairman-director, executive committee, Citigroup; former treasury secretary; Eric Schmidt, chairman-CEO, Google; Lawrence Summers, managing director, D.E. Shaw; former treasury secretary; Laura Tyson, former chairman, National Economic Council; Antonio Villaraigosa, mayor, City of Los Angeles; Paul Volcker, former chairman, Federal Reserve.

President-Elect Obama named **Mary Shapiro**, Chief Executive of FINRA, former SEC

Commissioner and former Chair of the Commodity Futures Trading Commission, to chair the Securities and Exchange Commission. Commissioner **Christopher Cox** had previously announced his intention to leave that post on January 20 when Obama takes office. Shapiro's prior service at both the CFTC and SEC make her an interesting choice if those two regulatory agencies, as has been suggested, are merged.

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## FROM THE CHAIR – RANDOM RANTS AND RAVES

By: *Alan M. Parness*  
Cadwalader, Wickersham & Taft LLP

This is my first article for the *Bugle* as Chair of the Committee on State Regulation of Securities, having assumed the post, effective August 15, 2008 for a three-year term, following the ABA's Annual Meeting in New York City.

I would first like to express my appreciation to Ellen Lieberman of Debevoise & Plimpton LLP for her dedicated and incredible service these past three years as Committee Chair. I note that she hasn't slipped away into a blissful and ABA-free retirement, but rather has remained an active member of the Committee, serving as a member of the drafting committees for several of our recent comment letters, continuing her "Blue Sky Bits and Pieces" column for the *Bugle*, and otherwise providing her insights for various projects the Committee has undertaken. While I served as Committee Vice Chair during her tenure and was privy to certain of the matters she was involved in on behalf of the Committee, I have quickly learned that this position is a substantial undertaking, and requires expenditure of a lot of time (and many e-mails!), between dealing with the powers that be at the ABA and Committee members. Again, I sincerely thank Ellen for her past (and future) contributions to the Committee's work.

### Electronic Form D

As most of you know by now, the SEC has revised Regulation D under the Securities Act of 1933 (the "1933 Act"), so as to change Form D and provide for electronic filing of the form through the SEC's EDGAR system, voluntarily as of September 15, 2008, and mandatorily as of March 16, 2009. See SEC Securities Act Rel. No. 33-8891 ("Release 33-8891"), reprinted at 73 Fed. Reg. 10592 (Feb. 27,

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2008). While Part I.B.3 of Release 33-8891, *Id.* at 10593-10594, discussed the prospects that the electronic filing of Form D will “promote uniformity and coordination between federal and state securities regulation,” and the potential creation of a “one-stop filing” system for Form D with the SEC and the states, unfortunately the SEC proceeded with its plans before the states could set up such a system. Further, since neither the SEC nor FINRA leaped at the opportunity to set up and maintain this system, the states, working through NASAA, are working at creating their own electronic system to receive filings and collect fees on behalf of the individual states, in similar manner to the CRD and IARD systems maintained by FINRA for broker-dealer, agent, investment adviser, and investment adviser representative registrations with the states. According to a chart of committee assignments at NASAA Reports (CCH) ¶ 221, Michael Stevenson of Washington and Jack Herstein of Nebraska are co-chairs of NASAA’s “Regulation D Electronic Filing Committee.”

I hate to be cynical, but having been around long enough to recall the ill-fated “Securities Registration Depository” which NASAA attempted to set up years ago for state filings of SEC-registered offerings, I recall that system died of its own accord principally when NASAA added on substantial additional user fees and charges to the regular filing fees, and the intended registrants (principally mutual funds) determined that it would be cheaper to continue with direct paper filings with the individual states. Further, I recall that it took years for all states to amend their laws and/or rules to enable them to participate in the CRD system, and some states still require applicants to submit all or part of the requisite forms and related materials directly with the state, and not through the CRD (see the charts at 1 Blue Sky L. Rep. (CCH) ¶ 6531). Finally, I note that state statutes, rules or orders currently governing notice filings for Rule 506 “covered securities” may have to be amended to permit: (1) submission not only of the new electronic Form D, but Temporary Form D (see new Rule 503T of SEC Regulation D, as added by Release 33-8891), which replaced the old paper version of Form D, effective September 15, 2008; (2) use of the built-in consent to service of process in electronic Form D in lieu of a Form U-2 consent to service of process; and/or (3) submission of the filing and applicable fee through NASAA or some other third party service provider instead of directly to the state. While a handful of states have adopted or proposed rules or orders to accomplish this

changeover to date, I’m not optimistic that a “one-stop filing” system in which all states may participate will be established any time soon, let alone by March 16, 2009.

### State Rulemaking Proposals

Commencing with Ellen Lieberman’s tenure, the Committee has gone into overdrive monitoring rule proposals from the state securities administrators and the SEC (where SEC proposals impact state law), and submitting comment letters where deemed necessary, sometimes in conjunction with other Committees of the ABA Section of Business Law (typically the Federal Regulation of Securities or Middle Market and Small Business Committees). A review of our Committee website (<http://www.abanet.org/buslaw/committees/CL680000pub/comments.shtml>) reveals that, under Ellen’s leadership, we submitted 19 comment letters to the states and the SEC; as of December 18, 2008, we’ve submitted four new letters (to Colorado, Vermont, California, and Utah) on my watch. The comment letters to Colorado, Vermont, and Utah relate to Rule 506 notice filings, and we anticipate further rule proposals by the states (and a possible need for more comment letters) in this regard as time goes on.

Speaking of rulemaking proposals by the states, those of you attending various NASAA and ABA meetings have heard me complain over the years about the dismal failure of most states to provide timely notice of their rule proposals to those of us who may actually be interested in such proposals (Maine and Washington are two states which I have to single out as notable exceptions, since they have graciously and consistently e-mailed notices of their proposals to Ellen and me as soon as they’re publicly available). Unfortunately, it appears that most state securities administrators stick to the letter of their respective administrative procedure laws, and thereby publish their rulemaking proposals solely in the local “State Register” (or comparable official publication, serving as the state’s version of the “Federal Register”), although some may add a reference to the proposal on their websites or mail out notices to persons on whatever mailing list they maintain.

As a practical matter, however, few attorneys receive, let alone read, official state registers announcing rulemaking proposals, and it’s somewhat ludicrous that a Blue Sky attorney would have the time to review every state’s website daily to check for rulemaking proposals; further, I have found these

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state mailing lists to be generally poorly maintained and mailings to be inconsistent. While most of us tend to depend on the standard source for Blue Sky information, the CCH *Blue Sky Law Reporter*, for statutory or rule updates, invariably, it seems that, whether due to the lateness of CCH's receipt of such notices or publishing delays, rulemaking proposals tend to be published with little time, if any, to prepare and submit comments in a timely fashion, and I recall numerous times when revised rules are simply published in the *Reporter* after the fact, with no prior notice of the proposals.

I don't want to be accusatory or a conspiracy theorist, but I find it rather curious that so many states seem to be loathe to publicize their rulemaking proposals in a more timely and widespread manner. I recall with shock and surprise the adverse and defensive reaction of some state representatives at a NASAA Ombudsman meeting at a NASAA Spring Meeting in Washington, D.C., a few years ago when I raised this issue and made some suggestions for improvement. Why are the states so afraid of having to deal with the possibility of getting comments from interested persons? There's something clearly wrong with the current system, and I believe that the states which have traditionally avoided providing more timely and widespread notices of their proposals are losing out on the possibility of receiving constructive suggestions from interested parties, which may help them clarify ambiguities in the proposals, conform state rules to conflicting state laws and federal securities laws and rules, or fill in gaps which the regulators may not have considered, and, moreso, avoid the potential cost of litigation over the legality of new or amended rules.

In this day and age of instant communications, it is disappointing that most states don't maintain their own "listservs" for distributing e-mail notices of rulemaking proposals to interested parties. Alternatively, I note that NASAA's website (see [http://www.nasaa.org/industry\\_regulatory\\_resources/directory\\_of\\_securities\\_laws\\_regulations/895.cfm](http://www.nasaa.org/industry_regulatory_resources/directory_of_securities_laws_regulations/895.cfm)) includes links to a limited number of state rule proposals (the last one, a North Carolina proposal dated November 17, 2008). It would seem to be a "no-brainer" for states to simply e-mail copies of their proposals to NASAA for posting on the website, and for NASAA in turn to send out e-mail notices to its listserv upon receipt of a proposal. This "one-stop shopping" service would be beneficial to all concerned, and I believe would greatly improve the quality of rules ultimately adopted.

In the meantime, as I've previously requested in several e-mails to Committee members, I again ask that any Committee member who obtains a notice of a Blue Sky rule proposal from a local state register, a securities administrator's website, or via a state mailing list, to pass along that information via e-mail to me ([alan.parness@cw.com](mailto:alan.parness@cw.com)) and Michele Kulerman ([makulerman@hhlaw.com](mailto:makulerman@hhlaw.com)), so that we may consider whether they're worth a Committee comment letter. I've been most impressed that the states receiving our letters have frequently been swayed by our suggestions, and this can certainly be beneficial to both you and your clients.

#### Registration by Coordination – Does it Work?

By my count, with the exception of Arizona, Florida, Georgia, Hawaii, Louisiana, New York, North Dakota, and Oregon, every Blue Sky law (including those enacted by the District of Columbia, Guam, Puerto Rico, and the Virgin Islands) includes a provision for registration of securities "by coordination," when the securities are being registered with the SEC under the 1933 Act (note that the Florida law provides for registration of such securities by notification, and Georgia and Louisiana require an exemption filing for such securities, all rather simple filings, while Hawaii exempts all securities registered under the 1933 Act).

As is evident from the registration by coordination provision in both versions of the Uniform Securities Act, from which most of the relevant state provisions were derived [see Section 303 of the 1956 version (the "1956 USA"), as reprinted at 1 Blue Sky L. Rep. (CCH) ¶ 5533, and Section 303 of the 2002 version (the "2002 USA"), as reprinted at 1 Blue Sky L. Rep. (CCH) ¶ 5612], registration by coordination contemplates a process whereby, if the applicant submits the registration application to the state at roughly the same time that the 1933 Act registration statement is initially filed with the SEC, and the filing is on hand with the state for a minimum period of time (10 days under the 1956 USA, 20 days under the 2002 USA, but sometimes longer under actual statutes), the state filing would be automatically effective in the state upon the applicant giving the state notice of SEC effectiveness, regardless of whether the state previously reviewed or commented on the filing. The burden would thereupon shift to the state to issue a stop order denying, suspending, or revoking the registration in accordance with the authority and procedures described in provisions comparable to 1956 USA § 306, as reprinted at 1

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Blue Sky L. Rep. (CCH) ¶ 5536, or 2002 USA § 306, as reprinted at 1 Blue Sky L. Rep. (CCH) ¶ 5615.

Thus, ideally, states should immediately review and comment on these filings, taking into consideration the SEC's time schedule for reviewing the particular type of filing, in lieu of facing the prospect of commencing stop order proceedings after effectiveness. However, as one of what seems to be an ever-dwindling number of Blue Sky attorneys still handling nationwide securities offerings subject to coordination registrations, it's been my unfortunate experience that a number of states (particularly the so-called "merit review" states) have embarked on a routine practice of ignoring the applicable statutory time constraints, and instead demanding that applicants "waive concurrent effectiveness" (*i.e.*, agree not to request simultaneous effectiveness in the state as of the time of SEC effectiveness) early on in the review process, sometimes before they even commence their review of the filing, or include such a demand as one of their initial comments on the filing.

In the case of states which demand waivers of concurrent effectiveness, applicants and their counsel should be aware that once they grant such waivers, they've effectively converted a registration by coordination into a "registration by qualification" (see 1956 USA § 304, as reprinted at 1 Blue Sky L. Rep. (CCH) ¶ 5534, and 2002 USA § 304, as reprinted at 1 Blue Sky L. Rep. (CCH) ¶ 5613), whereby the state either has no specific time constraints on its review and clearance of the filing, or operates under liberal time limits (while 1956 USA § 304(c) simply provides that registrations by qualification are effective when the administrator "so orders," 2002 USA § 304(c) provides for automatic effectiveness of such registrations in 30 days after the filing of the last amendment to the registration statement, or a shorter period provided by rule or order, although 2002 USA § 304(d) permits the administrator to delay effectiveness for up to 90 days, plus an additional 30 days, under certain circumstances). Thus, the grant of such a waiver places the applicant totally at the mercy of the state examiner and his or her supervisor(s) to process the filing in a fair and timely fashion. (Because of the potential for further delay, it's been my practice to refuse to grant a waiver prior to SEC effectiveness; instead, I undertake that if any comments haven't been resolved by the time of SEC effectiveness, my notice of effectiveness will include such a waiver.)

Further, I note that certain states simply comment on coordination filings whenever they get around to it, regardless of the timing of the SEC review process (and even though the SEC process may take far longer than the minimum review period under the applicable state law). This "regulation by inaction" seems designed in certain cases to assure that, if an applicant is unable or unwilling to delay the offering so as to comply with a particular state's protracted review process (since the timing of an offering may be critical to an issuer's business and the pricing of an offering, an extended delay in potential clearance by a given state may make the filing there meaningless), the filing will simply be withdrawn (and, of course, in most cases, the state will retain the filing fee previously paid, essentially for doing nothing).

Ironically, it's been my experience that the filings which have been subject to this "regulation by inaction" have also been those subject to full reviews by the SEC staff, where the SEC review process may take 30 days or more, and the registrant may have to file one or more pre-effective amendments to its registration statement to satisfy the SEC staff. In those cases, the timing of the SEC review inevitably exceeds the statutory minimum review period under applicable Blue Sky laws, thereby making the failure of any state to at least provide comments prior to the time the first pre-effective amendment is filed with the SEC inexcusable. In this regard, I note that if a state's comments include matters requiring changes or additions to the prospectus, the delay in providing such comments in a timely fashion not only affects the timing of the offering, but adds additional costs, since the registrant may thereby be forced to file additional pre-effective amendments to its registration statement with the SEC and the states in response to state comments.

Except under extreme or highly unusual circumstances, no Blue Sky attorney who's familiar with the registration by coordination process would ever simply comply with the literal requirements of a particular coordination provision by ignoring state comments or failing to obtain a written or verbal clearance from a state prior to SEC effectiveness, and simply sending notice of SEC effectiveness to the state. While, as a matter of law, the attorney in that case would be correct that the filing would be deemed automatically effective in that state as of the same time as the SEC filing, such a routine subjects the applicant to the serious risk of a stop order being issued by that state.

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In sum, the practice of a number of states of ignoring statutory time constraints on reviewing registrations by coordination forces applicants, depending on the timing of the offering and the prospective market for the securities in the problematic states, to either: (1) delay SEC effectiveness pending resolution of these state filings; (2) obtain SEC effectiveness, but waive concurrent effectiveness in those states which haven't cleared the filing by that time; or (3) withdraw the filing from the recalcitrant states. Any of these alternatives not only impacts the timing of the offering, but results in additional costs to the issuer (which customarily absorbs all fees and expenses related to Blue Sky filings) and, ultimately, to investors when the offering proceeds are reduced by these added costs.

While I recognize that some state securities administrators' offices are understaffed, and that some of these filings may entail difficult reviews of complex and novel offerings, unfortunately, I believe that the protracted delay in reviewing a particular filing is more often than not due solely to bureaucracy moving at a glacial pace. It is also my belief that to the extent that our clients are expected to comply with Blue Sky laws, state securities administrators are likewise obligated to comply with the law, too, and routinely demanding that applicants waive their statutory right to a prompt review of these filings and coordinated effectiveness, or reviewing filings in a manner so as to conflict with the SEC's review schedule, are both inappropriate and unfair practices, whether done inadvertently or deliberately. States must realize that these practices not only represent a disservice to applicants, but also to prospective investors in the state, who may be foreclosed from what may be a perfectly suitable investment, solely because of the administrator's failure to process the filing in the timely manner mandated by the legislature.

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## **WASHINGTON'S RULE 506 REGULATION IS NOT AN APPROPRIATE MODEL FOR OTHER STATES**

*By Mike Liles, Jr.*  
Karr Tuttle Campbell

Those of us who attended the 91<sup>st</sup> Conference of the North American Securities Administrators Association (NASAA) in Las Vegas, Nevada, September 15, 2008 learned that the approach to Rule 506 offerings being used by the State of Washington

is being considered for use by NASAA as the model for other states to follow in state coordination of Rule 506 compliance with the federal regulatory scheme.<sup>1</sup> This Washington securities lawyer submits that Washington's Rule 506 regulatory scheme, as amended in September of 2008 to coordinate with the new electronic filing requirements for Form D under federal law, is defective and inappropriate as a regulatory tool, especially in the current economic climate in which small businesses may increasingly seek to rely upon private offerings of securities to fund their operations in lieu of traditional sources of credit. Accordingly, it should not be used as model regulation for other states.

Rule 506 is the safe harbor from registration under federal and state securities laws that is used by most small businesses and others for raising equity capital privately within the United States. Reliance upon Rule 506 is typically accompanied by the filing of a Form D, which is readily accessible by the public. Originally designed to generate statistics to enable the Securities and Exchange Commission (SEC) to gauge the extent to which private and other limited offerings are a source of financing in the United States, a Form D acts as a notice to regulators and to the public that such an offering has occurred or is in progress. A Form D does not serve as a disclosure document to investors in the offering.

In 1989 the SEC eliminated the filing of a Form D under federal law as a condition to the availability of Rule 506 in private offerings, so that no such condition exists in the federal version of Rule 506 today. Unlike the SEC, Washington has retained as a condition to the availability of the Washington version of Rule 506 the requirement of filing a Form D in Washington and with the SEC before the lapse of 15 days from the date of first sale

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<sup>1</sup> Statement by the General Counsel to the Texas State Securities Board in his capacity as a member of the NASAA Corporate Finance Section Committee at the Corporation Finance Section Forum during the 91<sup>st</sup> Conference of the North American Securities Administrators Association in Las Vegas, Nevada, September 15, 2008. The dilemma presented by Washington's conditioning federal preemption upon the timely filing of a Form D with the SEC and the state, and the angst it has engendered among securities practitioners when combined with Washington's September regulation requiring disclosure of the date of first sale in Washington, had been noted in the discussion at the Corporation Finance Section Forum immediately preceding this statement by the General Counsel to the Texas State Securities Board.

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in the state.<sup>2</sup> Absent another available exemption, any loss of the Rule 506 safe harbor would give investors in a private offering a right to sue in a private lawsuit for rescission of the investment, prejudgment interest and attorneys fees under the civil liability provisions of the Securities Act of Washington at any time before Washington's three-year statute of limitations has run, irrespective of any enforcement restraint that regulators may exercise.<sup>3</sup> Indeed, although in apparent contradiction to the preemptive provision of the National Securities Market Improvement Act of 1996 (NSMIA),<sup>4</sup> Washington's conditioning of federal preemption on the filing of a Form D both in Washington and with the SEC has been upheld by a federal District Court in a private lawsuit in the Western District of Washington.<sup>5</sup> A comment to the Washington Securities Division by the State Regulation of Securities Committee of the Business Law Section of the American Bar Association (ABA) urged the Division to take the opportunity in adopting the September regulation to conform the Washington approach to that of the SEC by rescinding that portion of the Washington Rule 506 regulation that conditions the availability of Washington's Rule 506 upon the filing of a Form D.<sup>6</sup> However, the Division declined to do so,<sup>7</sup> and that provision remains on the books today as part of Washington's Rule 506 regulation.

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<sup>2</sup> WAC 460-44A-506(2) under the Securities Act of Washington, as amended (SAW).

<sup>3</sup> RCW 21.20.430(1) of SAW.

<sup>4</sup> Section 18(b)(4)(D), Securities Act of 1933, as amended.

<sup>5</sup> *Chamberlin v. Advanced Equities, Inc.*, 2002 U.S. Dist. LEXIS 28307 (W.D. Wash. 2002); but see *Hamby v. Clearwater Consulting Concepts, LLLP*, 428 F. Supp. 2d 915 (E. D. Ark. 2006). It is unclear from the decision why the defendants in *Chamberlin v. Advanced Equities, Inc.* did not argue as a fallback position the availability of Washington's statutory private offering exemption under the second phrase of RCW 21.20.430(1) of SAW for "sales not involving a public offering, whether effected through a broker-dealer or not," which is self executing in that it does not depend upon the filing of a form of any type, either before or after the transaction. That exemption is interpreted, at least administratively, in the same manner as Section 4(2) of the Securities Act of 1933, as amended. See WAC 460-44A-050(2) under SAW.

<sup>6</sup> Comment C on page 9 of the letter (ABA State Securities Laws Committee Comment Letter) dated April 8, 2008 Ellen Lieberman, Chair of the State Regulation of Securities Committee of the ABA Business Law Section.

<sup>7</sup> Comment C on page 5 of letter (Washington Securities Division Response Letter) dated July 31, 2008 to Ellen Lieberman by Faith L. Anderson, Associate General Counsel of the Washington Securities Division.

Washington's September regulation for the first time requires that companies raising capital in reliance upon Rule 506 set forth in the filing of the Form D in Washington the date of first sale of the securities within the state of Washington.<sup>8</sup> If the date of first sale in Washington is not set forth in the Form D, the safe harbor under Washington Rule 506 by its terms would fail. Also, setting forth the date of first sale in a Form D makes it particularly easy for disgruntled investors to track the Form D filing history and assert failure of the Rule 506 safe harbor if there is the slightest failure to meet the Washington Form D filing deadline. A comment by the ABA State Regulation of Securities Committee urging the Securities Division not to require separate disclosure of the date of first sale in the filing of a Form D in Washington was rejected by the Securities Division when it adopted the September regulation.<sup>9</sup>

The SEC has a rule that provides flexibility for "inadvertent and immaterial" lapses in compliance with Rule 506,<sup>10</sup> but no such flexibility exists as to Rule 506 under Washington's comparable regulation.<sup>11</sup> Indeed, Washington's September regulation included a very meticulously parsed provision tolling the 15-day deadline for filing a Form D until the next day if the deadline should fall on a weekend or holiday,<sup>12</sup> which suggests that the intention behind the September regulation is that there be no flexibility at all for the Form D filing deadline and that it be strictly construed. Similarly, no "inadvertent and immaterial" flexibility would exist if the Form D filed in Washington should omit to set forth the date of first sale.

Historically, Rule 506 has been extensively used as a compliance tool by small businesses in private offerings in Washington, and with the current credit crunch, small businesses may increasingly seek to rely upon private offerings of securities to fund their operations. Although no Form D need be filed with the SEC in order for federal Rule 506 to be available, Washington's Rule 506 will by its terms fail if for whatever reason the 15-day filing deadline

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<sup>8</sup> WAC 460-44A-503(1)(a)(ii)(A) under SAW.

<sup>9</sup> Comment B on page 8 of the ABA State Securities Laws Committee Comment Letter; Comment B on page 4 of Washington Securities Division Response Letter.

<sup>10</sup> Rule 508 under the Securities Act of 1933, as amended.

<sup>11</sup> WAC 460-44A-508(1) under SAW.

<sup>12</sup> WAC 460-44A-503(1)(a)(i)(A) under SAW.

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is missed or the date of first sale in Washington is not included. And any such missed filing deadline or date of first sale omission will now be publicly available for anyone to see. Under some circumstances, the date of first sale and filing deadline requirements could interact with one another to create a compliance dilemma, which might not be capable of being fixed. For example, a re-filing after the 15-day deadline has passed of a defective Form D that omitted to set forth the date of first sale would jeopardize reliance upon the Washington Rule, irrespective of any waiver of the late filing by the Division (which might not be available in any event). These new nuances should be at the top of the checklist for those who intend to rely upon Rule 506 in private securities offerings in Washington in the future.

Because of the subtle but serious problems that Washington's Rule 506 regulatory scheme creates for small businesses that rely upon Rule 506 in private offerings in Washington, that scheme is not an appropriate model for other states to follow in coordinating state Rule 506 compliance with the federal Rule 506 regulatory scheme under Regulation D, including the new electronic filing of Form D online.

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## **CHILLING EFFECT FELT ON FLORIDA AGENT LICENSING**

*By R. Michael Underwood*  
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It has never been easy to become licensed to sell financial products in Florida. The state's historical vulnerability to fraud, its large elderly population and the state legislature's response with strict laws have lead industry to expect delays when seeking registration of agents in Florida. The resignation of Florida Office of Financial Regulation Commissioner Don Saxon, effective September 30, 2008, in response to criticism of lax licensing standards for mortgage brokers, is making the process worse. New standards may result in slower decisions on license applications.

The Office of Financial Regulation's Division of Securities registers individuals to offer and sell securities in or from Florida. Section 517.12(7), Florida Statutes requires each applicant for registration to file a complete set of fingerprints. The Florida Financial Services Commission has implemented this requirement with Rule 69W-

600.006, Florida Administrative Code. That rule permits waiver of the fingerprint requirement when the applicant's fingerprints have been processed pursuant to SEC Rule 17f-2. Florida's rule provides, however, that such waiver is effective only if the applicant's fingerprints have been processed "by said person's current employer."

In the wake of Commissioner Saxon's resignation, the Division of Securities' interpretation of Rule 69W-600.006 is changing. This can significantly impact applications for registration of personnel who are leaving an association with one broker-dealer for a new one. Formerly, if an applicant requested and qualified for "temporary registration" with a new broker-dealer (while technically still registered with the old broker-dealer), the Division of Securities would regard the old broker-dealer as the applicant's "current employer." The Division of Securities no longer feels it can interpret the regulation this way. Because the new broker-dealer is required to submit the applicant's fingerprints to FINRA for processing under SEC rules, Florida believes it must await the results of that review before acting permanently on the application. Under its new interpretation, the Division of Securities will allow "temporary registration" for no more than 25 days without a new fingerprint report. When an agent does not qualify for "temporary registration" or has already left association with a broker-dealer before applying for registration with a new firm, Florida's practice is unchanged. Before acting on the application, the Division of Securities will await processing of the agent's fingerprints submitted to FINRA by the new firm.

FINRA allows member firms 30 days to turn in fingerprints for a new associated person. Using that full 30 days, however, is likely to delay Florida approval. When a Form U-4 application clears FINRA, this triggers pendency of a registration application in Florida. If the Division of Securities has not received the results of FINRA's processing of the agent's fingerprints after 30 days from that point, the lack of a report and any criminal acts that might be disclosed on the missing report will be noted in a deficiency letter. Issuance of that letter tolls the time within which the Division of Securities must act on the application. Firms can avoid this result by promptly submitting fingerprints to FINRA with the agent's Form U-4 application.

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## EDITORIAL

*By: Martin A. Hewitt*

“It was the best of times, it was the worst of times; it was the age of wisdom, it was the age of foolishness; it was the epoch of belief, it was the epoch of incredulity; it was the season of Light, it was the season of Darkness; it was the spring of hope, it was the winter of despair; we had everything before us, we had nothing before us; we were all going directly to Heaven, we were all going the other way.” – Charles Dickens.

The preceding paragraph started our last editorial. We suppose that the only changes to said paragraph are deletions to the following references: “best of times,” “age of wisdom,” “epoch of belief,” “season of Light,” “spring of hope,” “we had everything before us,” and “we were all going directly to heaven.”

This editorial is being written, appropriately enough, on New Year’s Eve 2009. We have reached a point in history which, without hyperbole, can best be described as the bottom or near bottom of the ultimate perfect storm of financial and monetary disasters the world has seen in perhaps 100 years or more. The question is, where do we go from here? Where do we go in 2009?

At a recent holiday party the discussion turned to the financial markets. A friend in the computer industry asked how one can trust anything if someone the likes of Bernard Madoff is found to be less than a pillar of society? The discussion turned to whether or not one could trust month end or yearend statements from Fidelity or any other financial institution. It was at that moment that one could argue that if such insecurity is held by a majority of investors, then perhaps we have indeed entered another Great Depression. In reviewing the history of economic disasters dating back to the Great Depression of the 1930’s, the Panic of 1907, the crash of 1873 and perhaps all the way back to the Tulip Scandal of the 1600s, what one sees as a recurring theme is the complete capitulation of investor confidence. Perhaps that is the hallmark of a depression versus a recession.

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Perhaps the greatest problem before both practitioners and regulators alike is how to ensure that investors regain that confidence which is the backbone of the financial markets. Without investor confidence there can be no economic recovery. The solution to that problem is what we must all come to by working together over the next several months and years. On the one side it is not enough to say we have all the regulation we need, but that such regulation has to be applied more consistently. On the other side it is not enough to say that we must throw the baby out with the bath water and start from scratch, that perhaps there are too many regulators and that one super regulator ought to be enough. Each side, speaking in such generalities, cannot even begin to discuss the problems of securities regulation in the 21<sup>st</sup> century. Whatever the solution is, it cannot be to continue either the practice or regulation of securities law as business as usual. If there is one goal that we would like to see for 2009, one resolution, if you will, is that practitioners and regulators must talk openly and candidly about their concerns separate and apart from any particular offering or licensing issue. In the heat of battle it is nearly impossible not to go from advocate of one side or the other, to problem solver.

Perhaps one meeting place is in the pages of the Blue Sky Bugle. Please note that we are always looking for articles for upcoming editions of the Blue Sky Bugle. The next deadline is Valentine’s Day and we hope that you, the reader, will engage in a dialogue by writing an article for the next issue. If so, please forward your articles to [mhewittsq@gmail.com](mailto:mhewittsq@gmail.com).

Finally, as we do in every edition of the Blue Sky Bugle, we present below a timely photograph involving our Blue Sky community. It somehow seems appropriate that the photo below was taken during the September NASAA Conference in Nevada. This picture is of a long empty, lonely stretch of road heading west from the town of Beatty and into Death Valley. It seems appropriate because we are all travelling down a similar road in the financial markets. As lonely as that road may appear, we are actually on it together and as such we can hope that wherever that road leads, we can smooth out any potholes or speed bumps along the way together. So in that spirit, and on behalf of everyone who works so hard to make the Blue Sky Bugle what it is, and to those who can help it become even better in the coming year, we wish you a Happy New Year.



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