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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 ....

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## **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

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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.

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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

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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 Curll 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

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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.

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## 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