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## SUMMARY - SECURITIES IN A “NUTSHELL”

### INTRODUCTION

This information is a brief summary of certain matters related to the offer, sale, registration, exemptions from registration, liabilities and resales of securities under the Securities Act of 1933, as amended (the “Securities Act”), and the Securities Exchange Act of 1934, as amended (the “Exchange Act”), rules of the Securities and Exchange Commission (the “SEC”) promulgated under these securities laws, rules and regulations; and the Utah Uniform Securities Act and the rules and regulations promulgated by the Utah Division of Securities (the “Division”). It is designed only to point out many of the principal issues involving these matters; this information should be used only as a reference to the actual securities laws, rules and regulations that may be applicable.

In a “nutshell,” under federal and state securities laws, rules and regulations, the offer and sale of a security needs to be registered or exempt from registration, to avoid liability for unregistered offers and sales; there is no exemption from the anti-fraud provisions of applicable federal and state securities laws, rules and regulations, except for a preemption of state securities anti-fraud laws in certain class actions that is mentioned below in a brief discussion of the Securities Litigation Uniform Standards Act of 1998 below.

The late Norman S. Johnson, Esq. always said that in representing someone in connection with the purchase or sale of a security that it boils down to “what’s the deal and who are the players”? That comment cannot be stressed enough in the present regulatory climate in the securities industry.

### DEFINITION OF “SECURITY” AND MATERIAL RELATED DEFINITIONS

#### Federal Securities Acts

#### Section 2 of the Securities Act

*(a) Definitions. --When used in this title, unless the context otherwise requires --*

*(1) The term “**security**” (Emphasis added) means any note,*

#### Utah Uniform Securities Act

#### Section 61-1-13 – Definitions

*(n) “**Federal covered security**” (Emphasis added) means a security that is a covered security under Section 18(b) of the Securities Act of 1933 or rules or regulations promulgated under Section 18(b) of*

stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

(3) The term **“sale” or “sell”** shall include every contract of sale or disposition of a security or interest in a security, for value. The term **“offer to sell,” “offer for sale,” or “offer”** shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. The terms defined in this paragraph and the term **“offer to buy”** (Emphasis added) as used in subsection (c) of section 5 shall not include preliminary negotiations or agreements between an issuer (or any person directly or indirectly controlling or controlled by an issuer, or under direct or indirect common control with an issuer) and any underwriter or among underwriters who are or are to be in privity of contract with an issuer (or any person directly or indirectly controlling or controlled by an issuer, or under direct or indirect common control with an issuer). Any security given or delivered with, or

the Securities Act of 1933.

(t) **“Isolated transaction”** (Emphasis added) means not more than a total of two transactions that occur anywhere during six consecutive months.

(ee) (i) **“Security”** (Emphasis added) means a:

(A) note;

(B) stock;

(C) treasury stock;

(D) bond;

(E) debenture;

(F) evidence of indebtedness;

(G) certificate of interest or participation in a profit-sharing agreement;

(H) collateral-trust certificate;

(I) preorganization certificate or subscription;

(J) transferable share;

(K) investment contract;

(L) burial certificate or burial contract;

(M) voting-trust certificate;

(N) certificate of deposit for a security;

(O) certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such a title or lease;

(P) commodity contract or commodity option;

(Q) interest in a limited liability company;

(R) life settlement interest; or

(S) in general, an interest or instrument commonly known as a “security,” or a certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase an item listed in Subsections

as a bonus on account of, any purchase of securities or any other thing, shall be conclusively presumed to constitute a part of the subject of such purchase and to have been offered and sold for value. The issue or transfer of a right or privilege, when originally issued or transferred with a security, giving the holder of such security the right to convert such security into another security of the same issuer or of another person, or giving a right to subscribe to another security of the same issuer or of another person, which right cannot be exercised until some future date, shall not be deemed to be an offer or sale of such other security; but the issue or transfer of such other security upon the exercise of such right of conversion or subscription shall be deemed a sale of such other security. Any offer or sale of a security futures product by or on behalf of the issuer of the securities underlying the security futures product, an affiliate of the issuer, or an underwriter, shall constitute a contract for sale of, sale of, offer for sale, or offer to sell the underlying securities.

(11) The term **“underwriter”** (Emphasis added) means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors’ or sellers’ commission. As used in this paragraph the term “issuer” shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

(I)(ee)(i)(A) through (R).

(ii) **“Security”** (Emphasis added) does not include:

(A) an insurance or endowment policy or annuity contract under which an insurance company promises to pay money in a lump sum or periodically for life or some other specified period;

(B) an interest in a limited liability company in which the limited liability company is formed as part of an estate plan where all of the members are related by blood or marriage, or the person claiming this exception can prove that all of the members are actively engaged in the management of the limited liability company; or

(C) (I) a whole long-term estate in real property;

(II) an undivided fractionalized long-term estate in real property that consists of ten or fewer owners; or

(III) an undivided fractionalized long-term estate in real property that consists of more than ten owners if, when the real property estate is subject to a management agreement:

(Aa) the management agreement permits a simple majority of owners of the real property estate to not renew or to terminate the management agreement at the earlier of the end of the management agreement’s current term, or 180 days after the day on which the owners give notice of termination to the manager;

(Bb) the management agreement prohibits, directly or indirectly, the lending of the proceeds earned from the real property estate or the use or pledge of its assets to a person or entity affiliated with or under common control of the manager; and

(Cc) the management agreement complies with any other requirement imposed by rule by the Real Estate Commission under Section 61-2-26.

(iii) For purposes of Subsection (I)(ee)(ii)(B), evidence that members vote or have the right to vote, or the right to information concerning the business and affairs of the limited liability company,

**Section 18 of the Securities Act**

*(b) **Covered Securities.** --For purposes of this section, the following are covered securities:*

**Excerpt from Section 18:**

*(1) Exclusive federal registration of nationally traded securities.*

*--A security is a covered security if such security is --*

*(A) listed, or authorized for listing, on the New York Stock Exchange or the American Stock Exchange, or listed, or authorized for listing, on the National Market System of the Nasdaq Stock Market (or any successor to such entities);*

*(B) listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule (on its own initiative or on the basis of a petition) are substantially similar to the listing standards applicable to securities described in subparagraph (A); or*

*(C) is a security of the same issuer that is equal in seniority or that is a senior security to a security described in subparagraph (A) or (B).*

**Rule 501 of the SEC**

*a. Accredited investor. Accredited investor shall mean any person who comes within any of the following categories, or who the issuer reasonably believes comes within any of the following categories, at the time of the sale of the securities to that person:*

*(1) Any bank as defined in Section 3(a)(2) of the Securities Act or any savings and loan association or other institution as*

*or the right to participate in management, may not establish, without more, that all members are actively engaged in the management of the limited liability company.*

*(bb) (i) **“Sale” or “sell”** (Emphasis added) includes a contract for sale of, contract to sell, or disposition of, a security or interest in a security for value.*

*(ii) **“Offer” or “offer to sell”** (Emphasis added) includes an attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value.*

*(iii) The following are examples of the definitions in Subsection (1)(bb)(i) or (ii):*

*(A) a security given or delivered with or as a bonus on account of a purchase of a security or any other thing, is part of the subject of the purchase, and is offered and sold for value;*

*(B) a purported gift of assessable stock is an offer or sale as is each assessment levied on the stock;*

*(C) an offer or sale of a security that is convertible into, or entitles its holder to acquire or subscribe to another security of the same or another issuer is an offer or sale of that security, and also an offer of the other security, whether the right to convert or acquire is exercisable immediately or in the future;*

*(D) a conversion or exchange of one security for another constitutes an offer or sale of the security received in a conversion or exchange, and the offer to buy or the purchase of the security converted or exchanged;*

*(E) securities distributed as a dividend wherein the person receiving the dividend surrenders the right, or the alternative right, to receive a cash or property dividend is an offer or sale;*

*(F) a dividend of a security of another issuer is an offer or sale; or*

*(G) the issuance of a security under a merger, consolidation,*

<p><i>defined in Section 3(a)(5)(A) of the Securities Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934; any insurance company as defined in Section 2(13) of the Securities Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in Section 2(a)(48) of that Act; any small business investment company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974, if the investment decision is made by a plan fiduciary, as defined in Section 3(21) of such Act, which is either a bank, savings and loan association, insurance company, or registered investment advisor, or if the employee benefit plan has total assets in excess of \$5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;</i></p> <p><i>(2) Any private business development company as defined in Section 202(a)(22) of the Investment Advisors Act of 1940;</i></p> <p><i>(3) Any organization described in Section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5,000,000;</i></p> <p><i>(4) Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer;</i></p> <p><i>(5) Any natural person whose individual net worth, or joint net worth with the person's spouse, at the time of this purchase exceeds \$1,000,000;</i></p>	<p><i>reorganization, recapitalization, reclassification, or acquisition of assets constitutes the offer or sale of the security issued as well as the offer to buy or the purchase of a security surrendered in connection therewith, unless the sole purpose of the transaction is to change the issuer's domicile.</i></p> <p><i>(iv) The terms defined in Subsections (1)(bb)(i) and (ii) do not include:</i></p> <p><i>((A) a good faith gift;</i></p> <p><i>(B) a transfer by death;</i></p> <p><i>(C) a transfer by termination of a trust or of a beneficial interest in a trust;</i></p> <p><i>(D) a security dividend not within Subsection (1)(bb)(iii)(E) or (F);</i></p> <p><i>or</i></p> <p><i>(E) a securities split or reverse split.</i></p>
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<p>(6) Any natural person who had an individual net income in excess of 200,000 in each of the two most recent fiscal years or joint income with the person's spouse in excess of \$300,000 in each of those two years and has a reasonable expectation of reaching the same income level in the current fiscal year;</p> <p>(7) Any trust, with total assets in excess of \$5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Section 230.506(b)(2)(ii); and</p> <p>(8) Any entity in which all of the equity owners are accredited investors.</p>	
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**REGISTRATION**

<p><b><u>Section 5 of the Securities Act</u></b></p> <p>(a) <b><u>Unless a registration statement is in effect</u></b> as to a security, it shall be <b><u>unlawful</u></b> for any person, directly or indirectly –</p> <p>(1) to make use of any means or instruments of transportation or communication <b><u>in interstate commerce</u></b> or of the mails <b><u>to sell such security</u></b> through the use or medium of any prospectus or otherwise (Emphasis added); or</p> <p>(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.</p> <p>(b) It shall be unlawful for any person, directly or indirectly –</p> <p>(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 10, or</p> <p>(2) to carry or to cause to be carried through the mails or in</p>	<p><b><u>Section 61-1-7 - Registration before sale</u></b></p> <p>It is <b><u>unlawful for any person to offer or sell any security in this state unless it is registered</u></b> under this chapter, the security or transaction is exempted under Section 61-1-14, <b><u>or the security is a federal covered security</u></b> for which a notice filing has been made pursuant to the provisions of Section 61-1-15.5 (Emphasis added).</p>
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*interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10.*

*(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding of examination under section 8.*

- You cannot register the sale of a security that has been already offered and sold pursuant to an available exempt transaction; however, you can register the resale of the security under a resale prospectus. This can be especially troublesome in a negotiated reorganization transaction where a majority by ownership of interested stockholders have pre-approved the reorganization and are bound by agreement or otherwise to vote for the reorganization.
- In a PIPE offering, the offering of all other securities being offered by an issuer that may be “integrated” with the securities being offered need to have been completed or the filing of the registration statement will constitute a “public solicitation” of those other securities that are integrated.

**EXEMPTIONS (summary of selected registration exempt securities)**

<p><b><u>Section 3 of the Securities Act</u></b></p> <ul style="list-style-type: none"> <li>• Generally exempts securities of the type that are usually guaranteed by governmental institutions, banks, public utilities, savings and loan associations, insurance companies and similar securities, along with an interest in a railroad equipment trust; short term notes; charitable issuances;</li> <li>• Section 3(a)(9) defines an “exempt security” to include any security of an issuer exchanged for another security of an issuer.</li> <li>• Section 3(a)(10) defines an “exempt security” to include a security of an issuer issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and for cash, where the terms and conditions of the exchange have been determined to have been fair at a hearing by a court or other governmental institution held to consider such fairness.</li> <li>• Section 3(a)(11) defines an “exempt security” as a security that is part of an issue offered and sold only to residents of a single state, where the issuer of such securities is a resident or entity of such state and is doing business within such state. Rule 147 of the SEC provides objective standards for determining eligibility of this exemption.</li> </ul>	<p><b><u>Section 61-1-14(1)</u></b></p> <ul style="list-style-type: none"> <li>• Generally exempts securities of the same type that are usually guaranteed by governmental institutions, banks, savings and loan associations, insurance companies and similar securities; short term notes, with certain limitations; charitable issuances; securities of companies listed on national exchanges or another securities market approved by a rule adopted under this chapter.</li> <li>• Section 61-1-14(1)(e) exempts a <b><u>federal covered security</u></b> (Emphasis added) <i>specified in the Securities Act of 1933, Section 18(b)(1), 15 U.S.C. Section 77r(b)(1), or by rule adopted under that provision.</i></li> <li>• Section 61-1-14(1)(g) exempts an <b><u>investment contract</u></b> (Emphasis added) <i>issued in connection with an employees’ stock purchase, option, savings, pension, profit-sharing, or similar benefit plan.</i></li> <li>• See the website of the Division referenced below under the heading “Governmental Websites” under “Exemptions” in this website for a summary table of all exempt securities and requirements.</li> <li>• See the “Securities Library” in the Division website referenced below under the heading “Governmental Websites.”</li> </ul>
<p><b>EXEMPTIONS (registration transactional exemptions only)</b></p>	
<p><b><u>Section 4 of the Securities Act (bold type and underlines are added)</u></b></p>	<p><b><u>Section 61-1-14(2) (bold type and underlines are added)</u></b></p> <p><i>The following transactions are exempt from Sections 61-1-7 and 61-</i></p>

The provisions of section 5 shall not apply to --

(1) transactions by **any person other than an issuer, underwriter, or dealer.** (Emphasis added).

(2) transactions by an issuer **not involving any public offering.** (Emphasis added).

(3) transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except --

(A) transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter,

(B) transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under section 8 is in effect as to the security), or such shorter period as the

Commission may specify by rules and regulations or order, and (C) transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

With respect to transactions referred to in clause (B), if securities of the issuer have not previously been sold pursuant to an earlier effective registration statement the applicable period, instead of forty days, shall be ninety days, or such shorter period as the Commission may specify by rules and regulations or order.

(4) brokers' transactions, executed upon customers' orders on

1-15:

(a) an **isolated nonissuer transaction**, whether effected through a broker-dealer or not;

(b) a **nonissuer transaction** in an outstanding security, if as provided by rule of the division:

(i) information about the issuer of the security as required by the division is currently listed in a securities manual recognized by the division, and the listing is based upon such information as required by rule of the division; or

(ii) the security has a fixed maturity or a fixed interest or dividend provision and there is no default during the current fiscal year or within the three preceding fiscal years, or during the existence of the issuer and any predecessors if less than three years, in the payment of principal, interest, or dividends on the security;

(c) a **nonissuer transaction effected by or through a registered broker-dealer pursuant to an unsolicited order or offer to buy;**

(d) a transaction between the issuer or other person on whose behalf the offering is made and an underwriter, or among underwriters;

(e) **a transaction in a bond or other evidence of indebtedness secured by a real or chattel mortgage or deed of trust, or by an agreement for the sale of real estate or chattels, if the entire mortgage, deed of trust, or agreement, together with all the bonds or other evidences of indebtedness secured thereby, is offered and sold as a unit;**

(f) a transaction by an **executor**, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian, or conservator;

(g) a transaction executed by a **bona fide pledgee** without a purpose of evading this chapter;

(h) an offer or sale to one of the following whether the purchaser is acting for itself or in a fiduciary capacity:

(i) a depository institution;

any exchange or in the over-the-counter market but not the solicitation of such orders.

(5)

(A) Transactions involving offers or sales of one or more promissory notes directly secured by a first lien on a single parcel of real estate upon which is located a dwelling or other residential or commercial structure, and participation interests in such notes –

(i) where such securities are originated by a savings and loan association, savings bank, commercial bank, or similar banking institution which is supervised and examined by a Federal or State authority, and are offered and sold subject to the following conditions:

(a) the minimum aggregate sales price per purchaser shall not be less than \$250,000;

(b) the purchaser shall pay cash either at the time of the sale or within sixty days thereof; and

(c) each purchaser shall buy for his own account only; or

(ii) where such securities are originated by a mortgagee approved by the Secretary of Housing and Urban Development pursuant to sections 203 and 211 of the National Housing Act and are offered or sold subject to the three conditions specified in subparagraph (A)(i) to any institution described in such subparagraph or to any insurance company subject to the supervision of the insurance commissioner, or any agency or officer performing like function, of any State or territory of the United States or the District of Columbia, or the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association.

(B) Transactions between any of the entities described in subparagraph (A)(i) or (A)(ii) hereof involving non-assignable contracts to buy or sell the foregoing securities which are to be

(ii) a trust company;

(iii) an insurance company;

(iv) an investment company as defined in the Investment Company Act of 1940;

(v) a pension or profit-sharing trust;

(vi) other financial institution or institutional investor; or

(vii) a broker-dealer;

(i) an **offer or sale of a preorganization certificate** or subscription if:

(i) no commission or other remuneration is paid or given directly or indirectly for soliciting a prospective subscriber;

(ii) the number of subscribers acquiring a legal or beneficial interest therein does not exceed ten;

(iii) there is no general advertising or solicitation in connection with the offer or sale; and

(iv) no payment is made by a subscriber;

(j) subject to Subsection (6), a transaction pursuant to an offer by an issuer of its securities to its existing securities holders, if:

(i) no commission or other remuneration, other than a standby commission is paid or given directly or indirectly for soliciting a security holder in this state; and

(ii) the transaction constitutes:

(A) the conversion of convertible securities;

(B) the exercise of nontransferable rights or warrants;

(C) the exercise of transferable rights or warrants if the rights or warrants are exercisable not more than 90 days after their issuance;

(D) the purchase of securities under a preemptive right; or

(E) a transaction other than one specified in Subsections

(2)(j)(ii)(A) through (D) if:

(I) the division is furnished with:

(Aa) a general description of the transaction;

completed within two years, where the seller of the foregoing securities pursuant to any such contract is one of the parties described in subparagraph (A)(i) or (A)(ii) who may originate such securities and the purchaser of such securities pursuant to any such contract in any institution described in subparagraph (A)(i) or any insurance company described in subparagraph (A)(ii), the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, or the Government National Mortgage Association and where the foregoing securities are subject to the three conditions for sale set forth in subparagraphs (A)(i)(a) through (c).

(C) The exemption provided by subparagraphs (A) and (B) hereof shall not apply to resales of the securities acquired pursuant thereto, unless each of the conditions for sale contained in subparagraphs (A)(i)(a) through (c) are satisfied.

(6) transactions involving offers or sales by an issuer solely to one or more accredited investors, if the aggregate offering price of an issue of securities offered in reliance on this paragraph does not exceed the amount allowed under section 3(b) of this title, if there is no advertising or public solicitation in connection with the transaction by the issuer or anyone acting on the issuer's behalf, and if the issuer files such notice with the Commission as the Commission shall prescribe.

(Bb) the disclosure materials to be furnished to the issuer's securities holders in the transaction; and

(Cc) a non-refundable fee; and

(II) the division does not, by order, deny or revoke the exemption within 20 working days after the day on which the filing required by Subsection (2)(j)(ii)(E)(I) is complete;

(k) an offer, but not a sale, of a security for which a registration statement is filed under both this chapter and the Securities Act of 1933 if no stop order or refusal order is in effect and no public proceeding or examination looking toward such an order is pending;

(l) a **distribution of securities as a dividend if the person distributing the dividend is the issuer of the securities distributed;**

(m) a nonissuer transaction effected by or through a registered broker-dealer where the broker-dealer or issuer files with the division, and the broker-dealer maintains in the broker-dealer's records, and makes reasonably available upon request to a person expressing an interest in a proposed transaction in the security with the broker-dealer information prescribed by the division under its rules;

(n) a **transaction not involving a public offering;**

(o) an **offer or sale of "condominium units"** or "time period units" as those terms are defined in Title 57, Chapter 8, Condominium Ownership Act, whether or not to be sold by installment contract, if the following are complied with:

(i) Title 57, Chapter 8, Condominium Ownership Act, or if the units are located in another state, the condominium act of that state;

(ii) Title 57, Chapter 11, Utah Uniform Land Sales Practices Act;

(iii) Title 57, Chapter 19, Timeshare and Camp Resort Act; and

(iv) Title 70C, Utah Consumer Credit Code;

(p) a transaction or series of transactions involving a merger, consolidation, reorganization, recapitalization, reclassification, or sale of assets, if the consideration for which, in whole or in part, is the issuance of securities of a person or persons, and if:

(i) the transaction or series of transactions is incident to a vote of the securities holders of each person involved or by written consent or resolution of some or all of the securities holders of each person involved;

(ii) the vote, consent, or resolution is given under a provision in:

(A) the applicable corporate statute or other controlling statute;

(B) the controlling articles of incorporation, trust indenture, deed of trust, or partnership agreement; or

(C) the controlling agreement among securities holders;

(iii) (A) one person involved in the transaction is required to file proxy or informational materials under Section 14(a) or (c) of the Securities Exchange Act of 1934 or Section 20 of the Investment Company Act of 1940 and has so filed;

(B) one person involved in the transaction is an insurance company that is exempt from filing under Section 12(g)(2)(G) of the Securities Exchange Act of 1934, and has filed proxy or informational materials with the appropriate regulatory agency or official of its domiciliary state; or

(C) all persons involved in the transaction are exempt from filing under Section 12(g)(1) of the Securities Exchange Act of 1934, and file with the division such proxy or informational material as the division requires by rule;

(iv) the proxy or informational material is filed with the division and distributed to all securities holders entitled to vote in the transaction or series of transactions at least ten working days prior to any necessary vote by the securities holders or action on any necessary consent or resolution; and

(v) the division does not, by order, deny or revoke the exemption

within ten working days after filing of the proxy or informational materials;

(q) subject to Subsection (7), a transaction pursuant to an offer to sell securities of an issuer if:

(i) the **transaction is part of an issue in which there are not more than 15 purchasers in this state**, other than those designated in Subsection (2)(h), during any 12 consecutive months;

(ii) no general solicitation or general advertising is used in connection with the offer to sell or sale of the securities;

(iii) no commission or other similar compensation is given, directly or indirectly, to a person other than a broker-dealer or agent licensed under this chapter, for soliciting a prospective purchaser in this state;

(iv) the seller reasonably believes that all the purchasers in this state are purchasing for investment; and

(v) the transaction is part of an aggregate offering that does not exceed \$1,000,000, or a greater amount as prescribed by a division rule, during any 12 consecutive months;

(r) a transaction involving a commodity contract or commodity option;

(s) a **transaction in a security, whether or not the security or transaction is otherwise exempt if:**

(i) the transaction is:

(A) in exchange for one or more outstanding securities, claims, or property interests; or

(B) partly for cash and partly in exchange for one or more outstanding securities, claims, or property interests; and

(ii) the **terms and conditions are approved by the director after a hearing under Section 61-1a-408;**

(t) a transaction incident to a judicially approved reorganization in which a security is issued:

(i) in exchange for one or more outstanding securities, claims, or

*property interests; or*

*(ii) partly for cash and partly in exchange for one or more outstanding securities, claims, or property interests;*

*(u) a nonissuer transaction by a federal covered investment adviser with investments under management in excess of \$100,000,000 acting in the exercise of discretionary authority in a signed record for the account of others; and*

*(v) a transaction as to which the division finds that registration is not necessary or appropriate for the protection of investors.*

*(3) A person filing an exemption notice or application shall pay a filing fee as determined under Section 61-1-18.4.*

*(4) Upon approval by a majority of the commission, the director, by means of an adjudicative proceeding conducted in accordance with Title 63G, Chapter 4, Administrative Procedures Act, may deny or revoke an exemption specified in Subsection (1)(f) or (g) or in Subsection (2) with respect to:*

*(a) a specific security, transaction, or series of transactions; or*

*(b) a person or issuer, an affiliate or successor to a person or issuer, or an entity subsequently organized by or on behalf of a person or issuer generally and may impose a fine if the director finds that the order is in the public interest and that:*

*(i) the application for or notice of exemption filed with the division is incomplete in a material respect or contains a statement which was, in the light of the circumstances under which it was made, false or misleading with respect to a material fact;*

*(ii) this chapter, or a rule, order, or condition lawfully imposed under this chapter has been willfully violated in connection with the offering or exemption by:*

*(A) the person filing an application for or notice of exemption;*

*(B) the issuer, a partner, officer, or director of the issuer, a person occupying a similar status or performing similar functions, or a person directly or indirectly controlling or controlled by the*

*issuer, but only if the person filing the application for or notice of exemption is directly or indirectly controlled by or acting for the issuer; or*

- (C) an underwriter;*
- (iii) subject to Subsection (8), the security for which the exemption is sought is the subject of an administrative stop order or similar order, or a permanent or temporary injunction or a court of competent jurisdiction entered under another federal or state act applicable to the offering or exemption;*
- (iv) the issuer's enterprise or method of business includes or would include activities that are illegal where performed;*
- (v) the offering has worked, has tended to work, or would operate to work a fraud upon purchasers;*
- (vi) the offering is or was made with unreasonable amounts of underwriters' and sellers' discounts, commissions, or other compensation, or promoters' profits or participation, or unreasonable amounts or kinds of options;*
- (vii) an exemption is sought for a security or transaction that is not eligible for the exemption; or*
- (viii) the proper filing fee, if required, has not been paid.*

*(5) (a) An order under Subsection (4) may not operate retroactively.*

*(b) A person may not be considered to have violated Section 61-1-7 or 61-1-15 by reason of an offer or sale effected after the entry of an order under this Subsection (5) if the person sustains the burden of proof that the person did not know, and in the exercise of reasonable care could not have known, of the order.*

*(6) The exemption created by Subsection (2)(j) is not available for an offer or sale of a security to an existing securities holder who has acquired the holder's security from the issuer in a transaction in violation of Section 61-1-7.*

*(7) As to a security, a transaction, or a type of security or*

	<p><i>transaction, the division may:</i></p> <p><i>(a) withdraw or further condition the exemption described in Subsection (2)(q); or</i></p> <p><i>(b) waive one or more of the conditions described in Subsection (2)(q).</i></p> <p><i>(8) (a) The director may not institute a proceeding against an effective exemption under Subsection (4)(b) more than one year from the day on which the order or injunction on which the director relies is issued.</i></p> <p><i>(b) The director may not enter an order under Subsection (4)(b) on the basis of an order or injunction entered under another state act unless that order or injunction is issued on the basis of facts that would constitute a ground for a stop order under this section at the time the director enters the order.</i></p> <ul style="list-style-type: none"> <li>• See the “Securities Library” in the Division web site referenced below under the heading “Governmental Websites.”</li> </ul>
<p><b><u>Rule 506 of the SEC</u></b></p> <p><b>Exemption for Limited Offers and Sales Without Regard to Dollar Amount of Offering</b></p> <p><i>(a) Exemption. Offers and sales of securities by an issuer that satisfy the conditions in paragraph (b) of this §230.506 shall be deemed to be transactions not involving any public offering within the meaning of section 4(2) of the Act.</i></p> <ul style="list-style-type: none"> <li>• Unlimited <b>“<u>accredited investors</u>”</b> (Emphasis added).</li> <li>• Can include 35 <b>“<u>sophisticated investors</u>”</b> (Emphasis added), who have knowledge, singly or with the aid or assistance of a personal representative not affiliated with</li> </ul>	<p><b><u>Division Rule 164-14-25s. Accredited Investor Exemption.</u></b></p> <p><i>(A) Authority and purpose</i></p> <p><i>(1) The Division enacts this rule under authority granted by Subsection 61-1-14(2)(s) and Section 61-1-24.</i></p> <p><i>(2) This rule provides an exemption for offers and sales to accredited investors. The rule also permits a limited use advertisement.</i></p> <p><i>(B) Definitions</i></p> <p><i>(1) "Accredited Investor" means an accredited investor as defined in 17 CFR 230.501(a) which is incorporated by reference.</i></p> <p><b>Deleted balance of Rule)</b></p>

<p>the issuer and not paid by the issuer, to evaluate risks and merits of prospective investment.</p> <ul style="list-style-type: none"> <li>• File Form D with SEC electronically within 15 days of the first sale, though the filing is not a condition of claiming the exemption.</li> <li>• <b><u>No required information</u></b> under Rule 502 if only “accredited investors” are included.</li> <li>• <b><u>No general solicitation.</u></b></li> </ul>	<p><b><u>Division Rule 164-15-2. Notice filing for Rule 506 offerings</u></b></p> <ul style="list-style-type: none"> <li>• Relates to offerings of “covered securities” and the recognition of SEC Rule 506.</li> <li>• Must file manually signed copy of SEC Form D no later than 15 days after first sale or Division can apply state law to suspend or require registration under Section 18 of the Securities Act.</li> <li>• Uniform Consent to Service of Process.</li> <li>• Filing fee of \$100.</li> <li>• Statement indicating the date of the first sale or that sales are to be made in the state.</li> </ul>
<p><b><u>Rule 505 of the SEC</u></b></p> <p><b>Exemption for Limited Offers and Sales of Securities Not Exceeding \$5,000,000</b></p> <ul style="list-style-type: none"> <li>• Unlimited “<b><u>accredited investors</u></b>” (Emphasis added).</li> <li>• <b><u>No more than 35 other purchasers.</u></b></li> <li>• Must inform investors that securities are “restricted securities” that cannot be sold for at least six months or longer without registration.</li> <li>• File Form D with SEC electronically within 15 days of the first sale, though the filing is not a condition of claiming the exemption.</li> <li>• No more that \$5,000,000 can be raised in any 12 month period.</li> <li>• <b><u>No general solicitation.</u></b></li> <li>• <b><u>Required information</u></b> under Rule 502(b) must be supplied to investors.</li> </ul>	<p><b><u>Division Rule 164-14-2n. Limited offering exemption</u></b></p> <ul style="list-style-type: none"> <li>• Not available for anyone subject to “bad boy” actions.</li> <li>• Must file manually signed copy of SEC Form D no later than 15 days after first sale or Division can apply state law to suspend or require registration under Section 18 of the Securities Act.</li> <li>• One copy of all information provided to investors must be filed.</li> <li>• Uniform Consent to Service of Process.</li> <li>• Filing fee of \$60.</li> <li>• Final sales reports within 30 days of last sale.</li> <li>• The issuer must be satisfied that all non-accredited investors and any person acting on their behalf have reasonable grounds to believe that the investment is suitable for these persons financial situation and needs (if less than 10% of net worth, that is presumed) and that these persons, singly or with a personal representative, have such knowledge and experience in financial and business matters that these</li> </ul>

	investors are capable of evaluating the risks and merits of the investment.
<p><b><u>Rule 504 of the SEC</u></b></p> <p><b>Exemption for Limited Offerings and Sales of Securities Not Exceeding \$1,000,000.</b></p> <p><i>(a) Exemption. Offers and sales of securities that satisfy the conditions in paragraph (b) of this §230.504 by an issuer <b><u>that is not</u></b> (Emphasis added):</i></p> <p><i>(1) <b><u>subject to the reporting requirements of section 13 or 15(d) of the Exchange Act</u></b> (Emphasis added);</i></p> <p><i>(2) <b><u>an investment company</u></b> (Emphasis added); or</i></p> <p><i>(3) a <b><u>development stage company that either has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company</u></b> (Emphasis added) or companies, or other entity or person, shall be exempt from the provision of section 5 of the Act under section 3(b) of the Act.</i></p> <ul style="list-style-type: none"> <li>• No more than <b><u>\$1,000,000 can be raised in 12 month</u></b> period.</li> <li>• <b><u>Public solicitation</u></b> is allowed.</li> <li>• Must be offered in <b><u>one or more states that provide for registration and substantive review of disclosure documents</u></b>; or in one or more states following registration in a state as aforesaid, provided prior delivery of disclosure documents has occurred and all offers and sales are made in accordance with such states securities laws, rules and regulations; <b><u>or exclusively under state law that allows public solicitation to “accredited investors.”</u></b></li> </ul>	<p><b><u>Division Rule 164-14-25s. Accredited Investor Exemption.</u></b></p> <p><i>(A) Authority and purpose</i></p> <p><i>(1) The Division enacts this rule under authority granted by Subsection 61-1-14(2)(s) and Section 61-1-24.</i></p> <p><i>(2) This rule provides an exemption for offers and sales to accredited investors. The rule also permits a limited use advertisement.</i></p> <p><b>(Deleted balance of Rule)</b></p> <p style="text-align: center;"><b>Or</b></p> <ul style="list-style-type: none"> <li>• Registration by qualification.</li> <li>• No free trading shares if reliance on Division Rule 164-14-25s.</li> </ul>

<ul style="list-style-type: none"> <li>• File Form D with SEC electronically within 15 days of the first sale, though the filing is not a condition of claiming the exemption.</li> <li>• <b><u>Can issue “free trading” securities</u></b>, subject to the foregoing.</li> <li>• <b><u>Integration</u></b> issues of Rule 502(a).</li> </ul>	
<p><b><u>Rule 502 of the SEC</u></b></p> <p><i>The following conditions shall be applicable to offers and sales made under Regulation D (§§230.501-230.508):</i></p> <p>(a) <b><u>Integration</u></b> (Emphasis added). <i>All sales that are part of the same Regulation D offering must meet all of the terms and conditions of Regulation D. <b><u>Offers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering, so long as during those six month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Regulation D</u></b> (Emphasis added), other than those offers or sales of securities under an employee benefit plan as defined in Rule 405 under the Act.</i></p> <p><b>(Deleted notes defining “offering)</b></p> <p><i>The following factors should be considered in determining whether offers and sales should be integrated for purposes of the exemptions under Regulation D:</i></p> <p>(a) <i>Whether the sales are part of a single plan of financing;</i>  (b) <i>Whether the sales involve issuance of the same class of</i></p>	

securities;

(c) Whether the sales have been made at or about the same time;

(d) Whether the same type of consideration is received; and

(e) Whether the sales are made for the same general purpose.

(b) **Information requirements** (Emphasis added).

(1) When information must be furnished.

If the issuer sells securities under §230.505 or 230.506 to any purchaser that is not an accredited investor, the issuer shall furnish the information specified in paragraph (b)(2) of this section to such purchaser a reasonable time prior to sale. The issuer is not required to furnish the specified information to purchasers when it sells securities under §230.504, or to any accredited investor.

**(Deleted notes about consideration of anti-fraud issues in providing information)**

(2) Type of information to be furnished.

(i) If the issuer is not subject to the reporting requirements of section 13 or 15(d) of the Exchange Act, at a reasonable time prior to the sale of securities the issuer shall furnish to the purchaser, to the extent material to an understanding of the issuer, its business and the securities being offered:

(A) Non-financial statement information. If the issuer is eligible to use Regulation A (§230.251-263), the same kind of information as would be required in Part II of Form 1-A (§239.90 of this chapter). If the issuer is not eligible to use Regulation A, the same kind of information as required in Part I of a registration statement filed under the Securities Act on the form that the issuer would be entitled to use.

(B) Financial statement information.

*(1) Offerings up to \$2,000,000. The information required in Article 8 of Regulation S-X (§ 210.8 of this chapter), except that only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited.*

*(2) Offerings up to \$7,500,000. The financial statement information required in Form S-1 (§ 239.10 of this chapter) for smaller reporting companies. If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited. If the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant.*

*(3) Offerings over \$7,500,000. The financial statement as would be required in a registration statement filed under the Act on the form that the issuer would be entitled to use. If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited. If the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant.*

**(Deleted balance of subparagraph (b))**

<p><i>(d) Limitations on resale. Except as provided in §230.504(b)(1), securities acquired in a transaction under Regulation D shall have the status of securities acquired in a transaction under section 4(2) of the Act and cannot be resold without registration under the Act or an exemption therefrom. The issuer shall exercise reasonable care to assure that the purchasers of the securities are not underwriters within the meaning of section 2(11) of the Act, which reasonable care may be demonstrated by the following:</i></p> <p><i>(1) Reasonable inquiry to determine if the purchaser is acquiring the securities for himself or for other persons;</i></p> <p><i>(2) Written disclosure to each purchaser prior to sale that the securities have not been registered under the Act and, therefore, cannot be resold unless they are registered under the Act or unless an exemption from registration is available; and</i></p> <p><i>(3) Placement of a legend on the certificate or other document that evidences the securities stating that the securities have not been registered under the Act and setting forth or referring to the restrictions on transferability and sale of the securities.</i></p> <p><i>While taking these actions will establish the requisite reasonable care, it is not the exclusive method to demonstrate such care. Other actions by the issuer may satisfy this provision. In addition, §230.502(b)(2)(vii) requires the delivery of written disclosure of the limitations on resale to investors in certain instances.</i></p>	
<b>LIABILITIES</b>	
<p><b><u>Section 17 Securities Act</u></b></p> <p>(a) It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as defined in Section 206B of the Gramm-Leach-Bliley Act) by the use of any</p>	<p><b><u>Section 61-1-1 - Fraud unlawful</u></b></p> <p>It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly to:</p> <p>(1) employ any device, scheme, or artifice to defraud;</p>

means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly - (1) to employ any device, scheme, or artifice to defraud, or (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in Section 3 shall not apply to the provisions of this Section.

(d) The authority of the Commission under this Section with respect to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) shall be subject to the restrictions and limitations of Section 2A(b) of this title.

### **SEC Rule 10b-5**

Employment of Manipulative and Deceptive Devices

(2) make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or

(3) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

### **“State of Mind” of Section 61-1-1**

**Fibro Trust, Inc. v. Brahman Financial, Inc.**

**1999 UT 13**

**974 P.2d 288**

**Case Number: 970422**

**Decided: 02/12/1999**

**Utah Supreme Court**

“Utah Code Ann. § 61-1-1 (1997). In State v. Larsen, [865 P.2d 1355](#) (Utah 1993), we held that a person violates Section 61-1-1(2) only if that person acts “willfully.” Id. at 1358. We also concluded that Section 61-1-1(2) did not have a “scienter” requirement; that is, a person need not have “the intent to deceive, manipulate, or defraud” to violate Section 61-1-1(2). Id. (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)). In so concluding, we determined that we must read Section 61-1-1 in conjunction with Section 61-1-21 of the Code, which proscribes penalties for a violation of Section 61-1-1. Section 61-1-21 provided that “a person who willfully violates Section 61-1-1 shall upon conviction be . . . fined . . . or imprisoned.” Utah Code Ann. § 61-1-21 (1997) (emphasis added). From this plain language, we held that a person violates Section 61-1-1(2) only if that person willfully misstates or omits material facts. See Larsen, 865 P.2d at 1358. But we declined to interpret willful as requiring scienter, which is the intent to deceive, manipulate, or

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

**Section 10(b) Exchange Act**

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in Section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rules promulgated under subsection (b) that prohibit fraud, manipulation, or insider trading (but not rules imposing or specifying reporting or recordkeeping requirements, procedures, or standards as prophylactic measures against fraud, manipulation, or insider trading), and judicial precedents decided

defraud. See Id. Instead, we relied on the definition of willful provided in Section 76-2-103 of the Code, stating that “[a] person engages in conduct . . . willfully . . . when it is his conscious objective or desire to engage in the conduct or cause the result.” Utah Code Ann. § 76-2-103(1) (1995). For additional support for our conclusion that Section 61-1-1(2) did not have a scienter requirement, we looked to Section 17(a)(2) of the Securities Act, which is almost identical to Section 61-1-1(2) and which the United States Supreme Court has held does not have a scienter requirement. See Aaron v. Securities & Exch. Comm’n, 446 U.S. 680, 697 (1980). We also recognized that declining to require scienter for a Section 61-1-1(2) violation would achieve uniformity with a majority of other states, an aim the legislature expressed in Section 61-1-27 of the Code. See Larsen, 865 P.2d at 1360 and cases cited therein. However, because Larsen dealt only with Section 61-1-1(2), we declined to determine the requisite mental state for a violation of either Section 61-1-1(1) or Section 61-1-1(3). See Id. at 1357 n.1 and 1359 n.6. We now answer that question. Employing the same interpretive process we used in Larsen, we conclude that proof of a violation of either Section 61-1-1(3) or Section 61-1-1(1) requires proof that the person willfully engaged in the prohibited conduct. Section 61-1-21 penalizes any willful violation of Section 61-1-1; it does not distinguish between Section 61-1-1’s subsections. Thus, a person violates Section 61-1-1(3) by willfully engaging in conduct “which operates or would operate as a fraud or deceit upon any person.” See Utah Code Ann. § 61-1-1(3) (1997). A person violates Section 61-1-1(1) by willfully “employ[ing] any device, scheme, or artifice to defraud.” See id. § 61-1-1(1). We recognize that applying the “willful” mental state to the prohibited conduct in Section 61-1-1(1) amounts to a scienter requirement. That is, a person violates Section 61-1-1(1) only if that person willfully engaged in conduct designed to defraud. As we explained in Larsen,

under subsection (b) and rules promulgated thereunder that prohibit fraud, manipulation, or insider trading, shall apply to security-based swap agreements (as defined in Section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities. Judicial precedents decided under Section 17(a) of the Securities Act and Sections 9, 15, 16, 20, and 21A of this title, and judicial precedents decided under applicable rules promulgated under such sections, shall apply to security-based swap agreements (as defined in Section 206B of the Gramm-Leach-Bliley Act) to the same extent as they apply to securities.

### **LIABILITY IN SECURITIES FRAUD DAMAGE**

#### **ACTIONS: Part IV – The Bright Line Test and Primary Liability**

*The following is a quoted excerpt from SEC Actions, a blog covering SEC investigations, civil and criminal enforcement actions, class actions and internal investigations prepared by Thomas O. Gorman, Esq., Porter Wright, Washington, D.C., as www.secactions.com):*

“A second test for determining who is a primary violator began with a decision of the Tenth Circuit Court of Appeals and evolved through subsequent decisions by the Second, Fifth and Eleventh Circuits. In its 1996 decision in Anixter v. Home-Stake Prod. Co., 77 F.3d 1215 (10<sup>th</sup> Cir. 1996), the Tenth Circuit rejected the holding of In re Software Toolworks, Inc., 50 F.3d 615 (9<sup>th</sup> Cir. 1994) as mere aiding and abetting. The case involved a securities law suit against an auditor who had issued false opinions regarding a failed ponzi scheme. After reviewing the allegations, the Court noted that “the critical element separating primary from aiding and abetting ... [is] a

“[t]o act willfully . . . means to act deliberately and purposefully, as distinguished from merely accidentally or inadvertently.” Larsen, 865 P.2d at 1358 n.3. Reading Section 61-1-1(1) as having a scienter requirement comports with both federal and sister state law. In Aaron, the United States Supreme Court held that Section 17(a)(1) of the Securities Act, unlike sections 17(a)(2) and (3), contained a scienter requirement. See 446 U.S. at 699-700. The Court explained that Congress’s use of the words, “device,” “scheme,” and “artifice” in Section 17(a)(1) plainly indicated an intent “to proscribe only knowing or intentional misconduct.” Id. at 696. The Court also recognized that the three terms, “device,” “scheme,” and “artifice,” “all connote knowing or intentional practices.” Id. Holding that Section 61-1-1(1) requires proof of scienter but that Section 61-1-1(2) and (3) do not comport not only with the Supreme Court’s reasoning in Aaron but also with other state court decisions interpreting state securities acts similar to Utah’s. See, e.g., Mann v. Oppenheimer & Co., 517 A.2d 1056 (Del. 1986); Illinois v. Witlow, 433 N.E.2d 629, 634 (Ill. 1982); Enservco, Inc. v. Indiana Sec. Div., 623 N.E.2d 416 (Ind. 1993). Given our decision in Larsen, the statute’s plain language, and the persuasive reasoning of other courts addressing the issue, we conclude that Section 61-1-1(1) of the Code contains a scienter requirement although neither Section 61-1-1(2) nor 61-1-1(3) has such a requirement.”

#### **Section 61-1-22 - Sales and purchases in violation - Remedies - Limitation of actions**

- (1) (a) *This Subsection (1) applies to a person who:*  
(i) *offers or sells a security in violation of:*  
(A) *Subsection 61-1-3(1);*  
(B) *Section 61-1-7;*

representation ... by the defendant, that is relied upon ... ." The speaker – here, the auditor – need not communicate the statement himself. It is sufficient, the Court stated, if the auditor knew or should have known that the representation would be communicated to shareholders. The Court noted that this test provides more guidance than the “substantial participation” or other similar tests.

The next year the Second Circuit decided the first of two cases following the Anixter approach. First, in Shapiro v. Cantor, 123 F.3d 717 (2<sup>nd</sup> Cir. 1997), the Court reviewed the sufficiency of securities fraud claims against the auditors of a failed video chain. Plaintiffs contended that the auditors failed to disclose a prior felony conviction of the chain owner and that financial projections prepared by the firm were circulated in offering memos. The Court rejected the claims as insufficient. As to the conviction, the Court held that the auditors had no duty to disclose. As to the financial projections, the court noted that preparing such materials is “consistent with the role of an accountant.”

Second, in Wright v. Ernst & Young, 152 F.3d 169 (2<sup>nd</sup> Cir. 1998), the Court followed Anixter in rejecting Software Toolworks, while noting that in Shapiro it had followed what is now known as the “bright line” test. Here, the Court rejected claims that an auditor orally approved release of financial data and results included in a press release which stated that the data was not audited. The Court held that “if Central Bank is to have any real meaning, a defendant must actually make a false or misleading statement ... ." In a second key portion of its opinion, the Court held that “[a] secondary actor cannot incur primary liability ... for a statement not attributed to that actor at

(C) *Subsection 61-1-17(2);*  
(D) *a rule or order under Section 61-1-15, which requires the affirmative approval of sales literature before it is used; or*  
(E) *a condition imposed under Subsection 61-1-10(4) or 61-1-11(7); or*  
(ii) *offers, sells, or purchases a security in violation of Subsection 61-1-1(2).*  
(b) *A person described in Subsection (1)(a) is liable to a person selling the security to or buying the security from the person described in Subsection (1)(a). The person to whom the person described in Subsection (1)(a) is liable may sue either at law or in equity to recover the consideration paid for the security, together with interest at 12% per year from the date of payment, costs, and reasonable attorney fees, less the amount of income received on the security, upon the tender of the security or for damages if the person no longer owns the security.*  
(c) *Damages are an amount calculated as follows:*  
(i) *subtract from the amount that would be recoverable upon a tender under Subsection (7)(b) the value of the security when the buyer disposed of the security; and*  
(ii) *add to the amount calculated under Subsection (1)(c)(i) interest at:*  
(A) *12% per year:*  
(I) *beginning the day on which the security is purchased by the buyer; and*  
(II) *ending on the date of disposition; and*  
(B) *after the period described in Subsection (1)(c)(ii)(A), 12% per year on the amount lost at disposition.*  
(2) *The court in a suit brought under Subsection (1) may award an amount equal to three times the consideration paid for the security, together with interest, costs, and attorney fees, less any amounts, all as specified in Subsection (1) upon a showing that the violation was*

the time of its dissemination.”

The Eleventh Circuit followed the same approach in Ziemba v. Cascade Int'l. Inc., 256 F.3d 1194 (2001). There, the complaint alleged securities fraud claims against a company and its auditors and law firm. The law firm, the complaint claimed, participated in drafting false letters and press releases later issued by the company. The auditors were alleged to have given incorrect advice on consolidating subsidiaries of the company and failed to have issued a “going concern” limitation as to a sub. The Court rejected the claims and, after reviewing the split in the Circuits, elected to follow Wright. A “misstatement or omission upon which a plaintiff relied must have been publicly attributed to the defendant” at the time of the investment decision, the court held. Here, the law firm did not make a misstatement because it had no duty to speak. The auditors did not make a misstatement because no opinion was ever disseminated to investors.

Finally, the Fifth Circuit also adopted this position in the Enron litigation, Regents of the Univ. of Cal. v. Credit Suisse First Bank (USA), Inc., 482 F.3d 372 (5<sup>th</sup> Cir. 2007). A petition for certiorari is pending in this case. Thus, the case may be heard with Stoneridge.

In Credit Suisse a securities fraud complaint was brought against a group of banks who were claimed to have assisted Enron in falsifying its financial statements. Essentially, the banks entered into business arrangements that permitted Enron to either improperly book revenue or keep liabilities off its books according to plaintiffs. The complaint claims that each bank knew Enron was engaged in long-term financial fraud.

*reckless or intentional.*

*(3) A person who offers or sells a security in violation of Subsection 61-1-1(2) is not liable under Subsection (1)(a) if the purchaser knew of the untruth or omission, or the seller did not know and in the exercise of reasonable care could not have known of the untrue statement or misleading omission.*

*(4) (a) Every person who directly or indirectly controls a seller or buyer liable under Subsection (1), every partner, officer, or director of such a seller or buyer, every person occupying a similar status or performing similar functions, every employee of such a seller or buyer who materially aids in the sale or purchase, and every broker-dealer or agent who materially aids in the sale or purchase are also liable jointly and severally with and to the same extent as the seller or purchaser, unless the nonseller or nonpurchaser who is so liable sustains the burden of proof that the nonseller or nonpurchaser did not know, and in exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.*

*(b) There is contribution as in cases of contract among the several persons so liable.*

*(5) A tender specified in this section may be made at any time before entry of judgment.*

*(6) A cause of action under this section survives the death of a person who might have been a plaintiff or defendant.*

*(7) (a) An action may not be maintained to enforce liability under this section unless brought before the earlier of:*

*(i) the expiration of five years after the act or transaction constituting the violation; or*

*(ii) the expiration of two years after the discovery by the plaintiff of the facts constituting the violation.*

*(b) A person may not sue under this section if:*

*(i) the buyer or seller received a written offer, before suit and at a*

The District Court adopted a position on scheme liability advocated by the SEC and refused to dismiss the complaint. Subsequently the District Court certified the class.

The Circuit Court, reviewing the case on an appeal of the certification ruling, reversed. The Fifth Circuit held that the banks had not made a misrepresentation because they had no duty to Enron's shareholders to disclose. While Enron committed fraud the banks were, at most, aiders and abettors. The Court went on to note that it is inappropriate to impose liability for securities fraud on one party to a business deal."

#### **Private Securities Litigation Reform Act of 1995**

- Requires a particular "state of mind" determined by courts to mean "scienter" or egregious conduct amounting to "recklessness," or "gross negligence, in some cases, and assuming an SEC Rule 10b-5 based action:
- Reliance.
- Loss causation.
- Damages.
- In connection with the purchase or sale of a security.

#### **Securities Litigation Uniform Standards Act of 1998**

- Preempts state antifraud provisions of applicable securities laws, rules and regulations in class actions. The Corporate Counsel, Vol. XXIII, No. 6, November-December, 1998, and as recited in The Corporate Counsel, Vol. XXXIV, No. 3, May-June, 2009.

*time when the buyer or seller owned the security, to refund the consideration paid together with interest at 12% per year from the date of payment, less the amount of any income received on the security, and the buyer or seller failed to accept the offer within 30 days of its receipt; or*

*(ii) the buyer or seller received such an offer before suit and at a time when the buyer or seller did not own the security, unless the buyer or seller rejected the offer in writing within 30 days of its receipt.*

*(8) A person who has made or engaged in the performance of any contract in violation of this chapter or any rule or order issued under this chapter, or who has acquired a purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may not base a suit on the contract.*

*(9) A condition, stipulation, or provision binding a person acquiring a security to waive compliance with this chapter or a rule or order issued under this chapter is void.*

*(10) (a) The rights and remedies provided by this chapter are in addition to any other rights or remedies that may exist at law or in equity.*

*(b) This chapter does not create a cause of action not specified in this section or Subsection 61-1-4(6).*

## **The Howey Case/Investment Contracts**

### **General**

*The following information on an “Investment Contract,” “Expectation of Profits” and “Common Enterprise” is virtually quoted from ALI-ABA, available in a Google search under “Definity of Security.”*

As the Supreme Court stated in Marine Bank v. Weaver, 455 U.S. 551, (1982), construing the virtually identical definition of “security” under the Exchange Act, the definition is “quite broad” and meant to include “the many types of instruments that in our commercial world fall within the ordinary concept of a security,” including “stocks and bonds, along with the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.” Weaver, 455 U.S. at 555. Thus the federal securities laws define “security” in both specific (any “stock,” “bond,” “note,” “debenture,” etc.) and general (e.g., any “investment contract” or “instrument commonly known as a ‘security’”) terms. The Supreme Court has suggested that “instrument commonly known as a security” and “investment contract” have the same meaning for purposes of the Securities Act and the Exchange Act. United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 852.”

### **Investment Contract**

In SEC v. W.J. Howey Co., 328 U.S. 293 (1946), the Howey Company, a Florida corporation, sold small tracts of land in a citrus grove to 42 purchasers, many of whom were patrons of a nearby resort hotel. While investing in the enterprise for profit,

the purchasers, for the most part, lacked the knowledge, skill and equipment necessary for the care and cultivation of citrus trees. And while the purchasers were free to service the tracts themselves, or contract with a number of companies to service the tracts for them, the sales contract stressed the superiority of a Howey-related service company, Howey-in-the-Hills Service, Inc. (“HITH”), which purchasers of 85% of the acreage chose to service their tracts. The service contracts granted HITH full and complete possession of the acreage. Individual purchasers had no right of entry to market the crop, but shared in the profits of the enterprise, which amounted to 20% in the 1943-44 growing season. The Howey Company did not register the interests in the enterprise as securities. The SEC brought an action to enjoin the sale of the citrus grove interests. Because the interest at issue did not constitute any of the specific, traditional kinds of securities enumerated in Section 2(a)(1) of the Securities Act, the SEC argued that the interests were “investment contracts.” Noting that the term “investment contract” had not been defined by Congress but was widely used in state securities laws, the Supreme Court adopted the definition used by most state courts and held that an investment contract is a security under the Securities Act if investors purchase with (1) an expectation of profits arising from (2) a common enterprise that (3) depends “solely” for its success on the efforts of others. Applying this test, the Court found that the interests in the citrus grove sold by the Howey Company were “investment contracts,” and thus securities, subject to the Securities Act.

**RESALES OF RESTRICTED SECURITIES**

**SEC Rule 144**

Rule 144 created a safe harbor for the resale of securities under the exemption from registration provided in Section 4(1) of the Securities Act. “Rule 144 is not an exclusive safe harbor. A person who does not meet all of the applicable conditions of Rule 144 still may claim any other available exemption under the Act for the sale of the securities. The Rule 144 safe harbor is not available to any person with respect to any transaction or series of transactions that, although in technical compliance with Rule 144, is part of a plan or scheme to evade the registration requirements of the Act.” See the Preliminary Note to Rule 144.

Rule 144(i) limits the use of Rule 144 by former “shell companies” (See SEC Rule 12b-2 promulgated under the Exchange Act for the definition of a “shell company”) until the satisfaction of certain conditions, including, among other requirements, the filing of the “Form 10 Information” about an acquisition that results in the “shell company” no longer being deemed to be a “shell company” and the passage of 12 months from such filing, among other requirements.

In this respect, the SEC has stated “transactions in a blank check company securities by their promoters and affiliates...are not the kind of ordinary trading transactions between individual investors of securities already issued that Section 4(1) was designed to exempt.” ...“both before and after the business combination or transaction with an operating entity or other person, the promoters or affiliates of blank check companies, as well as their transferees, are ‘underwriters’ of the securities issued.... Rule 144 would not be available for resale transactions in this situation, regardless of technical compliance...because the resale transactions appear to be designed to distribute or redistribute securities to the public without compliance with the registration requirements of the Securities Act.” Note 165, Securities Act Release No. 33-8869, 17 CFR Part 230 and 239, Volume 72, No. 241, page 71557. See also NASD Regulation, Inc., CCH Federal Securities Law Reporter, 1990-2000 Decisions, Paragraph No. 77,681, the so-called “Worm-Wulff Letter,” which the SEC cited in this quotation. The amendments to Rule 144 that were effective on February 15, 2008, eliminated the need for the Worm-Wulff Letter and codified it in subparagraph (i) of Rule 144, to some extent.

The following is a summary table of the requirements of Rule 144, initially appearing in The Corporate Counsel:

**Rule 144 Table**

	Affiliate or Person Selling on Behalf of an Affiliate	Non-Affiliate (and has not been an Affiliate During the Prior Three Months)
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Restricted Securities of Reporting Issuers	<p><u>During six-month holding period</u> – no resales under Rule 144 Permitted.</p> <p><u>After Six-month holding period</u> – may resell in accordance with all Rule 144 requirements including:</p> <ul style="list-style-type: none"> <li>• Current public information,</li> <li>• Volume limitations,</li> <li>• Manner of sale requirements for equity securities, and</li> <li>• Filing of Form 144.</li> </ul>	<p><u>During six- month holding period</u> – no resales under Rule 144 permitted.</p> <p><u>After six-month holding period but before one year</u> – unlimited public resales under Rule 144 except that the current public information requirement still applies.</p> <p><u>After one-year holding period</u> – unlimited public resales under Rule 144; need not comply with any other Rule 144 requirements.</p>
Restricted Securities of Non-Reporting Issuers	<p><u>During one-year holding period</u> – no resales under Rule 144 permitted.</p> <p><u>After one-year holding period</u> – may resell in accordance with all Rule 144 requirements including:</p> <ul style="list-style-type: none"> <li>• Current public information,</li> <li>• Volume limitations,</li> <li>• Manner of sale requirements for equity securities, and</li> <li>• Filing of Form 144.</li> </ul>	<p><u>During one-year holding period</u> – no resales under Rule 144 permitted.</p> <p><u>After one-year holding period</u> – unlimited public resales under Rule 144; need not comply with any other Rule 144 requirements.</p>

**Section 4(1) of the Securities Act**

Section 4(1) provides an exemption from registration for the sale of securities under the Securities Act, as amended (the “Securities Act”) for transactions by any person other than “an issuer, underwriter, or dealer.” Material to this discussion is whether the seller of the securities is an “underwriter” within the meaning of Section 2(11) referenced above.

The leading case construing facts supporting the availability of Section 4(1) for the sale of the shares of common stock is Ackerberg v. Johnson, CCH Federal Securities Law Reporter, 1989-90 Dec., ¶194,850 (8th Cir. 1989).

In Ackerberg, the court was faced with, among other things, a demand for rescission by Ackerberg claiming that Johnson had sold securities in violation of the registration provisions of the Securities Act and was liable to him for damages. It was conceded that Mr. Johnson was the Chairman of the Board of the company whose securities were offered and sold by him to Ackerberg; and that he was

also the principal stockholder of that company.

The court stated that Mr. Johnson did not come within the definitions of an “issuer” or a “dealer” as set out in the Securities Act, but focused on whether Johnson was an “underwriter.” A determination that Johnson came within any of these definitions would make Section 4(1) unavailable to him.

*When considering whether Johnson is an underwriter, it is helpful to consider that the Section 4(1) exemption is meant to distinguish “between distribution of securities and trading in securities.” The Securities Act “was created to exempt routine trading transactions with respect to securities already issued and not to exempt distributions by issuers or acts of others who engage in steps necessary to such distributions.”*

The court outlined the definition of the term “underwriter,” and stated that “The congressional intent in defining ‘underwriter’ was to cover all persons who might operate as conduits for the transfer of securities to the public.” “Thus, ‘underwriter’ is generally defined in close connection with the definition and meaning of ‘distribution.’” In citing Ingenito v. Bermec Corp., the court quoted “it is apparent that to be an underwriter within the meaning of the ‘33 Act,’ one must participate, in some manner, in the distribution of the securities to the public.” The court concluded that a discussion of the term “underwriter” must focus upon “distribution.” The court also stated that the Section 4(1) exemption would be available if “(1) the acquisition of the securities was not made ‘with a view to’ distribution”; or (2) the sale was not made “for an issuer in connection with” a distribution.

The court further noted that “Relevant to both inquiries are whether the securities have come to rest in the hands of the security holder and whether the sale involves a public offering.”

In considering whether Johnson had acquired the shares with a view to their distribution, the court stated that “so long as Johnson initially acquired his shares from the issuer with an investment purpose and not for the purpose of reselling them, the acquisition was not made ‘with a view to’ distribution. The court then recited that many courts have accepted the “two year rule of thumb” for when securities have “come to rest,” and seemingly, the court adopted this premise. It citing U.S. v. Sherwood, (SDNY 1959) 175 F. Supp. 480, where the court denied a motion to punish for contempt and stated:

*The passage of two years before the commencement of distribution of any of the shares is an insuperable obstacle to my finding that Sherwood took these shares with a view to distribution thereof in the absence of any relevant evidence from which I could conclude he did not take the shares for investment.*

The philosophy of Judge Sugarman in the cited case was restated by Manual Cohen, a former Chairman of the SEC. At page 31 of Carlos Israels' "SEC Problems of Controlling Stockholders and in Underwritings," Mr. Cohen is quoted as having said:

*. . . and I believe I then said that I could not recall any case in which we have taken exception to a sale free of registration in any situation where a person who was not a professional had taken securities not with a view of distribution and then held them for more than two (2) years unless the circumstances of his sale or other facts warranted a different view.*

The 8th Circuit court also indicated that the two year rule had been adopted by the SEC in Rule 144, noting its safe harbor provisions, and favorably quoted Professor L. Loss who had previously noted that "a three year holding period is 'well nigh conclusive' that securities were acquired without a view to distribution." The court went on to say "Thus, Johnson held his shares for at least four years before selling them to Ackerberg, a period well in excess of the usual two years required to find that the securities have come to rest."

The second inquiry of the court was whether the resale of the securities was made "for an issuer in connection with" a distribution. The court stated "Whether the sale was 'for an issuer' can also be determined by whether the shares have come to rest. The best objective evidence of whether a sale is 'for an issuer' is whether the shares have come to rest."

It should also be noted that since the Ackerberg decision, the SEC, effective February 15, 2008, has adopted changes to Rule 144 that reduced the one year holding period of Rule 144 to six months for "reporting issuers" under the Exchange Act, as amended, and one year for "non-reporting issuers," though the provisions that took effect on that date limit the resale of securities in "shell companies" under the Rule. Regardless, the SEC's revisions to Rule 144 are further support of the fact that the shares have "come to rest" once held for the applicable holding periods of Rule 144. See the Rule 144 Table above.

### **Section 18 of the Securities Act on Covered Securities and the National Securities Improvement Act of 1996**

#### **Excerpt from Section 18**

*(4) Exemption in connection with certain exempt offerings. --A security is a covered security with respect to a transaction that is exempt from registration under this title pursuant to –*

*(A) paragraph (1) or (3) of section 4, and the issuer of such security files reports with the Commission pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934;*

*(B) section 4(4);*

*(C) section 3(a), other than the offer or sale of a security that is exempt from such registration pursuant to paragraph (4), (10), or (11) of such section, except that a municipal security that is exempt from such registration pursuant to paragraph (2) of such section is not a covered security with respect to the offer or sale of such security in the State in which the issuer of such security is located; or*

*(D) Commission rules or regulations issued under section 4(2), except that this subparagraph does not prohibit a State from imposing notice filing requirements that are substantially similar to those required by rule or regulation under section 4(2) that are in effect on September 1, 1996.*

*(c) Preservation of Authority. –*

*(1) Fraud authority. --Consistent with this section, the securities commission (or any agency or office performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.*

*(2) Preservation of filing requirements. –*

*(A) Notice filings permitted. --Nothing in this section prohibits the securities commission (or any agency or office performing like functions) of any State from requiring the filing of any document filed with the Commission pursuant to this title, together with annual or periodic reports of the value of securities sold or offered to be sold to persons located in the State (if such sales data is not included in documents filed with the Commission), solely for notice purposes and the assessment of any fee, together with a consent to service of process and any required fee.*

### **National Securities Improvement Act of 1996**

This National Securities Improvement Act of 1996 is a codification of Section 18, or vice versa. It exempts:

- Registered investment companies and certain securities listed on nationally-recognized stock exchanges.
- Offers and sales to “qualified purchasers.”
- Certain resale transactions under Section 4 of the Securities Act, including but not limited to those in Sections 4(1), 4(3) and 4(4), though in some instances, the filing with states of reports filed with the SEC during the past year may be required, along with state required notices and fees.
- SEC Rule 506 offerings, though states may still require a notice filing and a fee and have the power to require registration or suspend offerings for which notices have not been filed.
- States also retain jurisdiction and the power to enforce their own laws, including anti-fraud laws, rules and regulations.

### **GOVERNMENTAL WEBSITES**

<p><b>Federal:</b> <a href="http://www.sec.gov">www.sec.gov</a></p> <p>The information available on this website is invaluable and includes, among other information:</p> <ul style="list-style-type: none"> <li>• Information about the SEC, offices, divisions and contact information.</li> <li>• Access to company filings and forms of the SEC.</li> <li>• Regulatory Actions.</li> <li>• Staff interpretations, FAQ's, bulletin and no-action letters.</li> <li>• Investor information.</li> <li>• News and public statements.</li> <li>• Litigation and enforcement.</li> </ul>	<p><b>State of Utah:</b> <a href="http://www.securities.gov/staff">www.securities.gov/staff</a></p> <p>The information available on this website is invaluable and includes, among other information:</p> <ul style="list-style-type: none"> <li>• Corporate Finance.</li> <li>• Licensing.</li> <li>• Enforcement.</li> <li>• Investor information.</li> <li>• Securities library, including all current and proposed rules, the Utah Uniform Securities Act, interpretive opinions, no action letters, attorney general's opinions, forms, fee schedules and much more.</li> <li>• Table of all exemptions from registration.</li> </ul>
<p style="text-align: center;"><b>A FEW PRACTICAL TIPS</b></p> <ul style="list-style-type: none"> <li>• Mere technical compliance with the letter of the law will mean little where actions demonstrate a “public distribution” of securities that is not registered or exempt under federal and state securities laws, rules and regulations and that brings the issuers or sellers of these securities within the definition of an “underwriter” under Section 2(11) thereof. Every resale also needs an exemption.</li> <li>• Do not represent just anyone in securities transactions. If your client violates the law, you may be implicated.</li> <li>• Conduct extensive due diligence on any client that intends to raise funds from the public, regardless of whether the offer and sale is to be made only to “accredited investors” and “sophisticated investors.” Coming within either of these definitions does not necessarily mean that the person is knowledgeable.</li> <li>• If there is a question as to whether the transaction involves the sale of a “security,” register the transaction or the security or seek an exemption from registration at the federal and state level. Neither of these processes is very difficult, though registration is time intensive, costly in terms of legal and accounting fees and may take some time to have the registration statement declared effective.</li> <li>• If the security sought to be sold is complex, confusing or not easily understandable for an ordinary investor, this may be a red flag that the investment is a scheme or artifice to defraud. Many of the sophisticated investors in the “Madoff” scheme did not understand his investment strategy or program and invested regardless.</li> <li>• Be suspicious of promoters who ask for your services to review an offering or disclosure document that they have prepared,</li> </ul>	

indicating that all they require is your review and advice on the sufficiency of the document.

- Do not be too creative in finding ways to get around the applicability of securities laws, rules and regulations; you cannot go around the block to avoid the issue.
- Regardless of whether a disclosure statement is required for potential investors, always provide access to all material information and give the potential investors adequate time to assimilate the information.
- If there is a real question, assume the transaction involves the sale of a “security” and utilize Rule 506 to the extent possible.