



2-14-1986

Seminar on Securities Law

Office of Continuing Legal Education at the University of Kentucky College of Law

James A. Kegley
Greenebaum Doll & McDonald

H. Alexander Campbell
Wyatt, Tarrant & Combs

Gary L. Stage
Stoll, Keenon & Park

Ralston W. Steenrod
Stites & Harbison

See next page for additional authors

[Click here to let us know how access to this document benefits you.](#)

Follow this and additional works at: https://uknowledge.uky.edu/uky_cle

 Part of the [Securities Law Commons](#)

Repository Citation

Office of Continuing Legal Education at the University of Kentucky College of Law; Kegley, James A.; Campbell, H. Alexander; Stage, Gary L.; Steenrod, Ralston W.; Strode, James C.; Ross, Robert P.; Martin, Gerald R.; Trower, C. Christopher; Ham, Willburt D.; Paul, Ronda S.; Marting, Rodger A.; Persons, Oscar N.; Marciniak, Francesca; Davis, O. Wayne; and Campbell, Rutheford B. Jr., "Seminar on Securities Law" (1986). *Continuing Legal Education Materials*. 15.
https://uknowledge.uky.edu/uky_cle/15

Authors

Office of Continuing Legal Education at the University of Kentucky College of Law, James A. Kegley, H. Alexander Campbell, Gary L. Stage, Ralston W. Steenrod, James C. Strode, Robert P. Ross, Gerald R. Martin, C. Christopher Trower, Willburt D. Ham, Ronda S. Paul, Rodger A. Marting, Oscar N. Persons, Francesca Marciniak, O. Wayne Davis, and Rutheford B. Campbell Jr.

SEMINAR
ON
SECURITIES LAW
FEBRUARY 14-15, 1986



Presented by the
OFFICE OF CONTINUING LEGAL EDUCATION
UNIVERSITY OF KENTUCKY COLLEGE OF LAW

In Cooperation with the
KENTUCKY BAR ASSOCIATION
CONTINUING LEGAL EDUCATION COMMISSION

TABLE OF CONTENTS

SCHEDULE OF SEMINAR ON SECURITIES LAW

OUTLINES OF SPEAKERS' PRESENTATIONS

OVERVIEW OF THE FEDERAL SECURITIES LAWS AND THE DEFINITION OF A SECURITY

James A. KegleyA, 1 - 12

REGULATION OF PUBLIC OFFERING UNDER THE 33 ACT AND THE KENTUCKY SECURITIES ACT

H. Alexander CampbellB, 1 - 38

REGULATION OF PUBLICLY HELD COMPANIES UNDER THE 34 ACT

Gary L. StageC, 1 - 22

THE INITIAL PUBLIC OFFERING - TAKING A COMPANY PUBLIC

Ralston W. Steenrod, ChairpersonD, 1 - 3

James C. Strobe

Lawrence L. Pedley

Gerald R. Martin

FINANCING TRANSACTIONS THROUGH THE USE OF EXEMPTIONS FROM REGISTRATION

C. Christopher TrowerE, 1 - 8

INSIDER TRADING

Willburt D. HamF, 1 - 30

COMPLIANCE WITH STATE BLUE SKY PROVISIONS

Ronda S. Paul, ChairpersonG, 1a- 20a

O. Wayne DavisG, 1b

Rodger A. MartingG, c

Francesca MarciniakG, 1d- 15d

THE ANTI-FRAUD PROVISIONS OF THE 33 AND 34 ACTS

Oscar N. PersonsH, 1 - 23

SALE OF SECURITIES BY CONTROL PERSONS: DEFINITION OF CONTROL, PLEDGES, REALES AND OTHER PROBLEMS UNDER THE 33 ACT

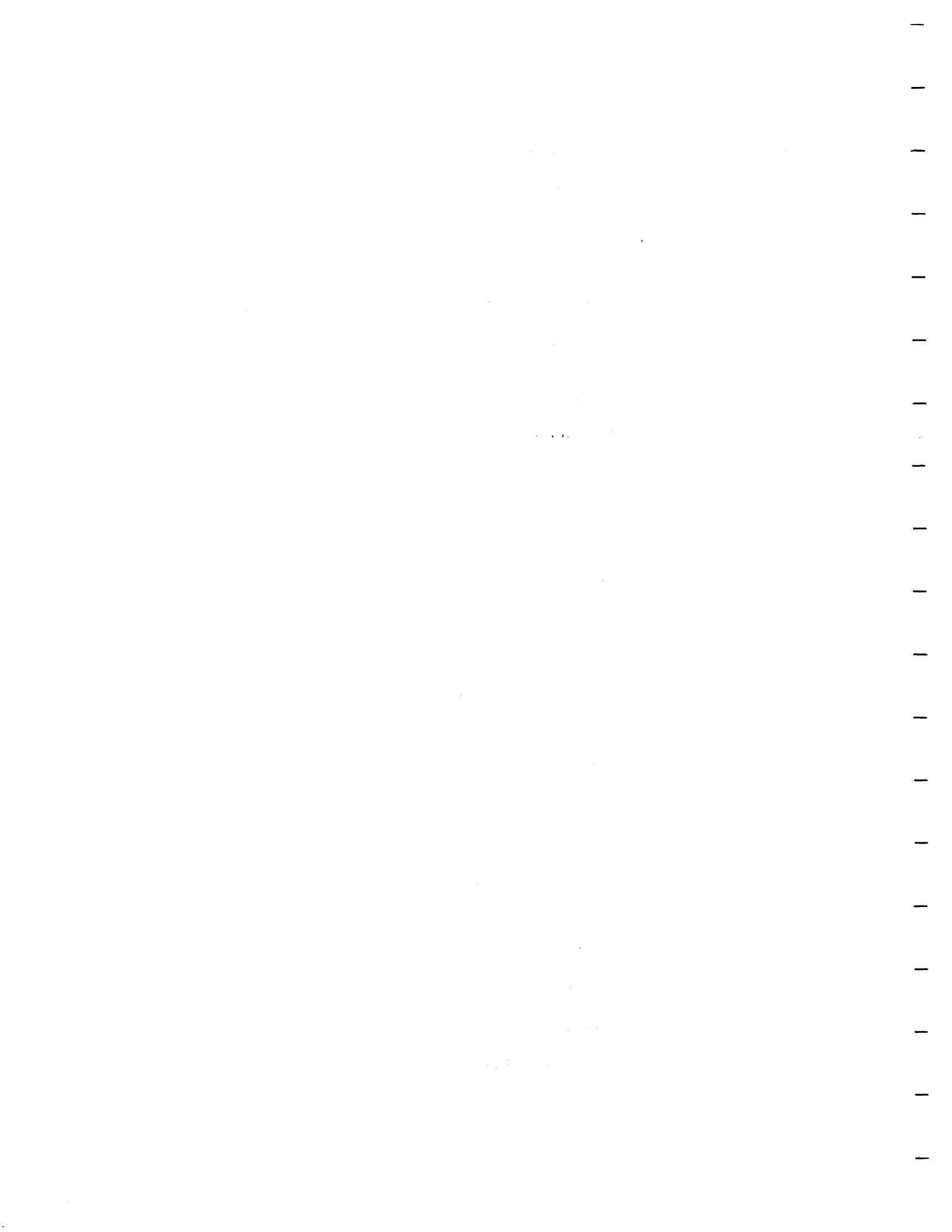
Rutheford B Campbell, Jr.I, 1 - 15

PRE-REGISTRATION LIST

PUBLICATIONS AVAILABLE FOR SALE

ORDER FORM FOR PUBLICATIONS

FUTURE CONTINUING LEGAL EDUCATION PROGRAMS SCHEDULED



SEMINAR
ON
SECURITIES LAW
FEBRUARY 14-15, 1986

FRIDAY, FEBRUARY 14, 1986

- 8:00 a.m. LATE REGISTRATION, Courtroom, College of Law Building.
- 8:55 a.m. WELCOME, John K. Hickey, Director, Continuing Legal Education, College of Law, University of Kentucky.
- CHAIRMAN-MODERATOR, Richard A. Getty, Greenebaum Doll & McDonald, Lexington, Kentucky.
- 9:00 a.m. OVERVIEW OF THE FEDERAL SECURITIES LAWS AND THE DEFINITION OF A SECURITY. James A. Kegley, Greenebaum Doll & McDonald, Lexington, Kentucky.
- 9:50 a.m. REGULATION OF PUBLIC OFFERINGS UNDER THE 33 ACT AND THE KENTUCKY SECURITIES ACT. H. Alexander Campbell, Wyatt, Tarrant & Combs, Louisville, Kentucky.
- 10:40 a.m. BREAK
- 10:55 a.m. REGULATION OF PUBLICLY HELD COMPANIES UNDER THE 34 ACT. Gary L. Stage, Stoll, Keenon & Park, Lexington, Kentucky.
- 11:45 a.m. THE INITIAL PUBLIC OFFERING - TAKING A COMPANY PUBLIC.
Panel Discussion
- Ralston W. Steenrod, Chairperson, Stites & Harbison, Louisville, Kentucky;
James C. Strode, Sturgill, Turner & Truitt, Lexington, Kentucky;
Lawrence L. Pedley, Ross, Zeilke & Gordinier, Louisville, Kentucky;
Gerald R. Martin, J.J.B. Hilliard, W.L. Lyons, Inc., Louisville, Kentucky.
- 12:30 p.m. LUNCHEON, President's Room, Student Center
SIGNIFICANT CORPORATE AND TAKEOVER DEVELOPMENTS - THE POISON PEN AND OTHER DEFENSES. R. Franklin Balotti, Richards, Layton & Finger, Wilmington, Delaware.
- 1:45 p.m. FINANCING TRANSACTIONS THROUGH THE USE OF EXEMPTIONS FROM REGISTRATION. C. Christopher Trower, Brown, Todd & Heyburn, Louisville, Kentucky.
- 2:35 p.m. INSIDER TRADING. Willburt D. Ham, Professor, College of Law, University of Kentucky, Lexington, Kentucky.

3:25 p.m. BREAK

3:40 p.m. COMPLIANCE WITH STATE BLUE SKY PROVISIONS. Panel Discussion

Ronda S. Paul, Chairperson, Director, Division of Securities, Department of Financial Institutions, Frankfort Kentucky;
O. Wayne Davis, Commissioner of Securities, Indianapolis, Indiana;
Rodger A. Marting, Commissioner of Securities, Columbus, Ohio;
Francesca Marciniak, Director, Division of Securities, Springfield, Illinois.

5:00 p.m. RECESS

5:00-8:00 p.m. Cocktail Reception: Bodley-Bullock House, Lexington, Kentucky, Hosted by David E. Schon, Chas. P. Young Co., Chicago.

SATURDAY, FEBRUARY 15, 1986

9:00 a.m. THE ANTI-FRAUD PROVISIONS OF THE 33 AND 34 ACTS. Oscar M. Persons, Alston & Bird, Atlanta, Georgia.

9:50 a.m. SALE OF SECURITIES BY CONTROL PERSONS: DEFINITION OF CONTROL, PLEDGES, RESALES AND OTHER PROBLEMS UNDER THE 33 ACT. Rutheford B Campbell, Jr., Professor, College of Law, University of Kentucky, Lexington, Kentucky.

10:40 a.m. BREAK

10:55 a.m. REGULATION OF BROKER-DEALERS, INVESTMENT ADVISERS AND FINANCIAL PLANNERS. Panel Discussion

Charles C. Mihalek, P.S.C., Chairperson, Attorney-at-Law, Lexington, Kentucky;
James A. Kegley, Greenebaum Doll & McDonald, Lexington, Kentucky;
C. Prewitt Lane, Jr., Chartered Financial Analyst, Todd Investment Advisors, Louisville, Kentucky.

12:00 noon ADJOURN

OVERVIEW OF THE FEDERAL
SECURITIES LAWS AND
THE DEFINITION OF A SECURITY

James A. Kegley
Greenebaum Doll & McDonald
1400 Vine Center Tower
P.O. Box 1808
Lexington, Kentucky 40593



I. OVERVIEW OF THE FEDERAL SECURITIES LAWS

- A. Federal Jurisdiction. Federal jurisdiction over transactions involving securities is based on Congress' power to regulate interstate commerce. Federal securities laws therefore apply to all transactions involving a security which uses "any means or instruments of transportation or communication in interstate commerce or of the mails." Securities Act of 1933, §5.
1. Federal jurisdiction over securities has been expansively applied to include intrastate use of the mails and intrastate telephone calls to accomplish any portion of a transaction.
- B. The Securities Act of 1933. The "Securities Act" or the "'33 Act" has two basic objectives:
1. To provide investors with material financial and other information concerning securities offered for public sale, generally through a formal registration statement filed with the Securities and Exchange Commission ("SEC") and distributed to investors; and
 2. To prohibit misrepresentation, deceit and other fraudulent acts and practices in the sale of securities generally (whether or not the securities are required to be registered).
 3. Every offering of securities, regardless of size must be registered with the SEC, or an exemption must be found.
 4. The '33 Act contains civil and criminal penalties against issuers, persons signing a registration statement, underwriters, accountants, "or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared any part of the registration statement." Securities Act of 1933, §11(a)(4).
- C. The Securities Exchange Act of 1934. The "Exchange Act" or the "'34 Act" extended the "disclosure doctrine" of investor protection to securities

listed and registered for public trading on national exchanges. Amendments in 1964 applied periodic reporting requirements to securities not traded on a national exchange when the issuer is a company having 500 or more shareholders and assets exceeding \$3 million.

1. The '34 Act requires companies to register securities to be traded on a national exchange such as the American Stock Exchange, or the New York Stock Exchange. Following this registration, which is distinct from the registration provisions of the '33 Act, company issuers must file annual and other periodic reports to keep the Commission's information current.
2. Proxy solicitations from holders of securities registered under the '34 Act are also governed.
3. The '34 Act contains provisions limiting "margin trading", or the amount of credit that may be granted for the purchase of securities.
4. The '34 Act also provides a system for regulating trading practices in the national exchanges and over-the-counter markets to curb market manipulations and other fraudulent practices.
5. Importantly, the registration and regulation of broker-dealers are prescribed by the '34 Act.
 - a. "Broker" is defined in §3(4) as "any person engaged in the business of effecting transactions in securities for the account of others".
 - b. A "dealer" is "any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise,... or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity but not as a part of a regular business." §3(5).

6. Civil and criminal actions are available under the '34 Act.

D. Other Federal Securities Laws:

1. The Trust Indenture Act of 1939 governs bonds, debentures, notes and other debt securities. The basic purpose of the TIA is to provide an independent trustee to enforce the rights of debt holders. TIA prescribes minimum standards of independence and trustee responsibility.
2. The Investment Company Act of 1940 governs the activities of companies engaged primarily in the business of investing, reinvesting and trading in securities. The Act requires such companies to register with the SEC and to disclose their financial condition and investment policies.
3. The Investment Advisers Act of 1940 established registration requirements for investment advisers similar to the broker-dealer registration provisions of the '34 Act. The Act governs persons or firms who, for compensation, advise others about securities transactions. Anti-fraud provisions and rules thereunder are designed to prevent fraudulent or manipulative practices, including a requirement that investment advisers disclose to investors their interest in transactions executed on behalf of a client.
4. The Securities Investor Protection Act of 1970 created the Securities Investor Protection Corporation ("SIPC") to supervise the liquidation of securities firms in financial distress.

II. DEFINITION OF "SECURITY"

- A. A "security" is defined in §2(1) of the Securities Act of 1933 as:

"[A]ny note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, 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, in general any interest or instrument commonly known as a "security".

1. The Securities Exchange Act of 1934 §3(10) contains a definition substantially the same as the above.
2. The definition of "security" has been construed expansively and "embodies a flexible rather than static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others for the promise of profits," Tcherepnin v. Knight, 389 U.S. 332, 338 (1967); S.E.C. v. W.J. Howey Co., 328 U.S. 293, 299 (1946); United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 848 (1975).

B. The Early Cases: "Investment Contracts" under the Howey Test.

1. The definition of a security in §2(1) includes a list of specific instruments, followed by the generic label of "investment contract". The early cases considering the definition of "security" construed the meaning of "investment contracts".
2. The Supreme Court defined investment contracts as:

[A] contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

W.J. Howey Co., supra at 298-99. The Court will look to the "economic reality" of the specific transaction. See Forman, supra, at 848.

3. The Howey test, summarized, consists of four elements:
- a. "An investment of money", (or other consideration).
 - b. "In a common enterprise." The "commonality" of a given enterprise has been analyzed in two ways:
 - (i) The Third, Sixth and Seventh Circuit Courts of Appeal have required the presence of "horizontal" commonality, defined as the pooling of capital, received by a promoter from multiple investors. See Salcer v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 682 F.2d 459 (3rd Cir. 1982); Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 622 F.2d 216 (6th Cir. 1980), aff'd on other grounds, 456 U.S. 353 (1982); Milnarik v. M-S Commodities, 457 F.2d 274 (7th Cir.), cert. denied, 409 U.S. 887 (1972).
 - (ii) The Tenth Circuit Court of Appeals has rejected the more stringent "horizontal" commonality test, ruling that a security may be present when there is only one investor. This latter view is the "vertical commonality" approach. See McGill v. American Land & Exploration Co., Tenth Circuit, No. 84-1932 (Nov. 12, 1985).
 - (iii) The Supreme Court has never decided whether horizontal commonality is required before a joint venture may be a "common enterprise" under the Howey test. See Mordaunt v. Incomo, U.S. , 105 S.Ct. 801 (1985) (White, J. dissenting from denial of certiorari).

- c. "With an expectation of profit."
"Profit" has been construed by the Supreme Court to mean either:
- (i) "capital appreciation resulting from the development of the initial investment." Forman, supra; S.E.C. v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943).
 - (ii) "participation in earnings resulting from the use of investors' funds." Forman, supra; Tcherepnin, supra.
 - (iii) Tax losses alone, do not constitute "profits".
- d. "Solely from the efforts of the promoter or a third party". This element was later expanded by the Court in Forman to include "a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." Forman, supra at 852.
4. Examples of transactions held to be "securities" under the Howey and Forman tests:
- a. A contract to bottle and sell whiskey and pay the contract holders the proceeds less expenses. The Penfield Co. of California v. S.E.C., 143 F.2d 746 (9 Cir. 1944), cert. denied 323 U.S. 768 (1944).
 - b. Interests in citrus groves, including cultivation of the land, selling the fruit, and paying net income to investors. S.E.C. v. W.J. Howey Co., 328 U.S. 293 (1946).
 - c. Coin investing programs. S.E.C. v. Comstock Coin Co., CCH Fed. Sec. Law Rep. ¶91,414 (D.C. Nev. 1964).
 - d. Sale of condominium units tied to an agreement to perform rental and other services for the purchaser. SEC Release No. 33-5347 (1973), CCH ¶79,163.

- e. Multi-level "franchise" deals now referred to as "pyramid" schemes. S.E.C. v. Koscot Interplanetary, Inc., 497 F. 2d 473 (5th Cir. 1974); S.E.C. v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476 (9 Cir. 1973) cert. denied, 414 U.S. 821 (1973).
 - f. Contracts to care for and sell offspring of fur-bearing animals. Continental Marketing Corp. v. S.E.C., 387 F.2d 466 (10th Cir. 1967), cert. denied, 391 U.S. 905 (1968).
 - g. Cattle shelter programs relying primarily on efforts of the promoters. American Dairy Leasing Corp., CCH ¶78,584 (1971).
 - h. Land purchase contracts guaranteeing a fixed rate of return. S.E.C. v. Lake Havasu Estates, 314 F. Supp. 1318 (D.C. Minn. 1972).
- C. Stock as "stock" within the §2(1) definition: United Housing Foundation, Inc. v. Forman, 421 U.S. 837. Whereas securities bearing the name "stock" will almost always be deemed to be a security, the U.S. Supreme Court has adopted an "economic reality" test to exclude so called "stock" when the instrument does not bear the usual characteristics of stock.
- 1. The "stock" in the Forman case evidenced shares in a government-financed housing cooperative. By its own terms the stock could never appreciate in value, no dividends were paid, there were no voting rights associated with the proportion of share ownership and shares could not be negotiated, pledged or hypothecated.
 - 2. Since the instruments lacked the characteristics normally associated with stock, Tcherepin v. Knight, 389 U.S. 332 (1967), and the purchasers lacked the requisite investment motive, the Forman Court held that these instruments were not securities despite the fact that they carried the label "stock".
 - a. Purchasers of the "stock" were buying a home, not an investment.

- b. When the thing being purchased is primarily for personal use or consumption, and not for investment, the "economic reality" test of Forman should be applied.
- D. Notes, Bonds and Debentures: The Howey Test Falls Short.
- 1. The Howey test generally does not apply to these instruments, although a conclusive substitute test remains elusive. The courts have not applied the literal definition of §2(1) to these instruments, instead reading the term "note" very narrowly. See Lino v. Investing Co. 487 F.2d 6891 (3rd Cir).
 - 2. The common case of a consumer credit purchase, whereby a purchaser of merchandise gives a note in partial payment would typically be exempt from registration as a private transaction. However, if this note is a "security", the anti-fraud provisions of the '33 Act would still apply.
 - a. The several courts of appeal have developed their own analysis to soften the literal application of the securities laws as in the above consumer transaction.
 - b. The courts have applied the introductory "context" clauses of §2 of the '33 Act, and §3(a) of the '34 Act, to exclude "notes" from the definition of "security" where "the context otherwise requires." See Joseph v. Norman's Health Club, 336 F. Supp. 307 (D. Mo. 1977).
 - c. Further, §3(3) of the '33 Act exempts from the definition of "security" most notes having a maturity of less than nine months, including commercial paper.
 - 3. The Fifth Circuit has ruled that notes issued in "commercial" transactions are not "securities", making a distinction

between "investment" purposes and "commercial" motives in the issuance of a note. McClure v. First Nat'l Bank, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶93, 986 (N.C. Tex. 1973), aff'd 497 F.2d 490 (5th Cir. 1974), cert. denied 420 U.S. 930 (1975).

- a. Under this test most bank notes "issued" by a borrower in a commercial transaction, would not come within the definition of a security.
 - b. The rationale for this test is that banks and other commercial lenders do not require the additional protections of the securities laws, which were primarily intended for the investing public. See Marine Bank v. Weaver, 455 U.S. 551 (1982) (holding that a certificate of deposit is not a security, noting that bank CD's are subject to a comprehensive set of banking regulations, including FDIC insurance).
4. The Ninth Circuit has adopted a similar test, inquiring whether one has invested "risk capital" or not. Funds are deemed to be risk capital when the payment of interest and the repayment of the notes is dependent on the entrepreneurial activities of the issuer. Great W. Bank & Trust v. Kotz, 532 F.2d 1252 (9th Cir. 1976).
- a. "Equity kicker" loans fall into the category of "risk capital" since returns are contingent to a certain extent on the profits of the borrower.
 - b. The typical secured loan executed in a commercial transaction generally would not meet the risk capital test.
5. The Second Circuit focused on the distinction between long term and short term notes (the latter being exempted securities in §3(5)), and created a list of exempt notes not ordinarily deemed to be "securities". Exchange Nat'l Bank v. Touche Ross, 544 F.2d 1126, 1137-38 (2d Cir. 1976):

- (i) Notes which are a part of a consumer financing transaction;
 - (ii) business loans by commercial banks for current operations regardless of the length of maturity. See Chemical Bank v. Arthur Anderson & Co., 726 F.2d 930 (2d Cir. 1984).
 - (iii) home real estate loans.
 - (iv) unsecured character loans made by a bank.
 - (v) short term notes secured by receivables or other business assets.
 - (iv) open account indebtedness converted into a note.
- b. The Second Circuit extended the above exemption to any note bearing a "strong family resemblance" to the exempt notes listed.
6. The following guidelines may be gleaned from the cases construing when a "note" constitutes a "security". Bloomenthal, 3 Securities and Federal Corporate Law §2.03[1]:
- (1) Notes issued to finance companies or banks are not securities under the federal securities laws. Chemical Bank v. Arthur Anderson & Co., 726 F.2d 930 (2d Cir. 1984). C.N.S. Enterprises, Inc. v. G & G Enterprises, Inc., 502 F.2d 1354 (7th Cir. 1975); Avenue State Bank v. Tourtelot, 379 F. Supp. 250 (N.D. Ill. 1974).
 - (2) Notes issued in mercantile transactions, and in particular as part of a transaction for the purchase of consumer goods on credit, are not securities. C.N.S. Enterprises., supra; Lino v. City Investing Co., supra; Rosen v. Dick [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,786 (S.D.N.Y. 1974). See also Alberto Culver

Co. v. Scherk, 484 F.2d 611 (7th Cir. 1973), rev'd on other grounds 94 S. Ct. 2449 (1974). Similarly, notes issued as part of the credit arrangement for the purchase of real estate in a conventional real estate transaction probably are not securities. Oxford Fin. Cos. v. Harvey, 385 F. Supp. 431 (E.D. Pa. 1974); Chess v. Nieport, 386 F. Supp. 312 (E.D. Cal. 1974); C.N.S. Enterprises, Inc., supra.

- (3) Notes issued by a private party rather than a corporation are less likely to be a security provided they are issued in commercial transactions rather than to finance a business enterprise. Lino v. City Investing Co., *supra*; Zabriskie v. Lewis, 507 F.2d 546 (10th Cir. 1974). Compare Llanos v. United States, 206 F. 2d 852 (9th Cir. 1953), cert. denied 346 U.S. 923#(1954).
- (4) Actions by a maker-borrower relating to fraud intrinsic to what was received rather than to the note of the maker are more likely to result in a holding of no security.

E. The Demise of the Sale of Business Doctrine.

1. A doctrine developed under the Howey and Foreman cases whereby the purchase of a controlling interest in a business through the sale of stock, was not considered the sale of a "security" See e.g., Canfield v. Rapp & Sons, Inc. 654 7.2d 459 (7th Cir. 1981).
 - a. The rationale for the doctrine was that a purchaser of a controlling interest in a business possesses entrepreneurial motives, and is not the passive investor that the securities laws were primarily aimed at protecting.
2. The sale of business doctrine and its rationale were rejected by the Supreme Court in Landreth Timber Co. v. Landreth, ___ U.S. ___, 105 S.Ct. 2297 (1985).

3. The Court in Landreth reviewed a private action based on Rule 10b-5 of the '34 Act claiming rescission and \$2.5 million in damages. The plaintiff was a tax attorney who, with a partner, had purchased all the stock in a lumber company. The defendant sellers claimed that plaintiff had no cause of action under the securities laws because the stock sold in the transaction fell outside the definition of "security". The Court found for plaintiff on the definition issue, stating:

[W]e cannot agree with the respondents that the Acts were intended to cover only "passive investors" and not privately negotiated transactions involving the transfer of control to "entrepreneurs." Id.

4. The Court also identified difficulty in determining the line between a passive investor and one exercising "control" over a business in cases where less than 100% of the company's stock was sold.

REGULATION OF PUBLIC
OFFERINGS UNDER THE '33 ACT
AND THE KENTUCKY SECURITIES ACT

H. Alexander Campbell
Wyatt, Tarrant & Combs
Louisville, Kentucky

I. INTRODUCTION AND OVERVIEW

A. Marketing the Public Offering

1. Underwriting
2. Underwriting/selling arrangements
 - a. Letter of intent
 - b. Underwriting agreement
 - c. Selected dealers agreement
 - d. Agreement among underwriters

B. Sources of Regulation of the the Public Offering

1. Federal securities laws
2. State securities ("blue sky") laws
3. National Association of Securities Dealers rules

II. REGULATION OF PUBLIC OFFERINGS UNDER THE SECURITIES ACT OF 1933 (15 U.S.C. 77a et seq.)

A. The Statutory Core -- Section 5

1. Section 5(a): the "registration" requirement

"Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly --

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise, or

(2) to carry or cause to be carried through the mails or in interstate commerce, by means or instruments of transportation, any such security for the purpose of sale or for delivery after sale."

2. Section 5(b): the "conforming prospectus" and "prospectus delivery" requirements

"It shall be unlawful for any person, directly or indirectly --

(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 (the '33 Act), unless such prospectus meets the requirements of section 10, or

(2) to carry or cause to be carried through the mails or in 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."

3. Section 5(c): the "gun-jumping" prohibition

"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 or examination under section 8."

B. Statutory Registration Provisions -- Sections 6, 7, 8, 10, 18, 19(a), and 23

1. Section 6 -- the barebones of registration

- a. "Any security may be registered ... by filing a registration statement...."
 - b. "A registration statement shall be deemed effective only as to the securities specified therein as proposed to be offered."
 - c. Required signatures (and resulting liabilities) of issuer, principal executive officer, principal financial officer, principal accounting officer, and majority of Board (or equivalent)
 - d. Registration Fee: 20¢ per \$1,000
2. Section 7 -- content of registration statement
- a. Statutory disclosure schedules:
 - (1) Schedule A -- applicable to all issuers other than foreign governmental issuers
 - (2) Schedule B -- applicable to foreign governmental issuers
 - b. A "registration statement shall contain such other information, and be accompanied by such other documents, as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors" -- specific authority (among other sources) for SEC's adoption of disclosure rules, forms, industry guides, etc. that shape and standardize disclosure
 - c. Consents required of named accountants, engineers, appraisers, and experts (including attorneys) -- resulting liabilities
3. Section 8 -- time of effectiveness and stop orders
- a. The nominal 20-day effectiveness rule and the delaying effect of amendments

- b. Post-effective amendments
 - c. The SEC's ultimate "stop-order" authority:
 - (1) Grounds for inquiry: "If it appears to the Commission at any time that the registration statement includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading...."
 - (2) Notice and opportunity for hearing
 - (3) Related investigative authority
4. Section 10 -- content of prospectus
- a. Statutory disclosure schedules -- Schedules A and B, with exception of items pertinent to registration statement *per se*
 - b. The SEC's delegated authority:
 - (1) In general: a "prospectus shall contain such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors."
 - (2) Classification powers: The SEC may "classify prospectuses according to the nature and circumstances of their use or the nature of the security, issue, issuer, or otherwise, and by rules and regulations and subject to such terms and conditions as it shall specify therein, ... prescribe as to each class the form and contents which it may find appropriate and consistent with the public interest and the protection of investors."

Preliminary prospectus for
waiting period -- Rule 430

Summary prospectus where permitted by applicable registration form -- Rule 431

- c. Statutory staleness -- a prospectus used more than nine months after effective date must contain information as of a date not more than sixteen months prior to use
- 5. Section 18 -- Nothing in '33 Act shall affect the jurisdiction of state authorities over any security or person
- 6. Section 19(a) -- SEC given authority to adopt "such rules and regulations as may be necessary to carry out the provisions of (the '33 Act), including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in" the '33 Act
- 7. Section 23 -- Fact that registration statement is filed or in effect, or fact that no stop order is in effect, (i) does not constitute an SEC finding that the registration statement is true or accurate even on its face or is not defective, and (ii) shall not be held to mean that the SEC has in any way passed upon the merits of, or approved, the security. Any representation to the contrary is unlawful

C. Preparation of the Registration Statement

1. Registration "Forms"

Given "Rule" status by Rule 130. Current Forms most frequently utilized (excluding, e.g. Forms for registering investment company or foreign private issuer securities, ADR's, etc.):

S-1 -- general form for use where no other form prescribed or available (e.g., S-2 or S-3)

See Attachment 1 to this outline for text of Form S-1

S-2 -- generally, available for any U.S. company with a class of securities registered under Section 12 of the '34 Act or reporting pursuant to Section 15(d) of the '34 Act that has been reporting under the '34 Act for at least three years

S-3 -- generally, available for companies meeting requirements for Form S-2 which also have a "float" of \$150,000,000 or of \$100,000,000 and annual trading volume of 3,000,000 shares or are offering "investment grade" debt or straight preferred

S-4 -- generally, available for offerings in connection with certain reclassifications, mergers, consolidations, asset sales, and exchange

S-8 -- generally, available for offerings to employees under employee-benefit plans by certain '34 Act reporting companies

S-11 -- mandatory for offerings by certain real estate issuers -- REIT's, limited partnerships, etc.

S-18 -- generally, available for certain offerings not exceeding \$7,500,000 by certain non-reporting issuers (other than investment or insurance companies)

2. Regulation S-K -- "Standard Instructions For Filing Forms Under Securities Act of 1933 and Securities Exchange Act of 1934"

See Attachment 2 to this outline for list of items in Regulations S-K

3. Securities Act Industry Guides if issuer is in one of the industries covered by the five current Guides

See Attachment 3 to this outline for list of Securities Act Industry Guides

4. Regulation C (Rules 400 - 499)

See Attachment 4 to this outline for list of Rules in Regulation C

5. Regulation S-X -- "Form and Content of and Requirements for Financial Statements."

See Attachment 5 to this outline for list of Rules in Regulation S-X

D. Filing and SEC Processing of the Registration Statement

1. Filing
 - a. Place of filing
 - b. Mechanics
 - c. Delaying amendment - Rule 473
2. Staff review and comment
3. Material amendment
 - a. Distribution of preliminary prospectus ("red herring") - Rule 130
 - b. "Tombstone" prospectus - Rule 134
 - c. Organization of selling group
4. Effectiveness
 - a. Pricing amendment
 - b. Request for acceleration of effectiveness - Rule 461
 - c. NASD clearance
 - d. Effectiveness amendment

E. Post-Effective Selling Effort

1. Distribution of definitive prospectus
 - a. Section 4(3) of '33 Act
 - b. Rule 174 exceptions

2. Stabilization
3. Rule 10b-6 constraints on market makers and affiliates

F. Post-Effective Reporting

1. Prospectus copies - Rule 424(b)
2. Sales and use-of-proceeds reports - Form SR-Rule 463
3. '34 Act Reporting - Section 15(d) of '34 Act
4. '34 Act Registration - Section 12(g) of '34 Act

III. REGULATION OF PUBLIC OFFERINGS UNDER THE SECURITIES ACT OF KENTUCKY (KRS CHAPTER 292)

A. The Registration Requirement -- KRS 292.340

"It is unlawful for any person to offer or sell any security in this state, except securities exempt under KRS 292.400 or when sold in transactions exempt under KRS 292.410, unless such security is registered under this chapter."

B. Registration -- KRS 292.350 -.390

1. Three types of registration permitted: registration by notification, by coordination, and by qualification
2. Registration by notification -- KRS 292.350
 - a. Generally, available for:

- (1) Primary or secondary distributions of securities of issuers that (i) have been in continuous operation for at least five years and (ii) have not defaulted in payments on debt or fixed dividend securities in last three years and (iii) have had earnings applicable to other securities equal to at least five percent of the market value of the other securities;

(2) Secondary distributions of securities of a class previously sold in transactions registered under, or exempted under, Chapter 292

- b. Registration Forms: Primary distribution - Form U-1; secondary distribution - Form 35-a

See Attachment 6 to this outline for text of Form U-1

- c. Registration statement takes effect five full business days after filing, unless stop order in effect or investigation pending

3. Registration by coordination -- KRS 392.360

- a. Generally, available for distributions being simultaneously registered under '33 Act

- b. Registration Form: Form U-1

- c. Registration statement takes effect at moment '33 Act registration takes effect if [i] no stop order in effect or investigation pending, [ii] registration statement has been filed with Director for at least ten days, and [iii] a statement of the maximum and minimum underwriting discounts and commissions has been filed with Director for at least two full business days (and informally, Director receives prompt notice of effectiveness)

- d. 808 KAR 10:090 specifies reporting requirements for keeping registration by coordination in effect beyond one year

4. Registration by qualification -- KRS 292.370

- a. Available for "any security"

- b. Registration Form: Form 37

See Attachment 7 to this outline for text of Form 37

- c. Elaborate statutory specification of information and documents to accompany registration form, including audited financials, and authorization for Director to require more by rule or order
 - d. Registration statement takes effect only upon Director's order (KRS 292.380(1))
 - e. 808 KAR 10:080 establishes qualitative guidelines for registrations by qualification by "promotional companies" (defined in 808 KAR 10:160), including maximum dilution
5. General provisions -- KRS 292.380
- a. Fees payable: examination - \$125; registration - \$0.60/\$1,000 but not less than \$60.00 nor more than \$1,200.00
 - b. Director may condition any registration upon delivery of prospectus but must accept for use any prospectus or offering circular filed under '33 Act or regulations
 - c. Director may condition any registration by coordination or qualification upon
 - (1) an impoundment of proceeds until a specified amount of sales have been realized (see Form 38 - a)
 - (2) an escrow of stock issued within past three years to a promoter for consideration substantially different from public offering price or to anyone for property
 - d. Director may condition any registration by qualification upon undertaking by issuer to keep registration statement current for five years and to distribute audited annual financial statements during same period
 - e. All outstanding securities of same class as a registered security are considered registered for secondary trading

purposes as long as registration statement is in effect

- f. Director may require person who filed registration statement to file periodic reports to keep information current

See 808 KAR 10:140 for significant postoffering reporting requirements applicable to registrations by qualification, including interim unaudited and annual audited financial statements

- g. 808 KAR 10:070 states signature requirements for all registration statements

6. Stop orders and investigations -- KRS 292.390

- a. Director may stop, suspend, or revoke the effectiveness of a registration statement on a number of grounds, most notably:

- (1) the registration statement, any amendment, or post-offering report is materially incomplete, false, or misleading

- (2) any willful violation of KRS Chapter 292 or rule or order thereunder has occurred in connection with the offering

- (3) the offering would work a fraud on purchasers

- (4) the offering involves unreasonable underwriters' compensation, promoters' profits, or options

- (5) selling commissions exceed 15% of proceeds

- b. Director may summarily postpone or suspend effectiveness of registration statement pending administrative procedure to determine whether stop order should be entered

C. The Director's Rule-making Powers -- KRS 292.500

1. KRS 292.500 -- Director may promulgate rules, forms, and orders to carry out Chapter 292, including rules and forms for registration and reports, definitions, and rules for the form and content of financial statements, but all financial statements are to conform to generally accepted accounting principles
2. 808 KAR 10:010 specifies Forms

HAC36/403

1/30/86

ATTACHMENT 1

Registration Form S-1

(Source: Commerce Clearing House, Federal Securities Law Reporter, Vol. 2, ¶7121)

1040 10-5-83

6211

[¶7121]

FORM S-1

[As revised, effective October 25, 1955; amended effective August 14, 1969, Release No. 33-4988 (¶ 77,729), 34 F. R. 12176; effective March 26, 1971, Release No. 33-5135 (¶ 77,961), 36 F. R. 4779; effective with respect to registration statements filed on or after February 28, 1973, Release No. 33-5354 (¶ 72,160), 38 F. R. 2447; effective for filings on or after July 3, 1973, Release No. 33-5386 (¶ 79,342), 38 F. R. 12100; effective August 1, 1973, Release No. 33-5395 (¶ 79,383), 38 F. R. 17202; effective July 1, 1974, Release No. 33-5488 (¶ 72,177), April 25, 1974, 39 F. R. 17929; Release No. 33-5704 (¶ 80,495), effective July 1, 1976, 41 F. R. 21636; Release No. 34-13291 (¶ 80,980), effective August 31, 1977, 42 F. R. 12349; amendments postponed to April 30, 1978 in Release No. 34-13844 (¶ 81,274), F. R. 41406; Release No. 33-5893 (¶ 72,258), effective for fiscal years ending after March 15, 1978, except as provided in the text (¶ 72,258) under "Effective Date," 42 F. R. 65553; amended in Release No. 33-5925 (¶ 81,571), effective May 29, 1978, 43 F. R. 18484; amended in Release No. 33-5949 (¶ 81,649), effective September 30, 1978, 43 F. R. 34402; amended in Release No. 33-6019 (¶ 81,924), effective May 1, 1979, 44 F. R. 7868; amended in Release No. 33-6230 (¶ 82,642), effective October 6, 1980, 45 F. R. 58822; amended in Release No. 33-6231 (¶ 72,301), September 2, 1980, effective with respect to fiscal years ended after December 15, 1980, 45 F. R. 63631; amended in Release No. 33-6234 (¶ 72,303), September 2, 1980, effective for companies with fiscal years ended after December 15, 1980, 45 F. R. 63682; amended in Release No. 33-6260 (¶ 72,306), effective November 21, 1980, 45 F. R. 76974; amended in Release No. 33-6383 (¶ 72,328), effective May 24, 1982, 47 F. R. 11380; amended in Release No. 33-6413 (¶ 72,402), June 24, 1982, effective for filings after September 30, 1982, 47 F. R. 29832; amended in Release No. 33-6441 (¶ 83,281), effective July 1, 1983, 47 F. R. 55661; amended in Release No. 33-6465 (¶ 83,344), effective May 3, 1983, 48 F. R. 19873; amended in Release No. 33-6486 (¶ 83,425), September 23, 1983, effective for all documents filed on or after December 31, 1983, 48 F. R. —.]

SECURITIES AND EXCHANGE COMMISSION

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

(Exact name of registrant as specified in its charter)

(State or other jurisdiction of incorporation or organization)

(Primary Standard Industrial Classification Code Number)

(I.R.S. Employer Identification No.)

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Approximate date of commencement of proposed sale to the public

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box.

Calculation of Registration Fee

Table with 5 columns: Title of each class of securities to be registered, Amount to be registered, Proposed maximum offering price per unit, Proposed maximum aggregate offering price, Amount of registration fee

[] Fees: see ¶ 3570; 3575 and 3580. CCH.]

[17122]

GENERAL INSTRUCTIONS

I. Eligibility Requirements for Use of Form S-1

This Form shall be used for the registration under the Securities Act of 1933 ("Securities Act") of securities of all registrants for which no other form is authorized or prescribed, except that this Form shall not be used for securities of foreign governments or political subdivisions thereof.

II. Application of General Rules and Regulations

A. Attention is directed to the General Rules and Regulations under the Securities Act, particularly those comprising Regulation C (17 CFR 230.400 to 230.494) thereunder. That Regulation contains general requirements regarding the preparation and filing of the registration statement.

B. Attention is directed to Regulation S-K (17 CFR Part 229) for the require-

ments applicable to the content of the non-financial statement portions of registration statements under the Securities Act. Where this Form directs the registrant to furnish information required by Regulation S-K and the item of Regulation S-K so provides, information need only be furnished to the extent appropriate.

III. Exchange Offers

If any of the securities being registered are to be offered in exchange for securities of any other issuer the prospectus shall also include the information which would be required by Item 11 if the securities of such other issuer were registered on this Form. There shall also be included the information concerning such securities of such other issuer which would be called for by Item 9 if such securities were being registered. In connection with this instruction, reference is made to Rule 409.

PART I

[17123]

INFORMATION REQUIRED IN PROSPECTUS

Item 1. Forepart of the Registration Statement and Outside Front Cover Page of Prospectus. Set forth in the forepart of the registration statement and on the outside front cover page of the prospectus the information required by Item 501 of Regulation S-K (§ 229.501 of this chapter).

Item 2. Inside Front and Outside Back Cover Pages of Prospectus. Set forth on the inside front cover page of the prospectus or, where permitted, on the outside back cover page, the information required by Item 502 of Regulation S-K (§ 229.502 of this chapter).

Item 3. Summary Information, Risk Factors and Ratio of Earnings to Fixed Charges. Furnish the information required by Item 503 of Regulation S-K (§ 229.503 of this chapter).

Item 4. Use of Proceeds. Furnish the information required by Item 504 of Regulation S-K (§ 229.504 of this chapter).

Item 5. Determination of Offering Price. Furnish the information required by Item 505 of Regulation S-K (§ 229.505 of this chapter).

Item 6. Dilution. Furnish the information required by Item 506 of Regulation S-K (§ 229.506 of this chapter).

Item 7. Selling Security Holders. Furnish the information required by Item 507 of Regulation S-K (§ 229.507 of this chapter).

Item 8. Plan of Distribution. Furnish the information required by Item 508 of Regulation S-K (§ 229.508 of this chapter).

Item 9. Description of Securities to Be Registered. Furnish the information required by Item 202 of Regulation S-K (§ 229.202 of this chapter).

Item 10. Interests of Named Experts and Counsel. Furnish the information required by Item 509 of Regulation S-K (§ 229.509 of this chapter).

Item 11. Information with Respect to the Registrant. Furnish the following information with respect to the registrant:

(a) Information required by Item 101 of Regulation S-K (§ 229.101 of this chapter), description of business;

(b) Information required by Item 102 of Regulation S-K (§ 229.102 of this chapter), description of property;

(c) Information required by Item 103 of Regulation S-K (§ 229.103 of this chapter), legal proceedings;

(d) Where common equity securities are being offered, information required by Item 201 of Regulation S-K (§ 229.201 of this chapter), market price of and dividends on the registrant's common equity and related stockholder matters;

(e) Financial statements meeting the requirements of Regulation S-X (17 CFR Part 210) (Schedules required under Regulation S-X shall be filed as "Financial Statement Schedules" pursuant to Item 15, Exhibits and Financial Statement Schedules, of this Form), as well as any Financial information required by Rule 3-05 and Article 11 of Regulation S-X; [Amended in Release No. 33-6413 (§ 72,402), June 24, 1982, effective for filings after September 30, 1982, 47 F. R. 29832; amended in Release No. 33-6465 (§ 83,344), April 22, 1983, effective May 3, 1983, 48 F. R. 19873.]

(f) Information required by Item 301 of Regulation S-K (§ 229.301 of this chapter), selected financial data;

(g) Information required by Item 302 of Regulation S-K (§ 229.302 of this chapter), supplementary financial information;

(h) Information required by Item 303 of Regulation S-K (§ 229.303 of this chapter), management's discussion and analysis of financial condition and results of operations;

(i) Information required by Item 304 of Regulation S-K (§ 229.304 of this chapter),

disbursements with accountants on accounting and financial disclosure;

(j) Information required by Item 401 of Regulation S-K (§ 229.401 of this chapter), directors and executive officers;

(k) Information required by Item 402 of Regulation S-K (§ 229.402 of this chapter), executive compensation; [Amended in Release No. 33-6441 (§ 83,281), December 2, 1982, effective July 1, 1983, 47 F. R. 55661; amended in Release No. 33-6486 (§ 83,425), effective for all documents filed after December 30, 1983, 48 F. R. 44467.]

(l) Information required by Item 403 of Regulation S-K (§ 229.403 of this chapter), security ownership of certain beneficial owners and management; and [Amended in Release No. 33-6441 (§ 83,281), December 2, 1982, effective July 1, 1983, 47 F. R. 55661.]

(m) Information required by Item 404 of Regulation S-K (§ 229.404 of this chapter), certain relationships and related transactions. [Added in Release No. 33-6441 (§ 83,281), December 2, 1982, effective July 1, 1983, 47 F. R. 55661.]

Item 12. Disclosure of Commission Position on Indemnification for Securities Act Liabilities. Furnish the information required by Item 510 of Regulation S-K (§ 229.510 of this chapter).

PART II

[§ 7124] INFORMATION NOT REQUIRED IN PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution. Furnish the information required by Item 511 of Regulation S-K (§ 229.511 of this chapter).

Item 14. Indemnification of Directors and Officers. Furnish the information required by Item 702 of Regulation S-K (§ 229.702 of this chapter).

Item 15. Recent Sales of Unregistered Securities. Furnish the information required by Item 701 of Regulation S-K (§ 229.701 of this chapter).

Item 16. Exhibits and Financial Statement Schedules. (a) Subject to the rules

regarding incorporation by reference, furnish the exhibits as required by Item 601 of Regulation S-K (§ 229.601 of this chapter).

(b) Furnish the financial statement schedules required by Regulation S-X (17 CFR Part 210) and Item 11(e) of this Form. These schedules shall be lettered or numbered in the manner described for exhibits in paragraph (a). [Amended in Release No. 33-6465 (§ 83,344), April 22, 1983, effective May 3, 1983, 48 F. R. 19873.]

Item 17. Undertakings. Furnish the undertakings required by Item 512 of Regulation S-K (§ 229.512 of this chapter).

[17125]

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of, State of, on, 19

(Registrant)
By (Signature and Title)

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the dates indicated.

(Signature)
(Title)
(Date)

Instructions. 1. The registration statement shall be signed by the registrant, its principal executive officer or officers, its principal financial officer, its controller or principal

accounting officer and by at least a majority of the board of directors or persons performing similar functions. If the registrant is a foreign person, the registration statement shall also be signed by its authorized representative in the United States. Where the registrant is a limited partnership, the registration statement shall be signed by a majority of the board of directors of any corporate general partner signing the registration statement.

2. The name of each person who signs the registration statement shall be typed or printed beneath his signature. Any person who occupies more than one of the specified positions shall indicate each capacity in which he signs the registration statement. Attention is directed to Rule 402 concerning manual signatures and to Item 601 of Regulation S-K concerning signatures pursuant to powers of attorney.

[17126]

INSTRUCTIONS AS TO SUMMARY PROSPECTUSES

1. A summary prospectus used pursuant to Rule 431 (§ 230.431 of this chapter), shall at the time of its use contain such of the information specified below as is then included in the registration statement. All other information and documents contained in the registration statement may be omitted.

(a) As to Item 1, the aggregate offering price to the public, the aggregate underwriting discounts and commissions and the offering price per unit to the public;

(b) As to Item 4, a brief statement of the principal purposes for which the proceeds are to be used;

(c) As to Item 7, a statement as to the amount of the offering, if any, to be made for the account of security holders;

(d) As to Item 8, the name of the managing underwriter or underwriters and a brief statement as to the nature of the underwriter's obligation to take the securities; if any securities to be registered are to be offered otherwise than through underwriters, a brief statement as to the manner of distribution; and, if securities are to be offered otherwise than for cash, a brief statement as to the general purposes of the distribution, the basis upon which the securities are to be offered, the amount of compensation and other expenses of distribution, and by whom they are to be borne;

(e) As to Item 9, a brief statement as to dividend rights, voting rights, conversion rights, interest, maturity;

(f) As to Item 11, a brief statement of the general character of the business done and intended to be done, the selected financial data (Item 301 of Regulation S-K (§ 229.301 of this chapter)) and a brief statement of the nature and present status of any material pending legal proceedings; and

(g) A tabular presentation of notes payable, long term debt, deferred credits, minority interests, if material, and the equity section of the latest balance sheet filed, as may be appropriate.

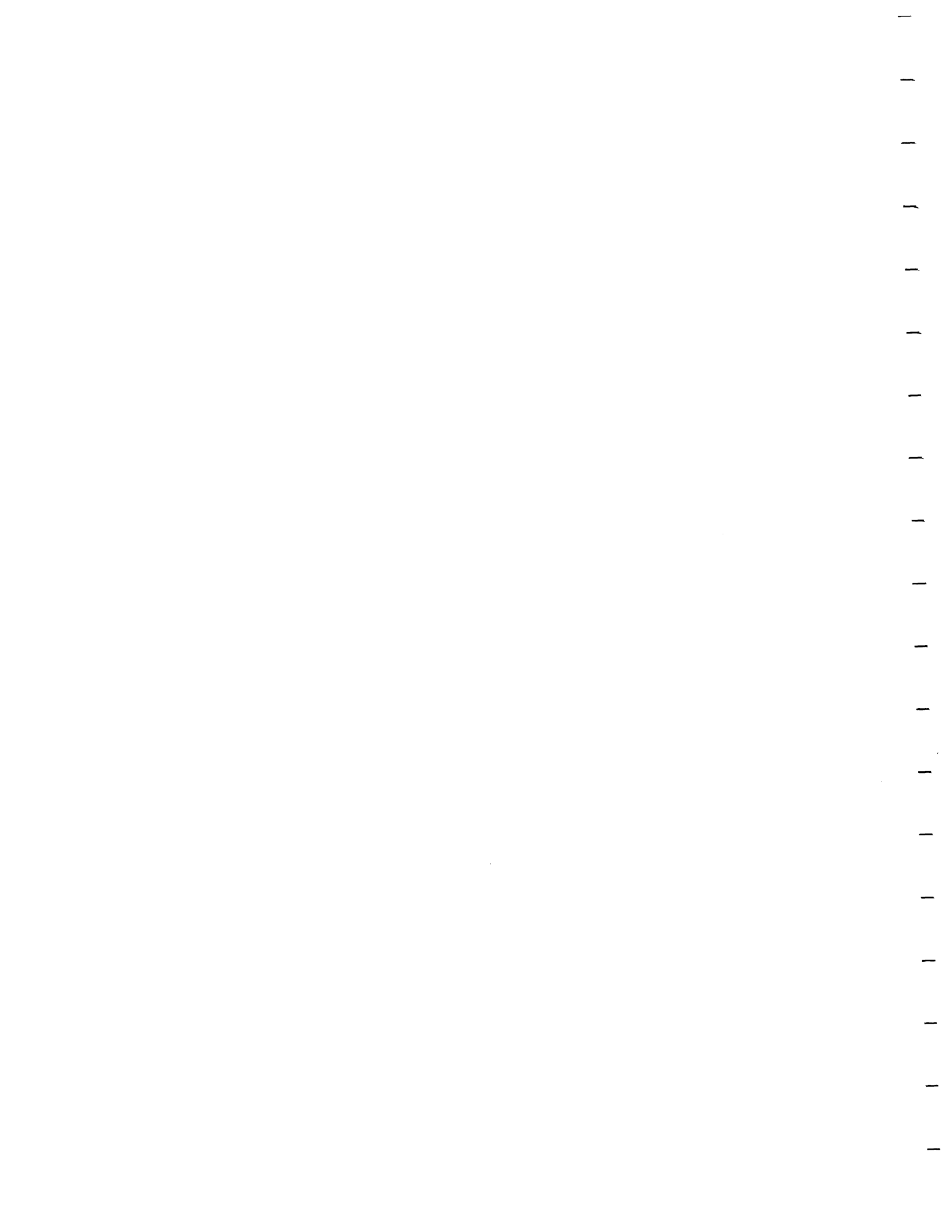
2. The summary prospectus shall not contain a summary or condensation of any other required financial information except as provided above.

3. Where securities being registered are to be offered in exchange for securities of any other issuer, the summary prospectus also shall contain that information as to Items 9 and 11 specified in paragraphs (e) and (f) above which would be required if the securities of such other issuer were registered on this Form.

4. The Commission may, upon the request of the registrant, and where consistent with the protection of investors, permit the omission of any of the information herein required

or the furnishing in substitution therefor of appropriate information of comparable character. The Commission may also require the inclusion of other information in addition to, or in substitution for, the information herein required in any case where such information is necessary or appropriate for the protection of investors.

[The next page is 6231.]



ATTACHMENT 2

List of Items in Regulation S-K
(Source: Commerce Clearing House,
Federal Securities Law Reporter,
Vol. 6, ¶61,701)

1041 10-12-83

61,701

REGULATION S-K

... standard instructions for filing forms
under the Securities Act of 1933 and the
Securities Exchange Act of 1934

TABLE OF CONTENTS

Reg. § (17 CFR —)	Subject	Paragraph
Interpretative Releases		
231.6166	(Rescinded) Disclosure of management re- muneration	70,962A
231.6364	(Rescinded) Interpretation of rules relating to disclosure of management remuneration	70,962B
Subpart 229.1—General		
229.10	General	71,001
Subpart 229.100—Business		
229.101	(Item 101) Description of business	71,011
229.102	(Item 102) Description of property	71,012
229.103	(Item 103) Legal proceedings	71,013
Subpart 229.200—Securities of the Registrant		
229.201	(Item 201) Market price of and dividends on the registrant's common equity and related stockholder matters	71,021
229.202	(Item 202) Description of registrant's securities	71,022
Subpart 229.300—Financial Information		
229.301	(Item 301) Selected financial data	71,031
229.302	(Item 302) Supplementary financial information	71,032
229.303	(Item 303) Management's discussion and anal- ysis of financial condition and results of operations	71,033
229.304	(Item 304) Disagreements with accountants on accounting and financial disclosure	71,034
Subpart 229.400—Management and Certain Security Holders		
229.401	(Item 401) Directors and executive officers	71,041
229.402	(Item 402) Executive compensation	71,042
229.403	(Item 403) Security ownership of certain bene- ficial owners and management	71,043
229.404	(Item 404) Certain relationships and related transactions	71,044

Federal Securities Law Reports

CONTENTS

Reg. § (17 CFR —)	Subject	Paragraph
Subpart 229.500—Registration Statement and Prospectus Provisions		
229.501	(Item 501) Forepart of registration statement and outside front cover page of prospectus . . .	71,051
229.502	(Item 502) Inside front and outside back cover pages of prospectus	71,052
229.503	(Item 503) Summary information, risk factors and ratio of earnings to fixed charges	71,053
229.504	(Item 504) Use of proceeds	71,054
229.505	(Item 505) Determination of offering price . . .	71,055
229.506	(Item 506) Dilution	71,056
229.507	(Item 507) Selling security holders	71,057
229.508	(Item 508) Plan of distribution	71,058
229.509	(Item 509) Interests of named experts and counsel	71,059
229.510	(Item 510) Disclosure of Commission position on indemnification for Securities Act liabilities	71,060
229.511	(Item 511) Other expenses of issuance and distribution	71,061
229.512	(Item 512) Undertakings	71,062
Subpart 229.600—Exhibits		
229.601	(Item 601) Exhibits	71,071
Subpart 229.700—Miscellaneous		
229.701	(Item 701) Percent sales of unregistered securities	71,081
229.702	(Item 702) Indemnification of directors and officers	71,082
Subpart 229.800—List of Industry Guides		
229.801	Securities Act industry guides	71,091
229.802	Exchange Act industry guides	71,092

[The next page is 61,771.]

ATTACHMENT 3

List of Securities Act Industry Guides

(Source: Commerce Clearing House,
Federal Securities Law Reporter,
Vol. 6, ¶71,091)

61,988

Regulation S-K

1102 12-5-84

Subpart 229.800—List of Industry Guides

[¶ 71,091]

Securities Act Industry Guides

➤➤➤ *For the text of the Securities Act Industry Guides, see ¶ 3825—3829.*

Reg. § 229.801. (a) Guide 1. Disclosure of principal sources of electric and gas revenues.

(b) Guide 2. Disclosure of oil and gas operations.

(c) Guide 3. Statistical disclosure by bank holding companies.

(d) Guide 4. Prospectuses relating to interests in oil and gas programs.

(e) Guide 5. Preparation of registration statements relating to interests in real estate limited partnerships.

[Added in Release No. AS-306 (¶ 72,328), effective May 24, 1982, 47 F. R. 11380.]

[¶ 71,092]

Exchange Act Industry Guides

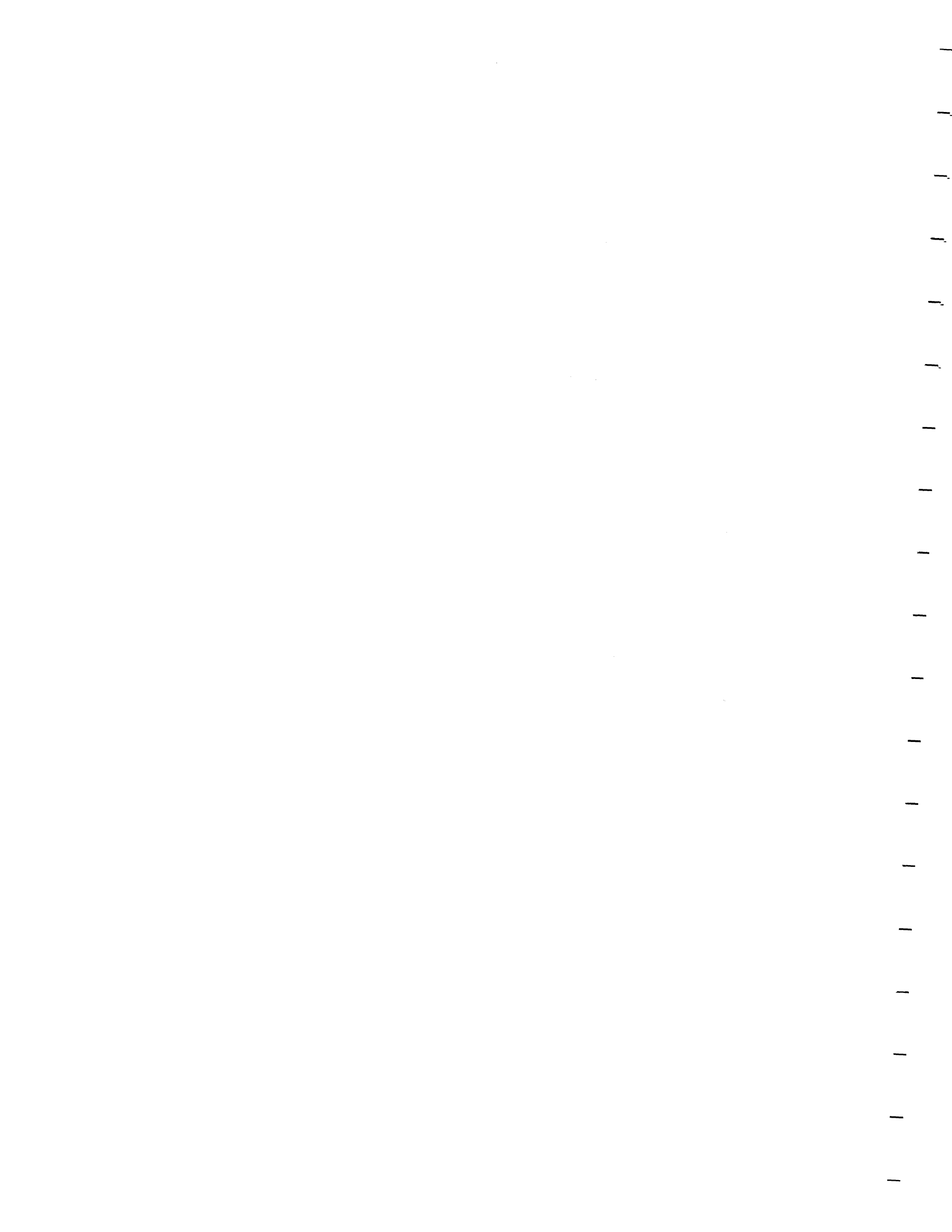
➤➤➤ *For the text of Exchange Act Industry Guides, see ¶ 23,056—23,058.*

Reg. § 229.802. (a) Guide 1. Disclosure of principal sources of electric and gas revenues.

(b) Guide 2. Disclosure of oil and gas operations.

(c) Guide 3. Statistical disclosure by bank holding companies.

[Added in Release No. AS-306 (¶ 72,328), effective May 24, 1982, 47 F. R. 11380.]



ATTACHMENT 4

List of Rules in Regulation C

REGULATION C

REGISTRATION

Rule
Number

Description

General Requirements

400	Application of rules
401	Requirements as to proper form
402	Number of copies -- binding -- signatures
403	Requirements as to paper, printing, language and pagination
404	Preparation of registration statement
405	Definition of terms
406	Confidential treatment of information filed with the Commission
408	Additional information
409	Information unknown or not reasonably available
410	Disclaimer of control
411	Incorporation by reference
412	Modified or superseded documents
413	Registration of additional securities
414	Registration by certain successor issuers
415	Delayed or continuous offering and sale of securities
416	Securities to be issued as a result of stock splits, stock dividends, and anti-dilution provisions
417	Date of financial statements
418	Supplemental information

Form and Content of Prospectuses

420	Legibility of prospectus
421	Presentation of information in prospectuses
423	Date of prospectuses
424	Filing of prospectuses -- number of copies
427	Contents of prospectus used after nine months
429	Prospectus relating to several registration statements
430	Prospectus for use prior to effective date
431	Summary prospectuses

432 Additional information required to be included
in prospectuses relating to tender offers

Written Consents

436 Consents required in special cases
437 Application to dispense with consent
438 Consents of persons about to become directors
439 Consent to use of material incorporated by
reference

Competitive Bids

445 Competitive bidding registration statement
446 Invitations for competitive bidding
447 Authorization of agent for service for filing
amendments

Filing; Fees; Effective Date

455 Place of filing
456 Date of filing
457 Computation of fee
459 Calculation of effective date
460 Distribution of preliminary prospectus
461 Acceleration of effective date
463 Report of offering of securities and use of
proceeds therefrom
464 Effective date of post-effective amendments on
Form S-8 or on Forms S-3, F-2, or F-3 for
registration statements relating to a dividend
or interest reinvestment plan
466 Effective date of certain registration statements
on Form F-6

Amendments; Withdrawals

470 Formal requirements for amendments
471 Signatures to amendments
472 Filing of amendments -- number of copies
473 Delaying amendments
474 Date of filing of amendments
475 Amendment filed with consent of Commission
475a Pre-effective amendments on Form S-8 and certain
pre-effective amendments on Forms S-3, F-2, or
F-3 deemed filed with consent of Commission
476 Amendment filed pursuant to order of Commission
477 Withdrawal of registration statement or amendment

478 Powers to amend or withdraw registration statement
479 Procedure with respect to abandoned registration
statements and post-effective amendments

Investment Companies; Business Development
Companies

480 Title of securities
481 Information required in prospectus
482 Advertising by an investment company as satisfying
requirements of section 10
483 Exhibits for certain registration statements
484 Undertaking required in certain registration
statements
485 Effective date of post-effective amendments filed
by certain registered investment companies
486 Effective date of post-effective amendments filed
by registered separate accounts of insurance
companies
487 Effectiveness of registration statement filed by
certain unit investment trusts
488 Effective date of registration statements relating
to securities to be issued in certain business
combination transactions

Registration by Foreign Governments or Political
Subdivisions Thereof

490 Information to be furnished under paragraph (3)
of Schedule B
491 Information to be furnished under paragraph (6)
of Schedule B
492 Omissions from prospectuses
493 Filing of opinions of counsel
494 Newspaper prospectus

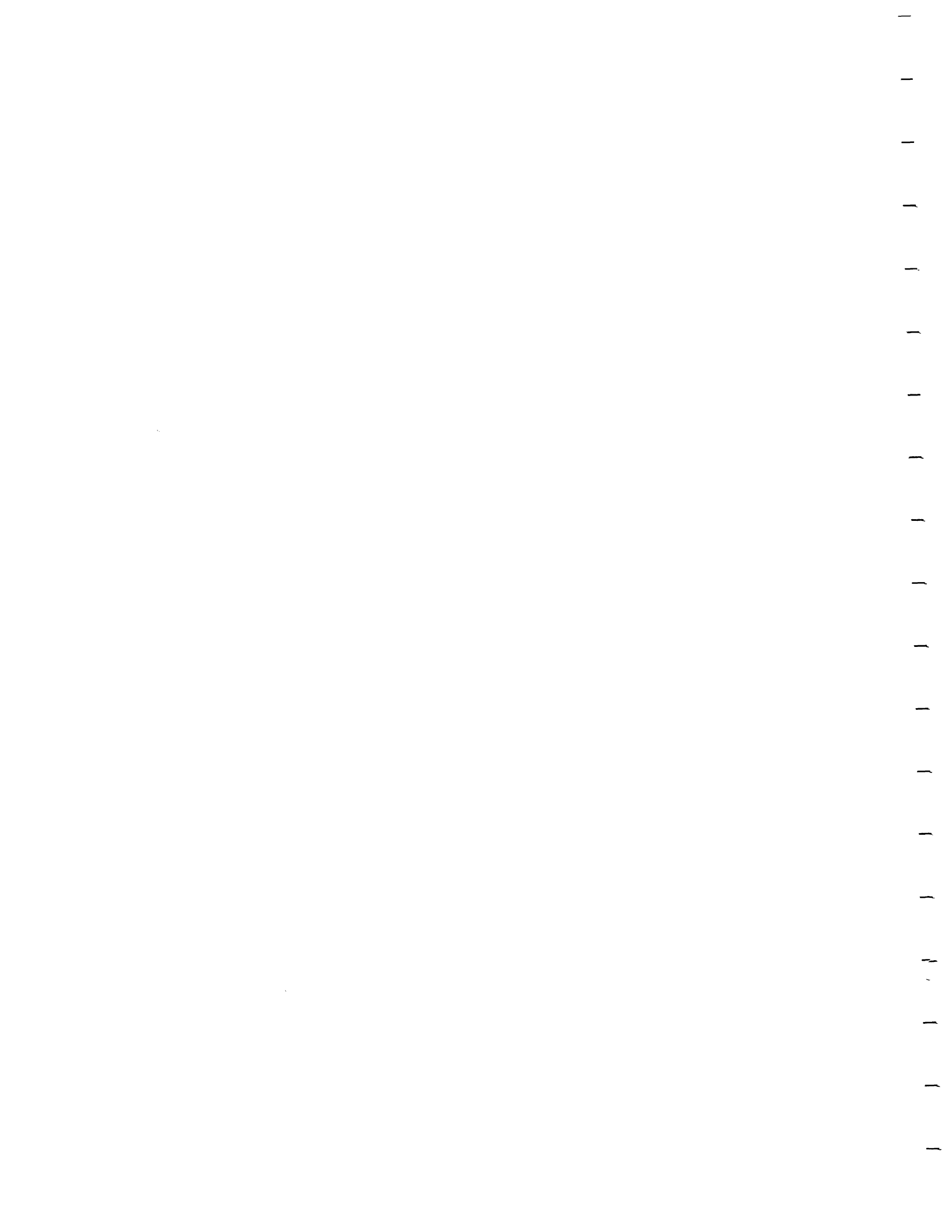
Additional Rules As To Investment Companies

495 Preparation of registration statement
496 Contents of prospectus used after nine months
497 Filing of prospectuses -- number of copies

EDGAR System

499 EDGAR temporary rule

HAC37/412



ATTACHMENT 5

List of Rules in Regulation S-X
 (Source: Commerce Clearing House,
Federal Securities Law Reporter,
 Vol. 6, p. 60,005)

1130 6-19-85

Table of Contents

60,005

ACCOUNTING RULES

Form and Content of Financial Statements

Reg. § (17 CFR —)	Subject	Paragraph
Article 1—Application of Regulation S-X		
§ 210.1-01	Application of Regulation S-X	69,101
§ 210.1-02	Definition of terms used in Regulation S-X	69,108
Article 2—Qualifications and Reports of Accountants		
§ 210.2-01	Qualifications of accountants	69,122
§ 210.2-02	Accountants' reports	69,126
§ 210.2-03	Examination of financial statements by foreign government auditors	69,131
§ 210.2-04	Examination of financial statement of persons other than the registrant	69,133
§ 210.2-05	Examination of financial statements by more than one accountant	69,135
Article 3—General Instructions as to Financial Statements		
	General instructions	69,141
§ 210.3-01	Consolidated balance sheets	69,142
§ 210.3-02	Consolidated statements of income and changes in financial position	69,143
§ 210.3-03	Instructions to income statement requirements	69,174
§ 210.3-04	Changes in other stockholders' equity	69,145
§ 210.3-05	Financial statements of businesses acquired or to be acquired	69,146
§ 210.3-07	(Rescinded) Past successions to other businesses	69,148
§ 210.3-08	(Rescinded) Future successions to other businesses	69,149
§ 210.3-09	Separate financial statements of subsidiaries not consolidated and 50 percent or less owned persons	69,150
§ 210.3-10	Financial statements of guarantors and affiliates whose securities collateralize an issue registered or being registered	69,151
§ 210.3-11	Financial statements of an inactive registrant ..	69,152
§ 210.3-12	Age of financial statements at effective date of registration statement or at mailing date of proxy statement	69,153
§ 210.3-13	Filing of other financial statements in certain cases	69,154
§ 210.3-14	Special instructions for real estate operations to be acquired	69,155
§ 210.3-15	Special provisions as to real estate investment trusts	69,156

Federal Securities Law Reports

CONTENTS

ACCOUNTING RULES—Continued

Reg. § (17 CFR —)	Subject	Paragraph
§ 210.3-16	Reorganization of registrant	69,157
§ 210.3-17	Financial statements of natural persons	69,158
§ 210.3-18	Special provisions as to registered management investment companies and companies required to be registered as management investment companies	69,159
§ 210.3-19	Special provisions as to financial statements for foreign private issuers	69,160
§ 210.3-20	Currency for financial statements of foreign private issuers	69,161
§ 210.3-21	Special provisions as to financial statements of companies engaged in marketing computer software	69,162
Article 3A—Consolidated and Combined Financial Statements		
§ 210.3A-01	Application of § 210.3A-01 to § 210.3A-05	69,171
§ 210.3A-02	Consolidated financial statements of the registrant and its subsidiaries	69,172
§ 210.3A-03	Statement as to principles of consolidation or combination followed	69,174
§ 210.3A-04	Intercompany items and transactions	69,176
§ 210.3A-05	Special requirements as to Public Utility Holding Company	69,178
Article 4—Rules of General Application		
§ 210.4-01	Form, order, and terminology	69,191
§ 210.4-02	Items not material	69,192
§ 210.4-03	Inapplicable captions and omission of unrequired or inapplicable financial statements	69,193
§ 210.4-04	Omission of substantially identical notes	69,194
§ 210.4-05	Current assets and current liabilities	69,195
§ 210.4-06	Reacquired evidences of indebtedness	69,196
§ 210.4-07	Discount on shares	69,197
§ 210.4-08	General notes to financial statements	69,198
§ 210.4-09	(Rescinded) Current replacement cost information	69,199
§ 210.4-10	Financial accounting and reporting for oil and gas producing activities pursuant to the Federal Securities laws and the Energy Policy and Conservation Act of 1975	69,200

Reg. § (17 CFR —)	Subject	Paragraph
Article 5—Commercial and Industrial Companies		
§ 210.5-01	Application of §§ 210.5-01 to 210.5-04	69,231
§ 210.5-02	Balance sheets	69,235
§ 210.5-03	Income statements	69,249
§ 210.5-04	What schedules are to be filed	69,253
Article 5A—Companies in the Development Stage (Rescinded)		
Article 6—Registered Investment Companies		
§ 210.6-01	Application of §§ 210.6-01 to 210.6-10	69,299
§ 210.6-02	Definition of certain terms	69,300
§ 210.6-03	Special rules of general application to registered investment companies	69,301
§ 210.6-04	Balance sheets	69,302
§ 210.6-05	Statements of net assets	69,303
§ 210.6-06	Special provisions applicable to the balance sheets of issuers of face-amount certificates	69,304
§ 210.6-07	Statements of operations	69,305
§ 210.6-08	Special provisions applicable to the statements of operations of issuers of face-amount certificates	69,306
§ 210.6-09	Statements of changes in net assets	69,307
§ 210.6-10	What schedules are to be filed	69,308
Article 6A—Employee Stock Purchase, Savings and Similar Plans		
§ 210.6A-01	Application of §§ 210.6A-01 to 210.6A-05	69,310
§ 210.6A-02	Special rules applicable to employee stock purchase, savings and similar plans	69,311
§ 210.6A-03	Statements of financial condition	69,312
§ 210.6A-04	Statements of income and changes in plan equity	69,313
§ 210.6A-05	What schedules are to be filed	69,314
Article 7—Insurance Companies		
§ 210.7-01	Application of §§ 210.7-01 to 210.7-06	69,325
§ 210.7-02	General requirement	69,326
§ 210.7-03	Balance sheets	69,327
§ 210.7-04	Income statements	69,328
§ 210.7-05	What schedules are to be filed	69,330

[The next page is 60,009.]

Reg. § (17 CFR —)	Subject	Paragraph
Article 7a—Life Insurance Companies (Rescinded)		
Article 8—Committees Issuing Certificates of Deposit (Rescinded)		
Article 9—Bank Holding Companies		
§ 210.9-01	Application of §§ 210.9-01 to 210.9-05	69,371
§ 210.9-02	General requirement	69,372
§ 210.9-03	Balance sheets	69,373
§ 210.0-04	Income statements	69,374
§ 210.9-05	Foreign activities	69,375
§ 210.9-06	Condensed financial information of registrant	69,376
§ 210.9-07	Schedules	69,377
Article 10—Interim Financial Statements		
§ 210.10-01	Interim financial statements	69,391
Article 11—Pro-Forma Financial Information		
§ 210.11-01	Presentation requirements	69,405
§ 210.11-02	Preparation requirements	69,406
§ 210.11-03	Presentation of financial forecast	69,407
Article 11A—Statement of Source and Application of Funds (Rescinded)		
Article 12—Form and Content of Schedules		
§ 210.12-01	Application of §§ 210.12-01 to 210.12-27	69,421
§ 210.12-02	Marketable securities—other investments	69,422
§ 210.12-03	Amounts receivable from related parties and underwriters, promoters, and employees other than related parties	69,423
§ 210.12-04	Condensed financial information of registrant	69,424
§ 210.12-05	Indebtedness of and to related parties—Not current	69,425
§ 210.12-06	Property, plant, and equipment	69,426
§ 210.12-07	Accumulated depreciation, depletion, and amortization of property, plant, and equipment	69,428
§ 210.12-08	Guarantees of securities of other issuers	69,429
§ 210.12-09	Valuation and qualifying accounts and reserves	69,430
§ 210.12-10	Short-term borrowings	69,431
§ 210.12-11	Supplementary income statement information	69,432

ACCOUNTING RULES—Continued

Reg. § (17 CFR —)	Subject	Paragraph
§ 210.12-12	Investments in securities of unaffiliated issuers	69,433
§ 210.12-12A	Investments—securities sold short	69,433A
§ 210.12-12B	Open option contracts written	69,433B
§ 212.12-13	Investments—other than securities	69,434
§ 210.12-14	Investments in and advances to affiliates	69,435
§ 210.12-15	Summary of investments—other than investments in related parties	69,436
§ 210.12-16	Supplementary insurance information	69,437
§ 210.12-17	Reinsurance	69,438
§ 210.12-18	Supplemental information	69,439
§ 210.12-19	(Removed) Investments in securities	69,440
§ 210.12-20	(Removed) Trust shares	69,441
§ 210.12-21	Investments in securities of unaffiliated issuers	69,442
§ 210.12-22	Investments in and advances to affiliates and income thereon	69,443
§ 210.12-23	Mortgage loans on real estate and interest earned on mortgages	69,465
§ 210.12-24	Real estate owned and rental income	69,466
§ 210.12-25	Supplementary profit and loss information	69,467
§ 210.12-26	Certificate reserves	69,468
§ 210.12-27	Qualified assets on deposit	69,469
§ 210.12-28	Real estate and accumulated depreciation	69,470
§ 210.12-29	Mortgage loans on real estate	69,471
§ 210.12-30	(Rescinded) Summary of realized gains or losses on sale or maturity of investments	69,472

➤➤➤ For text of Reg. § 229.10 (Regulation S-K) see ¶ 71,001 et seq.

PART 256—UNIFORM SYSTEM OF ACCOUNTS FOR MUTUAL SERVICE COMPANIES AND SUBSIDIARY SERVICE COMPANIES, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935
GENERAL INSTRUCTIONS

§ 256.00-1	Preface	70,451
§ 256.01-1	Companies for which this system of accounts is prescribed	70,452
§ 256.01-2	Application to service companies doing business with nonassociate companies	70,453
§ 256.01-3	General structure of accounting system	70,454
§ 256.01-4	Construction or service contracts, and centralized procurement accounting	70,455
§ 256.01-5	Determination of service cost accounting	70,456

1. The first part of the document discusses the importance of maintaining accurate records of all transactions. This is essential for ensuring the integrity of the financial statements and for providing a clear audit trail.

2. The second part of the document outlines the various methods used to collect and analyze data. These methods include direct observation, interviews, and the use of statistical models. Each method has its own strengths and limitations, and it is important to choose the most appropriate one for the specific situation.

3. The third part of the document describes the process of data collection and analysis. This involves identifying the sources of data, collecting the data, and then analyzing it to identify patterns and trends. The results of the analysis are then used to make informed decisions.

4. The fourth part of the document discusses the importance of data quality. Data that is inaccurate or incomplete can lead to misleading conclusions. Therefore, it is essential to ensure that the data is of high quality and that any errors are identified and corrected.

5. The fifth part of the document describes the various types of data that can be collected. These include quantitative data, which is numerical and can be measured, and qualitative data, which is non-numerical and describes characteristics or qualities.

6. The sixth part of the document discusses the importance of data security. Data is often sensitive and confidential, and it is essential to take steps to protect it from unauthorized access and theft.

7. The seventh part of the document describes the various methods used to analyze data. These include descriptive statistics, which summarize the data, and inferential statistics, which allow us to make predictions about the population based on a sample.

8. The eighth part of the document discusses the importance of data visualization. Visual representations of data, such as charts and graphs, can make it easier to understand complex information and identify trends.

9. The ninth part of the document describes the various types of data visualization. These include bar charts, line graphs, and scatter plots. Each type of visualization is best suited for different types of data and different purposes.

10. The tenth part of the document discusses the importance of data interpretation. It is essential to understand the context of the data and to be able to interpret the results of the analysis correctly.

11. The eleventh part of the document describes the various methods used to interpret data. These include comparing the results to previous studies, identifying potential biases, and considering the limitations of the study.

12. The twelfth part of the document discusses the importance of data communication. It is essential to be able to communicate the results of the analysis to others in a clear and concise manner.

13. The thirteenth part of the document describes the various methods used to communicate data. These include writing reports, giving presentations, and using visual aids.

14. The fourteenth part of the document discusses the importance of data ethics. It is essential to be transparent about the methods used and to respect the privacy of the individuals whose data is being used.

15. The fifteenth part of the document describes the various methods used to ensure data ethics. These include obtaining informed consent, anonymizing data, and following ethical guidelines.

8. Submitted herewith as a part of this application are the following documents (documents on file may be incorporated by reference):
- (a) One copy of the Registration Statement and two copies of Prospectus in the latest form on file under the Securities Act of 1933.
 - (b) Underwriting Agreement, Agreement among Underwriters, and Selected Dealers Agreement.
 - (c) Indenture.
 - (d) Issuer's charter or articles of incorporation as amended to date.
 - (e) Issuer's by-laws as amended to date.
 - (f) Signed copy of opinion of counsel filed with Registration Statement pursuant to the Securities Act of 1933.
 - (g) Specimen (type of security)
 - (h) Consent to service of process accompanied by appropriate corporate resolution.
 - (i) If an earning computation or similar requirement is required to be met in this state, attach a separate sheet as an exhibit showing compliance.
 - (j) One copy of all advertising matter to be used in connection with the offering.
 - (k) Others (list each):
9. The applicant hereby applies for registration or acceptance for filing of the above described securities under the law cited above and in consideration thereof agrees so long as the registration remains in effect that it will:
- (a) Advise the above named state authority of any change prior to registration in this state in any of the information contained herein or in any of the documents submitted with or as a part of this application.
 - (b) File with the above named state authority within two business days after filing with the Securities and Exchange Commission (i) any amendments other than delaying amendments to the federal registration statement, designating the changed, revised or added material or information by underlining the same; and (ii) the final prospectus, or any further amendments or supplements thereto.
 - (c) Notify the above named state authority within two business days (i) upon the receipt of any stop order, denial, order to show cause, suspension or revocation order, injunction or restraining order, or similar order entered or issued by any state or other regulatory authority or by any court, concerning the securities covered by this application or other securities of the issuer currently being offered to the public; and (ii) upon the receipt of any notice of effectiveness of said registration by the Securities and Exchange Commission.
 - (d) Notify the above named state authority at least two business days prior to the effectiveness of said registration with the Securities and Exchange Commission of (i) any request by the issuer or applicant to any other state or regulatory authority for permission to withdraw any application to register the securities described herein; and (ii) a list of all states in which applications have been filed where the issuer or applicant has received notice from the state authority that the application does not comply with state requirements and cannot or does not intend to comply with such requirements.
 - (e) Furnish promptly all such additional information and documents in respect to the issuer or the securities covered by this application as may be requested by the above named state authority prior to registration or acceptance for filing.

Date:

.....
Name of Applicant

By
(Name and Title)

STATE OF }
COUNTY OF } ss

The undersigned,, being first duly sworn, deposes and says:

That he has executed the foregoing application for and on behalf of the applicant named therein; that he is of such applicant and is fully authorized to execute and file such application; that he is familiar with such application; and that to the best of his knowledge, information and belief the statements made in such application are true and the documents submitted therewith are true copies of the originals thereof.

.....
Name

Subscribed and sworn to before me
this day of, 19....

.....
NOTARY PUBLIC

In and for the County of
State of
My Commission Expires:
(Notarial Seal)

Faint, illegible text, possibly bleed-through from the reverse side of the page.

ATTACHMENT 7
Kentucky Form 3.7

USE TYPEWRITER, EXCEPT FOR SIGNATURES,
ANSWER EVERY QUESTION DEFINITELY AND COMPLETELY.

FORM 37

DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF SECURITIES
FRANKFORT, KENTUCKY

APPLICATION FOR REGISTRATION OF SECURITIES BY QUALIFICATION

The undersigned applicant hereby applies for registration by qualification, of the securities described herein, under the applicable provisions of the Kentucky Securities Act.

1. Name of issuer _____
2. Address of issuer _____
3. Issuer's form of organization _____

4. State or foreign jurisdiction and date of issuer's organization _____

5. Issuer's general character and location of business _____

6. If issuer has any significant subsidiary, give the same information as was required in 1, 2, 3, 4 and 5 above _____

7. Kind and amount of securities _____

8. Kind and amount of securities to be offered in Kentucky _____

9. Proposed offering price _____

10. Registration fee \$ _____ (3/50 of 1% of aggregate offering price of securities to be offered in Kentucky, minimum \$60.00, maximum \$1,200.00). Examination fee of \$125.00. Fees must be paid in separate checks.
11. Any variation from the proposed offering price at which any portion of the offering is to be made to any persons except as underwriting and selling discounts and commissions _____

12. The estimated aggregate underwriting and selling discounts or commissions and finder's fees (including separately cash, securities, or anything else of value to accrue to the underwriters in connection with the offering) _____

13. The estimated amounts of other selling expenses, and legal, engineering and accounting expenses to be incurred by the issuer in connection with the offering _____

EXHIBITS

Information required by KRS 292.370(2) must be filed by exhibit. Exhibits should be identified in such a way as to clearly indicate the particular subsection to which they relate. (For example - "Exhibit 2(a)," "Exhibit 2(b)," etc.)

In addition to the information required by KRS 292.370(2), the application shall contain:

1. The registration fee and examination fee.
2. Impounding agreements, escrow agreements and undertakings required by the director pursuant to KRS 292.380.

SIGNATURES

Pursuant to the requirements of the Kentucky Securities Act, as amended, the registrant has duly caused this registration statement or amendment thereto to be signed on its behalf by the undersigned, thereunto duly authorized in the city of _____, state of _____, on the _____ day of _____, 19____.

Name of Registrant

By: _____
Title

Pursuant to the requirements of the Kentucky Securities Act, as amended, this registration statement or amendment thereto has been signed below by the following persons in the capacities and on the dates indicated.

SIGNATURE

TITLE

DATE

REGULATION OF PUBLICLY HELD COMPANIES UNDER THE
SECURITIES EXCHANGE ACT OF 1934

Seminar on Securities Law
February 14, 1986
University of Kentucky College of Law
Lexington, Kentucky

Gary L. Stage
Stoll, Keenon & Park
Lexington, Kentucky

- I. Overview of the Securities Exchange Act of 1934.
 - A. The Securities Exchange Act of 1934 (the "Exchange Act") focuses on regulation of:
 - 1. The purchase and sale of securities following issuance of the securities.
 - 2. The securities markets and exchanges.
 - 3. The issuers of publicly held securities.
 - 4. Securities industry professionals.
 - B. The regulatory framework under the Exchange Act includes:
 - 1. Registration and continuing reporting and disclosure by issuers of publicly held securities.
 - 2. Registration and regulation of securities exchanges and over-the-counter markets.
 - 3. Registration and regulation of brokers and dealers.
 - 4. Regulation of clearance and settlement procedures for securities transactions.
 - 5. Registration, regulation and oversight of self-regulatory organizations such as the NASD.
 - 6. Reporting of equity holdings by officers, directors and over-10% shareholders of publicly held companies and regulation of insider trading by such persons.
 - 7. Regulation of foreign corrupt practices.

8. Regulation and recovery of short-swing profits received by insiders in connection with purchases and sales of securities of publicly held companies.
9. Regulation, including reporting and disclosure requirements, of solicitations of proxies or other authorizations from security holders of publicly held companies.
10. Regulation, including reporting and disclosure requirements, of tender offers, exchange offers and changes in control.
11. Prohibition of manipulative, deceptive and fraudulent practices in connection with the purchase and sale of securities, tender offers and proxy solicitations.
12. Regulation of margin requirements to prevent excessive use of credit to finance the purchase or carrying of securities.

II. Registration and Continuing Reporting and Disclosure Requirements for Publicly Held Companies.

A. The issuers subject to the registration and continuing reporting and disclosure requirements of the Exchange Act are those that meet one or more of the following three criteria:

1. Issuers having securities registered and listed for trading on a national securities exchange. Section 12(b).
2. Issuers having, as of the last day of the issuer's fiscal year, total assets in excess of \$3,000,000 and a class of equity securities held of record by 500 or more holders. Section 12(g).
 - a. In order to be subject to Section 12(g), the issuer must also meet one of the jurisdictional tests by virtue of being engaged in interstate commerce or in a business affecting interstate commerce or having its securities traded by use of the mails or any means or instrumentality of interstate commerce. Obviously, virtually all issuer meet this requirement.
 - b. Section 12(g) sets the total asset threshold at \$1,000,000 but authorizes the Securities and Exchange Commission (the "SEC") to increase the threshold by regulation.

Pursuant to Rule 12g-1 the SEC has increased the threshold amount to \$3,000,000.

- c. The SEC has proposed an amendment to Rule 12g-1 that would increase the total asset threshold amount from \$3,000,000 to \$5,000,000. SEC Release No. 33-6605 (October 2, 1985).
 - d. Section 12(g)(5) of the Exchange Act defines a "class" of securities to "include all securities of the issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges."
 - e. Rule 12g5-1 defines securities "held of record" for purposes of Sections 12(g) and 15(d). Subject to certain qualifications, "securities shall be deemed to be 'held of record' by each person who is identified as the owner of such securities on records of security holders maintained by or on behalf of the issuer...."
 - f. Rule 12g5-2 defines "total assets".
3. Issuers that have registered securities with the SEC under the Securities Act of 1933 (the "Securities Act") are subject to the periodic reporting requirements of Section 13(a) of the Exchange Act. Section 15(d).
- a. The reporting obligation under Section 15(d) arises regardless of the kind of security registered under the Securities Act. In contrast, Section 12(g) applies only to equity securities.
 - b. An issuer subject to the periodic reporting requirements pursuant to Section 15(d) may be required to register under Section 12, as determined under the criteria set forth above. Such registration under Section 12 suspends the Section 15(d) reporting obligation during the time the securities are registered under Section 12 (although of course the issuer is then subject to the periodic reporting requirements pursuant to such Section 12 registration).
 - c. The reporting obligation commences with the fiscal year in which the Securities Act registration becomes effective. The issuer

is required to file an annual report for such year and quarterly reports beginning with the first fiscal quarter that ends after the Securities Act registration becomes effective.

B. Registration under the Exchange Act.

1. Issuers subject to Section 12(b) (i.e., issuers having securities listed for trading on a national exchange) are required to register the class of securities with the exchange and the SEC prior to the date trading of the securities on the exchange begins.
2. Issuers subject to Section 12(g) (i.e., issuers of securities traded over-the-counter that meet the \$3,000,000 total asset and 500 security holders thresholds) are required to register within 120 days following the last day of the issuer's fiscal year in which the conditions requiring registration are first met.
3. Form 10 is the general form for registration of securities under the Exchange Act pursuant to Section 12(b) or Section 12(g). Form 10 requires information similar to that required for registration of securities under the Securities Act on Form S-1. Issuers currently reporting pursuant to Section 15(d) of the Exchange Act that are now registering pursuant to Sections 12(b) or (g) and issuers that already have a class of securities registered under the Exchange Act can use an abbreviated registration statement (Form 8-A) that incorporates by reference information from other Securities Act and Exchange Act filings.
4. Note that registration under the Exchange Act applies to the entire class of securities being registered. This is in contrast to registration under the Securities Act, which applies only to the specific securities involved in a particular offering.

C. Continuing Reporting Requirements.

1. The continuing reporting requirements under the Exchange Act are designed to keep the information in registration statements current and to make available to the investing public a continuing flow of information concerning the issuer and its securities.

2. The continuing reporting requirement of issuers subject to Sections 12(b), 12(g) or 15(d) is imposed by Section 13(a) of the Exchange Act, as implemented through regulations and forms promulgated by the SEC. The types of periodic reports required by the Exchange Act and the SEC are as follows:

a. Annual Report. The issuer must file an annual report with the SEC within 90 days following the end of each fiscal year. Form 10-K is the basic annual report form and is used unless another annual report form is specifically prescribed for the issuer.

b. Quarterly Report. Issuers filing annual reports on Form 10-K must file quarterly reports with the SEC on Form 10-Q within 45 days following the end of each of the first three fiscal quarters of each fiscal year.

c. Current Report. Unless previously reported or unless the information is reported in an annual or quarterly report, issuers subject to the continuing reporting requirements must file a current report with the SEC on Form 8-K upon the occurrence of any one or more of the following reportable events:

- (i) A change in control of the registrant. "Control" means the ability to direct the company's management and policies and can be based upon ownership of voting stock (generally 20% or more) or contractual arrangements or other circumstances.
- (ii) The acquisition or disposition of a significant amount of assets by the registrant or any of its majority-owned subsidiaries other than in the ordinary course of business. The instructions to the Form provide guidance as to what constitutes "a significant amount of assets."
- (iii) Initiation of bankruptcy, insolvency or receivership proceedings by or against the registrant.
- (iv) A change in the registrant's certifying accountant.

- (v) If a director of the registrant resigns or declines to stand for re-election because of a disagreement with the registrant on any matter relating to the registrant's operations, policies or practices, and if the director furnishes the registrant with a letter describing the disagreement and requesting that the matter be disclosed.
- (vi) Other events the registrant deems to be of importance to security holders.

As a guideline, anything happening to the registrant that a prudent investor should know about should be reported. Form 8-K must be filed within 15 days following the occurrence of the reportable events described in (i) through (v) above. If there is more than one reportable event, the 15-day period is measured from the earliest event to occur. Filing Form 8-K upon the occurrence of any "other event" as described in (vi) above is optional and there is no specific time period within which the report must be filed; however, the report should be filed "promptly" after the event occurs.

d. Other reports include:

- (i) Form 8 for amendments to Exchange Act registration statements or annual, quarterly or current reports.
- (ii) Form 10-C to be filed by an issuer of securities quoted on NASDAQ to report a change in the number of shares outstanding or in the name of the issuer.
- (iii) Form 11-K to be used for annual reports with respect to employee stock purchase, savings and similar plans, interests in which constitute securities which have been registered under the Securities Act.
- (iv) Form 12b-25 to be used for applications for extensions of time to furnish information, documents or reports to the SEC.

D. Deregistration and Termination or Suspension of Periodic Reporting Requirements.

1. Section 12(b) Registrants. Under Section 12(d) of the Exchange Act, an issuer can deregister a class of securities registered pursuant to Section 12(b) by terminating the registration and listing of the securities on any securities exchange. Such deregistration ordinarily terminates the issuer's continuing reporting obligation under Section 13 unless:
 - a. The issuer would be subject to the reporting requirements pursuant to Section 12(g) (i.e., "deemed registration"); or
 - b. Within the three most recent fiscal years the issuer has failed to file any of the reports required to be filed with the SEC.

2. Section 12(g) Registrants. Issuers of over-the-counter securities registered pursuant to Section 12(g) (i.e., issuers having total assets in excess of \$3,000,000 and a class of securities held by more than 500 security holders) may terminate both registration of the class of securities and the obligation to comply with the reporting obligations of Section 13 by filing a certificate with the SEC on Form 15 to the effect that either:
 - a. The number of security holders of record is less than 300; or
 - b. The number of security holders of record is less than 500 and as of the last day of each of the issuer's three most recent fiscal years the total assets of the issuer have not exceeded \$3,000,000.

Termination of registration takes effect 90 days, or such shorter period as the SEC may determine, following the filing of the certification. The issuer's duty to file reports pursuant to Section 13 is suspended immediately following the filing of the certification. Rule 12g-4.

3. Section 15(d) Registrants.
 - a. Under Rule 12h-3, issuers subject to the Section 13 reporting requirements pursuant to Section 15(d) (i.e., issuers filing a Securities Act registration statement with regard to issuance of securities) may suspend the obligation to comply with the reporting requirements for any fiscal year by filing a

certificate with the SEC on Form 15 to the effect that either:

- (i) The number of record holders of each class of securities to which a Securities Act registration statement relates is less than 300; or
 - (ii) The number of record security holders of each class of securities to which a Securities Act registration statement relates is less than 500 and as of the last day of each of the issuer's three most recent fiscal years the total assets of the issuer have not exceeded \$3,000,000.
- b. The suspension is not effective with respect to the fiscal year in which the Securities Act registration became effective. In addition, if the suspension is based upon the less than 500 security holders of record and \$3,000,000 total asset test described above, the suspension cannot take effect with respect to the fiscal year within which the Securities Act registration became effective and the two succeeding fiscal years. Rule 12h-3(c).
- c. In order to qualify for suspension of the Rule 15(d) reporting obligations under Rule 12h-3, the issuer must also have filed all reports required under Section 13(a) for the shorter of:
- (i) The issuer's three most recent fiscal years plus the portion of the current year preceding the Form 15 filing date; or
 - (ii) The period since the issuer became subject to the reporting obligation.
- d. Under Rule 15d-6, the issuer is required to file Form 15 with the SEC within 30 days following the beginning of the first fiscal year in which the issuer's reporting obligation is suspended, unless the certification has already been filed pursuant to Rule 12h-3.
- e. The suspension of the reporting obligation remains in effect only so long as the

suspension criteria are met on the first day of any subsequent fiscal year. Rule 12h-3.

4. The SEC has proposed amendments to Rules 12g-4 and 12h-3 that would increase the total asset threshold amounts from \$3,000,000 to \$5,000,000. SEC Release No. 33-6605 (October 2, 1985).
5. Note that termination or suspension of an issuer's Section 13 reporting obligations must be evaluated independently with regard to each class of securities and each of the independent grounds (i.e., Section 12(b), Section 12(g) or Section 15(d)) for imposition of the continuing reporting obligation. An issuer remains subject to the reporting requirements (and to the proxy solicitation and insider trading provisions) until termination of these requirements for each class of the issuer's equity securities.

III. Reporting of Beneficial Ownership.

- A. Reporting of Beneficial Ownership under Section 13 of the Exchange Act.
 1. The principal objective of the Section 13 beneficial ownership reporting requirements is disclosure of possible changes in corporate control.
 2. Section 13(d) of the Exchange Act requires that any person acquiring direct or indirect beneficial ownership of more than 5% of a class of equity securities registered under Section 12 file Schedule 13D with the SEC within 10 days following such acquisition. Copies of the Schedule 13D are to be sent to the issuer of the security and to any stock exchange on which the security is traded.
 3. Schedule 13D requires disclosure of information concerning:
 - a. The identity, background and security ownership of the reporting person.
 - b. The source and amount of the funds used for the acquisition.
 - c. The purpose of the acquisition.
 - d. Any plans or proposals of the acquiring person relating to:

- (i) Acquisition of additional securities or disposition of securities of the issuer;
- (ii) Extraordinary corporate transactions, such as mergers, liquidations or sale or transfer of a material amount of assets;
- (iii) Changes in management or in the composition of the board of directors;
- (iv) Any other material change in the issuer's business or corporate structure; or
- (v) "Any action similar to those enumerated".

4. "Group" Acquisitions.

a. Section 13(d)(3) provides that for purposes of Section 13(d) when two or more persons act as a partnership, limited partnership, syndicate or other group for the purpose of holding or disposing of securities of an issuer, such partnership, syndicate or group is deemed to be a "person".

b. The basic prerequisite for formation of a Section 13(d) group is that the members of the group must agree to act in concert for the purpose of acquiring, holding or disposing of securities. The agreement can be formal or informal, however, mere preliminary negotiations do not constitute formation of a Section 13(d) group. See GAF Corp. v. Milstein, 453 F.2d 709 (2nd Cir. 1971) cert. denied, 406 U.S. 910 (1972); Wellman v. Dickinson, 475 F.Supp. 783 (S.D. N.Y. 1979) affirmed, 682 F.2d 355 (2nd Cir. 1982); Twin Fair Inc. v. Reeger, 394 F.Supp. 156 (W.D. N.Y. 1975); and Texasgulf Inc. v. Canada Development Corp., 366 F.Supp. 374 (S.D. Tex. 1973).

5. Rule 13d-3 sets forth rules for determining the beneficial ownership of securities for purposes of Section 13(d).

a. Under this Rule, "a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares:

(1) Voting power which includes the power to vote, or to direct the voting of, such security; and,

(2) Investment power which includes the power to dispose of, or to direct the disposition of, such security."

b. Rule 13d-3(d) provides that a person is also deemed to be the beneficial owner of a security if the person has the right to acquire beneficial ownership as defined in the Rule, within 60 days.

6. Amendment of Schedule 13D

a. In the event of a material change in the facts set forth in Schedule 13D, including without limitation a material increase or decrease in the percentage of the class beneficially owned, each reporting person is obligated to file an amendment disclosing such change. Rule 13d-3(d).

b. The amendment must be filed promptly after the change occurs and must be filed with the SEC, the issuer of the securities and each exchange on which the securities are traded.

c. Rule 13d-2(a) also provides: "An acquisition or disposition of beneficial ownership of securities in an amount equal to one percent or more of the class of securities shall be deemed 'material' for purposes of this rule; acquisitions or disposition of less than such amounts may be material depending upon the facts and circumstances."

B. Reporting and Regulation of Insider Trading under Section 16 of the Exchange Act.

1. Under Section 16(a), every beneficial owner of more than 10% of a class of securities registered under Section 12 and every director or officer of the issuer of such securities are required to report their ownership of such securities in such securities.

a. Initial statements of such beneficial ownership are filed on Form 204. This Form is required to be filed by the effective date of registration and listing of the security on a national exchange and the effective date of a registration statement filed pursuant to

12(g) or within 10 days following the date the reporting period begins such a beneficial owner, officer or director, as may be appropriate.

- b. Any change in such beneficial ownership must be reported on Form 4, which must be filed within 10 days after the close of the calendar month in which such change occurs.
 - c. Forms 3 and 4 are filed with the SEC, with a copy to be filed with each exchange on which any class of equity securities of the issuer is listed and traded.
 - d. Rules 16a-1 et seq. set forth further details with regard to the filing requirements, the rules for determining whether a person qualifies as beneficial owner of more than 10% of a class of securities and the exemptions to the reporting obligations.
2. Under Section 16(b), any "short-swing" profits of a director, officer or 10% security holder from the purchase and sale or the sale and purchase, of any equity security of a class registered under Section 12 inure to the benefit of and are recoverable by the issuer of the security.
- a. This provision is designed to prevent unfair use of "inside" information by officers, directors and 10% security holders. The rule applies without regard to whether such a person actually used "inside" information and without regard to the intent or motive of the person involved.
 - b. "Short-swing" profits are those realized from transactions occurring within a six-month period.
 - c. "As a general rule, the "profit realized" is calculated so as to produce the maximum recovery." SEC Release No. 34-18114 (September 23, 1981).
 - (i) Where the officer, director or 10% security holder has engaged in a series of transactions, the amount of profit realized is generally calculated by treating the securities as fungible and matching the highest sales price with the lowest purchase price in any given six-month period. See Smolowe v.

Delendo Corp., 136 F.2d 231 (2nd Cir.) cert. denied 320 U.S. 751 (1943); and Ohio Drill and Tool Company v. Johnson, 498 F.2d 186 (6th Cir. 1974) (interpreting an analogous Ohio statute).

- (ii) The SEC has adopted a special method of calculating profits from a sale of securities within six months of the exercise of an option acquired more than six months before its exercise or of an employee stock option, limiting such profits to the difference between the actual sales price and the lowest market price within six months before or after the sale date. Rule 16b-6.

- d. Section 16(b) applies only to purchases and sales occurring while the person is an officer, director or 10% security holder. See Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232 (1976) (Where a person makes a purchase that causes his beneficial ownership of the class of securities to exceed 10%, the person is not a 10% beneficial owner at the time of the purchase and is not required to account for any profits realized on a sale of those securities within six months.); and Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418 (1972) (The holder of more than 10% of a corporation's shares disposed of its entire holdings in two sales, both of which occurred within six months of the purchase of the shares. The first sale reduced the holder's ownership to less than 10% of the corporation's shares. Only the profits from the first sale, and not those from the second sale, are recoverable under Section 16 b)).

- e. The issuer may bring suit to recover short-swing profits. Section 16(b) also provides that if the issuer fails to bring suit within 90 days after being requested to do so or if the issuer fails to prosecute such a suit diligently, the owner of any security of the issuer can bring the suit in the name and on behalf of the issuer.

- f. The statute of limitations for recovery of profits under Section 16(b) is two years. However, the limitations period is tolled if the transactions are not discovered or if the

insider fails to comply with the Section 16(a) reporting requirements.

IV. Proxy Solicitation and Disclosure to Security Holders under Section 14 of the Exchange Act.

A. Section 14 of the Exchange Act and the SEC regulations thereunder regulate solicitation of proxies from, and disclosure of information to, holders of securities registered under Section 12.

B. Under Section 14(a), it is unlawful to solicit proxies regarding securities registered under Section 12 in violation of the SEC's proxy rules.

1. "Proxy" includes every proxy, consent or authorization with respect to a security. Rule 14a-1(d).

2. "Solicitation" is defined in Rule 14a-1(f) to include any request for a proxy, any request to execute or not execute a proxy or any communication made under circumstances "reasonably calculated to result in the procurement, withholding or revocation of a proxy."

C. Exemptions from the Proxy Rules.

1. Rule 14a-2(a) sets forth several types of proxy solicitations that are exempt from the proxy rules.

2. Rule 14a-2(b) specifies two types of proxy solicitations that are exempt from all of the proxy rules except the anti-fraud provisions of Rule 14a-9:

a. Solicitations made by any person other than the issuer to 10 or fewer persons.

b. Furnishing proxy voting advice to any person with whom the advisor has a business relationship if (i) the advisor renders financial advice in the ordinary course of business, (ii) the advisor receives no compensation for such advice other than from the recipient of the advice, (iii) the advisor discloses any significant relationship with the issuer and its affiliates, or with a shareholder proponent of the subject matter, as well as any material interest of the advisor in such matter, and (iv) such advice is not furnished on behalf of any person soliciting proxies or any participant in a proxy contest.

D. Disclosure to Security Holders.

1. Rule 14(a)-3(a) requires that any proxy solicitation subject to the proxy rules must be accompanied or preceded by a written proxy statement containing the information specified in Schedule 14A or a written proxy statement included in a registration statement filed under the Securities Act on Form S-4 and containing the information specified in such Form.

a. In general, Schedule 14A requires disclosure concerning the following items:

(i) Whether or not the proxy is revocable.

(ii) Explanation of dissenters' rights of appraisal with respect to any matter to be acted upon.

(iii) Identification of the person(s) making the solicitation and bearing the expense of the solicitation and description of the methods of solicitation. If the solicitation is part of a proxy contest subject to Rule 14a-11, certain other disclosures are required.

(iv) Description of any substantial interest, direct or indirect, by security holdings or otherwise, in any matter to be acted on (other than elections to office) held by the following persons:

(A) If the solicitation is on behalf of the issuer, each person who has been a director or officer at any time since the beginning of the last year.

(B) If the solicitation is not on behalf of the issuer, each person on whose behalf the solicitation is made.

(C) Each nominee for director of the issuer.

(D) Each associate of the foregoing persons.

(v) Description of the issuer's voting securities, the voting rights thereunder with respect to matters to be acted

upon, and identification of security holders who beneficially own 5% or more of any class of voting securities.

- (vi) If action is to be taken concerning election of directors, information concerning the directors and nominees for director.
 - (vii) Information concerning compensation of directors and executive officers. If the solicitation is made on behalf of persons other than the issuer, this information need be furnished only as to nominees of the persons making the solicitation and the associates of such nominees.
 - (viii) If the solicitation is made on behalf of the issuer and relates to an annual meeting at which directors are to be elected or if financial statements are included, certain information concerning the issuer's relationship with its independent public accountants.
 - (ix) Description and certain specified information concerning any other matters to be acted upon, such as: (A) bonus, profit sharing or other compensation plans, (B) pension or retirement plans, (C) granting or extension of any options, warrants or other rights to purchase the issuer's securities, (D) authorization or issuance of securities, (E) modification or exchange of securities, (F) mergers, consolidations, acquisitions or other similar matters, (G) acquisition or disposition of property, (H) restatement of any asset, capital or surplus account of the issuer, (I) with respect to any report of the issuer or its officers, directors, committees or shareholders, (J) amendment of the issuer's charter or by-laws, or (K) other proposed action.
 - (x) As to each matter to be voted upon, explanation of the vote required for approval.
- b. Rule 14a-5 imposes certain requirements as to the manner in which information is presented in the proxy statement. There are special

disclosure requirements concerning proposed "shark repellent" or anti-takeover measures.

- c. Form S-4 is used for registration under the Securities Act of securities to be issued in connection with certain business combination and exchange offer transactions. The Form S-4 registration statement requires disclosure of the same type of information as a Schedule 14A proxy statement plus a considerable amount of additional information.
2. Rule 14a-6 sets forth the rules and procedures governing filing with and review by the SEC of proxy materials.
 - a. In general, preliminary proxy materials, including the proxy statement, form of proxy and other soliciting materials, must be filed with the SEC at least 10 days prior to the date definitive copies of such materials are to be first sent to security holders. Any additional soliciting materials to be furnished to security holders subsequent to the proxy statement are to be filed with the SEC at least two business days prior to the date such materials are to be first sent to security holders.
 - b. Definitive copies of the proxy statement, form of proxy and other soliciting material are to be filed, or mailed for filing, with the SEC and with each exchange on which any class of security of the issuer is registered and listed not later than the date such material is first distributed to security holders.
 - c. It should be noted that in its review of proxy materials the SEC places particular emphasis on the disclosures concerning proposed "shark repellent" or anti-takeover measures.
 3. Rule 14a-3(b) requires that if the proxy solicitation is made on behalf of the issuer and relates to an annual meeting at which directors are to be elected, the proxy statement must be accompanied or preceded by an annual report to security holders.
 - a. In general, the annual report to security holders requires disclosure of the following items:

- (i) Financial statements of the issuer prepared in accordance with Regulation S-X.
 - (ii) Management's discussion and analysis of financial condition and results of operations.
 - (iii) Description of the issuer's business, including where applicable industry segment reporting.
 - (iv) Identification of the issuer's directors and executive officers.
- b. Rule 14a-3(c) requires copies of the annual report to security holders to be mailed to the SEC, "solely for its information", not later than the later of the date on which the report is first distributed to security holders or the date on which preliminary copies of proxy solicitation materials are filed with the SEC.
- c. Rule 14a-3(c) further provides: "The [annual] report is not deemed to be 'soliciting material' or to be 'filed' with the Commission or subject to this regulation otherwise than as provided in this rule, or to the liabilities of Section 18 of the [Exchange] Act, except to the extent that the issuer specifically requests that it be treated as a part of the proxy soliciting material or incorporates it in the proxy statement or other filed report by reference."
- (i) This excludes the annual report to security holders from the application of various other statutory and regulatory provisions, most notably the anti-fraud rules contained in Section 18 and Rule 14a-9.
 - (ii) As a practical matter, however, the annual report to security holders is frequently incorporated by reference in other Exchange Act filings, particularly the Annual Report on Form 10-K.
4. Rule 14a-9 is the general anti-fraud provision applicable to proxy solicitations.
- a. Rule 14a-9(a) prohibits solicitation of proxies "by means of any proxy statement,

form of proxy, notice of meeting, or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statement therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

- b. Rule 14a-9(b) identifies certain specific examples of types of statements that may be misleading, depending upon the particular facts and circumstances.
 - c. A fact is considered to be "material" if "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." TSC Industries, Inc. v. Northway, 426 U.S. 483 (1976). The Court went on to say that materiality "does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote." Instead, "a substantial likelihood that disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" will suffice.
 - d. A negligence standard is generally applied in actions against issuers and directors under Rule 14a-9. See Gould v. American-Hawaiian S.S. Co., 535 F.2d 761 (3rd Cir. 1976); and Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281 (2nd Cir. 1973). A higher standard of proof, requiring scienter, is generally applied in actions against accountants and other professionals under Rule 14a-9. See Adams v. Standard Knitting Mills, Inc., 620 F.2d 422 (6th Cir.) cert. denied, 449 U.S. 1067 (1980).
5. Section 14(c) of the Exchange Act and Regulation 14C (Rules 14c-1 through 14c-7) promulgated thereunder by the SEC require that, in connection with every annual or other meeting of the holders of a class of securities registered under Section 12, including the taking of action with the

written authorization or consent and without a meeting of such security holders, an information statement must be furnished to such security holders unless management has solicited proxies with regard to such securities, in which event it must comply with the obligations pursuant to Section 14(a) described above.

- a. The information to be furnished is either an information statement containing the information specified in Schedule 14C or an information statement included in a registration statement filed under the Securities Act on Form S-4. The disclosure requirements of Schedule 14C are basically the same as or analogous to those of a Schedule 14A proxy statement.
- b. The information statement must be sent at least 20 days prior to the meeting date, or in the case of corporate action taken with the written authorization or consent of security holders, at least 20 days prior to the earliest date on which the corporate action may be taken. Rule 14c-2(b).
- c. If the information statement relates to an annual meeting of security holders at which directors are to be elected, Rule 14c-3 requires that the information statement be accompanied or preceded by an annual report to security holders. The disclosure requirements of this annual report are essentially the same as those of the annual report required under Rule 14a-3(b) as described above. This annual report must also be mailed to the SEC according to the same procedures described above with respect to the Rule 14a-3(b) annual report. Rule 14c-3.
- d. Regulation 14C also contains requirements concerning the information statement similar to those of the proxy rules described above regarding the manner of presentation of information (Rule 14c-4), filing with the SEC (Rule 14c-5), and false or misleading statements (Rule 14c-5).

E. Other Proxy Rules.

1. Rule 14a-4 specifies certain requirements as to the form of the proxy.

2. Rule 14a-7 imposes certain requirements as to mailing communications for security holders or, alternatively, providing security holders with a reasonably current list of of the issuer's record security holders.
 3. Rule 14a-8 sets forth the rules regarding inclusion of security holder proposals in the issuer's proxy materials.
 4. Rule 14a-10 prohibits solicitation of undated or post-dated proxies.
 5. Rule 14a-11 contains special provisions applicable to proxy contests.
- F. The SEC has proposed a "comprehensive revision" of the proxy rules. SEC Release No. 33-6592 (July 1, 1985). The proposed revisions relate principally to application of the integrated disclosure system to proxy and information statements. The proposed changes would also require additional disclosure related to independent accountants in proxy and information statements and other filings containing audited financial statements.
- V. Other Significant Areas of Regulation under the Exchange Act.
- A. Issuer repurchases of securities registered under Section 12 in "going private" transactions and tender offers are subject to regulation under Section 13(e) of the Exchange Act and the SEC rules thereunder.
 - B. Third party tender offers involving securities registered under Section 12 are regulated under Section 14(d) of the Exchange Act and the SEC rules thereunder. It should be noted that the anti-fraud provision relating to tender offers, Section 14(e) of the Exchange Act, applies to tender offers regardless of whether the securities are registered under Section 12.
 - C. Section 13(b)(2) of the Exchange Act imposes two accounting requirements on all issuers having a class of securities registered pursuant to Section 12 or subject to the reporting obligation under Section 15(d). Such issuers are required to:
 1. "Make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer;" and

2. "Devise and maintain a system of internal accounting controls sufficient to provide reasonable assurance" that certain specific objectives relating to safeguarding corporate assets, assuring that transactions occur in accordance with management's authorization and recording of transactions so as to permit the preparation of financial statements, are met.

VI. Integrated Disclosure System.

- A. Regulation 12B contains general rules applicable to the preparation and filing of registration statements pursuant to Section 12 of the Exchange Act and reports filed pursuant to Sections 13 and 15(d). The rules set forth in Regulation 12B supplement the various Exchange Act forms. In the event of a conflict, between the Regulation B rules and an Exchange Act form, the contents and instructions of the form control. The Regulation 12B rules are analogous and very similar to the rules contained in Regulation C under the Securities Act.
- B. Regulation S-K contains standard instructions for the disclosures required in various forms filed under both the Exchange Act and the Securities Act. Such forms frequently call for disclosure in accordance with various specified items of Regulation S-K.
- C. Regulation S-X specifies the form, content and other requirements for financial statements under various federal securities laws, including both the Exchange Act and the Securities Act.
- D. The SEC has also promulgated four Exchange Act Industry Guides dealing with the form and content of certain specific disclosures by electric and gas utilities, issuers engaged in oil and gas operations, bank holding companies and property-casualty underwriters.
- E. To a significant degree the various reporting and disclosure requirements are integrated by standardizing the form and content of required disclosures and by allowing incorporation by reference.

SEMINAR ON THE FUTURE OF LAW

February 14 - 15, 1998

COLLEGE OF LAW UNIVERSITY OF KY. KENTUCKY

Panel Discussion: The Initial Public Offering - Taking A Company Public

Participants:

Ralston W. Steenrod - Chairperson
Stites & Harrison, Louisville

James C. Strode
Sturgill, Turner & Pruitt, Lexington

Lawrence Pedley
Pedley, Ross, Zielke & Gordinier, Louisville

Gerald R. Martin
J.J.B. Hilliard, W.L. Lyons, Inc., Louisville

THE INITIAL PUBLIC OFFERING - TAKING A COMPANY PUBLIC

Ralston W. Steenrod
James C. Strode
Robert P. Ross
Gerald R. Martin
Louisville, Kentucky

I. General Observations on Going Public* (Martin)

A. Why go public?

In order of importance to issuer:

1. To raise capital (increase equity, reduce debt, etc.) - 75%
2. Estate and personal liquidity considerations - 7%
3. Management needs (currency for acquisitions, management incentives, corporate visibility) - 6%

B. Satisfaction with IPO process and professionals?

1. Are you satisfied that you went public?
92% - Yes
8% - No
2. Rating the quality of advice received from advisors

	<u>Excellent</u>	<u>Very Good</u>	<u>Good</u>	<u>Poor</u>
Attorney	56	29	13	2
Investment bankers	27	26	31	16
Accountants	38	42	17	3

C. How long did it take?

Expectation - 6 months
Reality - 10 Months (average)

D. How much did it cost?

Average costs by category:

SEC filing fees	\$ 3,500
Blue sky filing fees	18,000
Printing/engraving	88,000
Accounting	76,000
Legal (issuer's counsel only)	111,000
Transfer agent	3,500
NASD fee	1,500
Miscellaneous	<u>14,000</u>
Total fixed costs	316,000
"Variable" costs	
Underwriter's "Spread"	<u>950,000</u>
Total	<u>\$1,266,000</u> =====

*Based on results of 1985 survey conducted by Alexander Grant & Company of 146 issuers headquartered in New York area who went public in 1983 and 1984 with offerings in excess of \$2.5 million.

Fixed costs were approximately 2% and variable costs approximately 5 1/2% of the average offering amount of \$17 million, (a total of 7 1/2%). Total expenses are probably in a range 5% to 18% for offerings between \$2.5 million and \$130 million.

II. Investment Bankers' Criteria for Underwriting Initial Public Offerings (Martin)

A. Different underwriters have different criteria

1. Institutional or major bracket firms
2. Smaller New York and large regionals
3. Small regionals
4. Industry specialists
5. IPO specialists

B. General Criteria

1. Size of offering - amount of stock sold to public must be large enough to have reasonable prospects for an efficient aftermarket.
2. Size of company - the earnings level of the issuer (historical and/or projected) must justify the offering price.
3. Industry growth and future prospects - investors in IPO's seek above average growth potential - rather than current yield or low volatility - resulting in more interest in issuers in those industries which are perceived as rapid growth.
4. Management - the single most important element of any business. Are they competent, honest, aggressive? Do they have a business plan prepared?
5. Market conditions - demand for new issues varies with prevailing market and economic conditions.

III. Major Events in an Initial Public Offering ("IPO")

A. Pre-Offering Planning (Strode)

1. Articles, By-laws and minutes
2. Cheap stock
3. Blue-sky compliance issues

B. Selection of the IPO Team (Pedley)

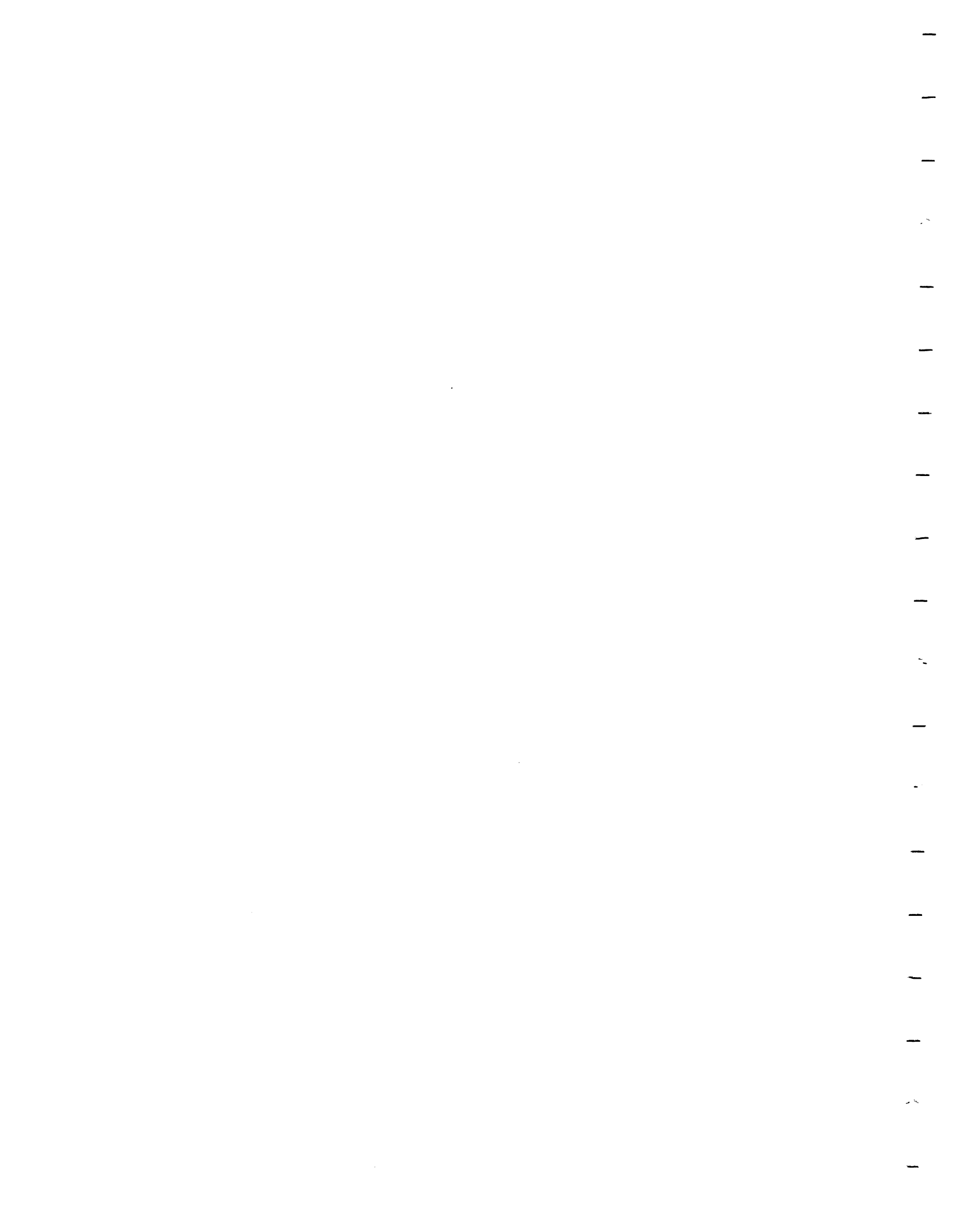
1. Lawyers
2. Accountants
3. Printer
4. Investment bankers
 - a. Letter of intent
 - b. "Firm" versus "best efforts" underwritings

C. Preparation, filing and use of the registration statements
(Steenrod)

1. Preparation and filing of documents and agreements
2. Waiting period and use of red herrings
3. Informational meetings - "road shows"

D. Underwriting and syndication (Martin)

1. Execution of the underwriting agreement
2. The manager or co-managers
3. The syndicate, underwriting and selling groups
4. Retention practices and institutional pots
5. Pricing and stabilization
 - a. Pricing
 - b. Green shoes and shorts
 - c. Snakes and free-riders



FINANCING TRANSACTIONS THROUGH THE USE
OF EXEMPTIONS FROM REGISTRATION

University of Kentucky
Seminar on Securities Law
February 14-15, 1986

Chris Trower
BROWN, TODD & HEYBURN
Louisville/Lexington, Kentucky



TABLE OF CONTENTS

	<u>Page</u>
I. Structure and Basic Requirements of Regulation D..	1
II. Maximum Number of Purchasers.....	2
III. Nature of Purchasers.....	3
IV. Limitation on Manner of Offerings.....	4
V. Access to Information.....	5
VI. Limitations on Disposition.....	6
VII. Integration of Offerings.....	6
VIII. Notice Filing Requirements.....	6
IX. Practical Issues in General Solicitation.....	7
X. Practical Aspects of Disclosure Compliance.....	8



FINANCING TRANSACTIONS THROUGH THE USE
OF EXEMPTIONS FROM REGISTRATION

Chris Trower
BROWN, TODD & HEYBURN
Louisville/Lexington, Kentucky

The principal exemption from the registration and prospectus delivery requirements of the Securities Act of 1933 is Regulation D, adopted and effective on April 15, 1982. Regulation D attempts to achieve uniformity between federal and state private placement exemptions.

Significant changes wrought by Regulation D include (i) the "accredited investor" concept, which permits an unlimited number of purchasers, eliminates sophistication requirements for investors, and reduces or eliminates information disclosure if all investors are accredited; (ii) no requirement that offerees be suitable or, in offerings under \$5,000,000, that purchasers be suitable; (iii) elimination of the test of ability to bear economic risk for purchasers who meet the sophistication test through purchaser representatives; (iv) sliding scale information requirements depending on the size of the offering and the nature of the offeree; and (v) a notice filing system.

I. Structure and Basic Requirements of Regulation D.

Regulation D does not provide an exemption from the anti-fraud, civil liability, or other provisions of the federal securities laws except the registration and prospectus delivery requirements of Section 5 of the 1933 Act. State law compliance is not assured by Regulation D compliance.

Regulation D is not the exclusive means of taking advantage of the nonpublic offering exemption under Section 4(2) of the 1933 Act. It is, however, available to issuers only, not to affiliates or others engaged in the resale of securities.

A. General Structure.

1. Rule 501 -- contains common terms and definitions used throughout Regulation D, such as "accredited investor," calculation of the number of purchasers, and determination of purchaser representatives.

2. Rule 502 -- sets forth general conditions for each of the exemptions: (i) integration, (ii) financial disclosure, (iii) manner of offering, (iv) limits on resale.

3. Rule 503 -- provides for the required filing of Form D to be used for all exempt offerings under Regulation D.

4. Rule 504 -- governs the exemption for sales of securities not exceeding \$500,000.

5. Rule 505 -- governs the exemption for sales of securities not exceeding \$5,000,000.

6. Rule 506 -- provides an exemption for sales of securities without regard to the amount of the offering.

B. Basic Requirements for Private Placements under Regulation D.

1. Maximum of 35 purchasers excluding accredited investors.

2. Nature of purchasers.

3. Limitations on the manner of the offering.

4. Furnishing of information.

5. Limitations on disposition.

6. Integration of offerings.

7. Notice filing requirements.

Each of these major requirements is discussed below under separate headings.

II. Maximum Number of Purchasers.

A. 35 purchasers is the maximum permitted except for accredited investors.

B. Accredited investors are not included for purposes of the 35 purchasers test and there is no limit to the number of accredited investors who may invest.

C. Clients of broker dealers or investment advisors are considered purchasers, regardless of the degree of discretion granted to the broker dealer or investment advisor.

D. General partners are not included in the 35 purchaser test. Brentwood Village Apartments, Ltd. (6/20/80).

E. Treatment of initial limited partners for purposes of the 35 purchaser test. Thunderbird Apartments, Ltd. (3/15/79).

F. In addition to the exclusion of the accredited investors, Rule 501(e) provides for the exclusion of certain other investors, including the following: (i) any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser; (ii) any trust or estate in which a purchaser and certain related persons collectively have more than 50% of the beneficial interest; and (iii) any corporation or organization in which a purchaser and certain related persons collectively have more than 50% of the equity securities or equity interest.

G. A corporation, partnership or other entity counts as one purchaser unless it is organized for the specific purpose of acquiring the securities being offered and is not an accredited investor under Rule 501(a)(8), in which case each beneficial owner of equity securities or equity interests in the entity counts as a separate purchaser for all provisions of Regulation D.

III. Nature of Purchasers.

A. Accredited investors are defined Rule 501(a) as including 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.

1. Institution investors.
2. Private business development companies.
3. Tax exempt organizations under § 501(c)(3) with total assets exceeding \$5,000,000.
4. Directors, executive officers and general partners of the issuer.
5. \$150,000 purchasers if the price does not exceed 20% of the purchaser's net worth or joint net worth with spouse.
6. Natural persons with an individual net worth or joint net worth with spouse in excess of \$1,000,000 inclusive of home, furnishings, and automobiles.

7. Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years and who reasonably expects an income in excess of \$200,000 for the current year.

8. Any entity in which all of the equity owners of accredited investors under paragraphs 1-4 and 6-7 above.

B. For unaccredited investors, "the issuer shall reasonably believe immediately prior to making any sale that each purchaser who is not an accredited investor either alone or with his purchaser representative has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment." Rule 506(b)(2)(i).

C. A few general comments are in order.

1. It is not necessary to make a preliminary determination of suitability.

2. Unsophisticated, nonaccredited investors require the use of an "offeree representative" in transactions involving sales of more than \$5,000,000.

3. An investor must acknowledge in writing that a purchaser representative is acting in that capacity.

4. Material relationships between the issuer, its affiliates, and the purchaser representative must be disclosed to the purchaser in writing prior to the acknowledgment described above.

5. Nonaccredited investors who, with purchaser representatives is necessary, are able to evaluate the transaction need not meet any financial tests. This represents a departure from prior practice.

6. Accredited investors need not be sophisticated, again a departure from prior practice and concepts.

IV. Limitation on Manner of Offering.

A. General solicitation and general advertising are prohibited. This includes but is not limited to (i) articles, notices or communications published in newspapers, magazines, or similar media, or broadcast over television or radio; and (ii) any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.

B. The commission's review on the general solicitation prohibition is reflected in the footnote to the proposed rule.

"The Commission is aware that, pursuant to the exclusion from accounting in Rule 146 for persons who purchase \$150,000 of securities, many offerings claiming the exemption provided by the Rule have been sold to hundreds of purchasers. Similarly, pursuant to the accredited investor concept in Regulation D, offerings could theoretically be made to an unlimited number of accredited investors. The Commission cautions issuers, however, that depending upon the actual circumstances, offerings made to such large numbers of purchasers may involve a violation of the prohibitions against general solicitation and general advertising."

V. Access to Information.

A. If an issuer sells securities only to accredited investors, Regulation D does not require any specific disclosure.

B. If the issuer sells securities to investors who are not accredited, then delivery of the following information is required to be furnished to all purchasers.

1. For offerings up to \$500,000, no information requirements are specified.

2. For offerings up to \$5,000,000, the issuer is required to furnish the same information as would be required by Part I of Form S-18, or for an issuer not qualified to use Form S-18, the same information required in Part I of a registration form available to the issuer. Two years of financial statement, with only the most recent year audited, need to be furnished. Limited partnerships may use tax basis financial statements.

3. For offerings over \$5,000,000 the same information as specified in Part I of an available form of registration is required.

C. A number of exceptions to the audited financial statements are permitted. In particular, the financial statement requirements may be relaxed where inappropriate or

preparing of the financials would result in unreasonable effort and expense.

VI. Limitations on Disposition.

Securities required in a Regulation D transaction cannot be resold without registration under the 1933 Act or an exemption therefrom, except securities sold under Rule 504 involving sales made exclusively in states required registration and delivery of a disclosure document before sale and which are made in accordance with these state provisions.

The issuer must exercise reasonable care that the purchaser is not an underwriter, which reasonable care should include, without limitation (i) reasonable inquiry to determine if the purchaser is acquiring the securities for his own account, (ii) written disclosure by the issuer to each purchaser that the securities are unregistered and cannot be resold unless registered or unless a registration exemption is available, and (iii) legending certificates to indicate the securities are unregistered, and the restrictions on their subsequent transfer.

VII. Integration of Offerings.

A. 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 the Regulation D offering will not be considered part of that offering, so long as during the six month period there are no offers or sales of securities by or for the issuer that are the same or a similar class.

B. The SEC's usual integration tests are applied: (i) whether the sales are part of a single plan of financing, (ii) whether the sales involve the issuance of the same class of securities, (iii) whether the sales have been made at or about the same time, (iv) whether the same type of consideration is received, and (v) whether the sales are made for the same general purpose.

C. Significantly, the first exemption is not lost by a subsequent offering. Note too Rule 504.

VIII. Notice Filing Requirements.

A. A uniform notice of sales form has been adopted for all offerings under Regulation D and Section 4(b) of the 1933 Act. The form requires, among other things, an indication of the exemptions being claimed.

B. Five copies of Form D must be filed no later than fifteen days after the first sale of securities. Receipt of subscription funds into escrow pending receipt of minimum subscriptions would technically trigger the filing requirements. Subsequent notices are due every six months and thirty days after the last sale. Receipt at the SEC's principal office in Washington or mailing by registered, certified mail constitutes filing.

IX. Practical Issues in General Solicitation.

A. The Staff's general reaction to advertising or general communications of any type has been strongly negative.

1. Tombstones. Interpretative Release Question 59; ALMA Securities Corporations (7/2/82).

2. Promotional Brochures. Aspen Grove (11/8/82).

3. Issuer-Prepared Summaries. Texas Investor Newsletter (1/23/84).

4. Non-issuer Newsletters. Oil and Gas Investors (9/9/83).

5. Simultaneous general advertising of products and services. Printing Enterprises Management Science, Inc. (4/25/83).

B. Mailing solicitations to participants in prior programs seems to be permissible. Woodtrails-Seattle Ltd. (7/8/82). Solicitation directed only to accredited investors, if general, would not necessarily mean the solicitation is in compliance with Rule 502(c) since Rule 502(c) relates to the nature of the offering, not to the nature of the offerees. Interpretative Release, Question 6.

C. Meetings and Seminars. The Staff has yet to express a definitive position.

D. Use of accountants, attorneys and other professional advisors. Arthur M. Borden, Esq. (9/15/77 and 10/6/78; Tax Investment Information Corporation (2/7/83). Fees may be paid to professional advisors without destroying Regulation D compliance. Interpretative Release Question 39; Markham Investments, Inc. (1/15/84).

X. Practical Aspects of Disclosure Compliance.

A. Even where no disclosure is required (such as for Rule 504 offerings not in excess of \$500,000 or offerings only to accredited investors), the offering will still subject the issuer and its controlling persons to potential liability under the antifraud and civil liability provisions of the 1933 Act and the 1934 Act other than the prospectus delivery and registration requirements of Section 5 of the 1933 Act.

B. Form S-18 requires the issuer's audited balance sheet. With respect to recently formed limited partnerships with minimal capitalization, the Staff has concluded that "if an audited balance sheet is not material to the investor's understanding then the issuer may elect to present an alternative to its audited balance sheet." Interpretive Release, Question 43. The Staff in this context stated "in analyzing this or any other disclosure question under Regulation D, the issuer starts with the general rule that it is obligated to furnish the specified information 'to the extent material to an understanding of the issuer, its business, and the securities being offered.'" But in the context of a startup venture, is it even necessary to furnish an unaudited balance sheet. Many practitioners simply use a capitalization table.

C. Item 21(h) of Form S-18 requires an audited balance sheet as of the end of the most recent fiscal year of any corporation or partnership that is a general partner of the issuer. Regarding individual persons serving as general partners, net worth statements in the text of disclosure documents with assets and liabilities estimated at fair market value and provisions for estimated tax and unrealized gain are permitted Interpretive Release, Question 45.

D. Sizzle Sheets can be utilized provided they are a fair and adequate summary of the deal, followed by a complete disclosure document. Interpretive Release, Question 40.

E. Investor Questionnaires and Subscription Documents are essential for the issuer to have a "reasonable basis" for believing that an investor is accredited and (if appropriate) sophisticated. Otherwise, the issuer runs the risk of losing the exemption.

* * * * *

INSIDER TRADING

Willburt D. Ham
Professor of Law
University of Kentucky

I. Introduction

A. The Insider Trading Doctrine

1. The prohibitions on insider trading which have led to the insider trading doctrine are primarily a feature of federal securities regulation as developed under the antifraud provisions of the federal securities laws.
2. The insider trading doctrine places restrictions on the purchase and sale of securities by certain classes of persons based on the use of material, nonpublic information.
3. The insider trading doctrine has been said to be "based on the premise that the use of such information undermines investor expectations of fairness and equal opportunity that are the foundation of public confidence in our securities markets." Phillips & Zutz, The Insider Trading Doctrine: A Need for Legislative Repair, 13 Hofstra L. Rev. 65 (1984).

B. Sources of the Federal Law of Insider Trading

1. The only direct prohibition on insider trading contained in the federal securities laws as originally drafted was that found in section 16(b) of the Securities Exchange Act of 1934.
2. This section condemns short-swing speculation on the part of corporate insiders in corporations whose stock is required to be registered pursuant to section 12 of that act by providing for recovery on the part of the corporation of any profit made by corporate directors or officers (or 10% beneficial owners of the corporation's stock) from any purchase and sale or sale and purchase of the corporation's stock within six months. (See Appendix A).

3. Section 16(a) of the Securities Exchange Act of 1934 contains a reporting requirement which requires the designated "insiders" to file a report with the Securities and Exchange Commission as to their stock ownership at the time they acquire their insider status and periodically thereafter when any changes in their ownership status occurs. (See Appendix A).
4. Much of the development of a federal corporation law relating to insider trading has come from SEC Rule 10b-5, which broadly condemns fraudulent practices in connection with the purchase or sale of a security. (See Appendix C).
5. Rule 10b-5 was promulgated by the Securities and Exchange Commission under authority granted to it in section 10(b) of the Securities Exchange Act of 1934 to adopt rules and regulations designed to prevent the use of manipulative or deceptive devices or contrivances in connection with the purchase or sale of a security. (See Appendix B).
6. Rule 10b-5, when first promulgated by the Securities and Exchange Commission in 1942, originated in an effort on the part of the Commission to fill a gap in the securities laws relating to fraud perpetrated on sellers of securities. See Proceedings, Conference on Codification of Federal Securities Laws, 22 Bus. Law. 793, 922 (1967) (remarks by Milton Freeman).
7. Since its modest beginnings, rule 10b-5 has come to dominate the corporate fiduciary scene, and as Justice Rehnquist put it, "[w]hen we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn." See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

8. Although rule 10b-5 has been applied to a wide variety of conduct involving fraudulent practices relating to the purchase and sale of securities, its frequent application to "insider trading" cases has led to it being thought of as an "insider trading" rule.
9. While section 16(b) remains an effective tool to combat short-swing trading activities by corporate officers and directors, rule 10b-5 has come to have a much broader scope of application.
 - a. There are no time limitations as far as the trading activity is concerned.
 - b. Trading is not limited to stocks of companies whose stock is required to be registered.
 - c. Those covered include a much broader spectrum of persons, such as employees and others in a relationship with the corporation giving access to inside confidential information not yet public. See In re Cady, Roberts & Co., 40 S.E.C. 907 (1961).
10. The case which firmly established rule 10b-5 as an insider trading rule was the well-known Texas Gulf Sulphur case. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).
 - a. This case involved an enforcement action brought by the Securities and Exchange Commission against Texas Gulf Sulphur and thirteen individual defendants charging the individual defendants with violation of rule 10b-5 by buying Texas Gulf stock at a time when they possessed undisclosed information as to a major ore find by the company.

- b. Judge Waterman, speaking for a majority of the court, commented that "anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed." See 401 F.2d at 848.

II. Insider Trading Under Rule 10b-5

A. Private damage actions

1. Where insider trading takes place in the context of a closely-held corporation on a face-to-face basis, there has been little doubt as to the right of those deceived to sue for damages under rule 10b-5. See, e.g., Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947).
2. The Supreme Court of the United States acknowledged the existence of an implied private cause of action under section 10(b) of the Securities Exchange Act in Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971).
 - a. The Court followed the lead of the Borak case, which had confirmed the existence of an implied private cause of action under section 14(a) of the Securities Exchange Act dealing with the solicitation of proxies. See J. I. Case Co. v. Borak, 377 U.S. 426 (1964).
 - b. The existence of the private cause of action under section 10(b) and rule 10b-5 remains viable despite the recent efforts of the Supreme Court of the United States to cut back on implied causes of action under the federal securities acts. See, e.g., Touche Ross & Co. v. Redington, 442 U.S. 560 (1979); Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979).

B. Open-Market Trading

1. When trading is not on a face-to-face basis but occurs on the anonymous public market, the problem arises as to how to define the class of investors to whom a remedy is to be afforded.
2. One view is that liability extends not only to purchasers of the actual shares from the wrongdoers (hard to establish in open-market trading) but also to all persons who, during the same period the wrongdoers were trading on the open market, purchased the corporation's stock in the open market without knowledge of the material inside information which was in the possession of the wrongdoers. See Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974).
3. A second view is that, absent privity between plaintiff and defendant, no liability can result since no causal connection would exist between defendant's conduct and plaintiff's loss. See Fridrich v. Bradford, 542 F.2d 307 (6th Cir. 1976), cert. denied, 429 U.S. 1053 (1977).
4. Courts following the no-liability position in the open-market trading cases have expressed concern with the crushing liability that could result by extending the reach of section 10(b) and rule 10b-5 to anonymous market transactions in private damage actions.
 - a. One solution to the problem of measuring damages in open-market trading cases has been to use a "disgorgement" measure of recovery (based on profits received) rather than the traditional "out-of-pocket" measure of recovery (based on losses incurred) and to limit recovery to a sum not in excess of the profits earned. See Elkind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980).

- b. In Elkind, which was a "tippee" case, the court observed that "[i]n most cases the damages recoverable under the disgorgement measure would be roughly commensurate to the actual harm caused by the tippee's wrongful conduct," since "[i]n a case where the tippee sold only a few shares . . . the likelihood of his conduct causing any substantial injury to intervening investors buying without benefit of his confidential information would be small," whereas, "[i]f, on the other hand, the tippee sold large amounts of stock, realizing substantial profits, the likelihood of injury to intervening uninformed purchasers would be greater and the amount of potential recovery thereby proportionately enlarged." See 635 F.2d at 172.
- c. The proposed ALI Federal Securities Code recommends such an approach to computing damages in the open-market trading cases. See ALI Federal Securities Code §1708(b)(3) (1980).
- d. In SEC v. MacDonald, 699 F.2d 47 (1st Cir. 1983), the First Circuit Court of Appeals, sitting en banc, held that, in the case of publicly traded securities where sellers can "cover" by replacing the securities sold, the measure of disgorgement in an insider trading case should be limited to accretions in stock value occurring up to a reasonable time after other investors receive the information.
- e. The SEC, in MacDonald, had urged that the entire profit realized by an insider over a period of slightly more than a year be disgorged in the interests of promoting investor confidence and the integrity of the nation's capital markets and that the limitation on disgorgement of profits imposed by the court be confined to private damage actions between individuals.

C. Trading on Market Information

1. A recent development in the area of insider trading has been as to whether trading by non-insiders on market information is to be treated the same as trading by insiders on corporate information.
2. The Supreme Court of the United States has rejected the position that trading on non-public market information by a non-insider could constitute a violation of section 10(b) and rule 10b-5. See Chiarella v. United States, 445 U.S. 222 (1980).
 - a. The Chiarella case involved an employee of a financial printing firm who decoded the names of target companies in tender offer documents, and who, after having done so, bought shares of stock in the target companies which he then sold at a profit when the tender offers were publicly announced.
 - b. In Chiarella, Chief Judge Kaufman, writing for the Second Circuit Court of Appeals, applied the parity-of-information rule and held that "[a]nyone--corporate insider or not--who regularly receives material nonpublic information may not use that information to trade in securities without incurring an affirmative duty to disclose." See United States v. Chiarella, 588 F.2d 1365 (2d Cir. 1978).
 - c. The Supreme Court rejected the "equal-access" test and held that failure to disclose material information becomes fraudulent only when there is a duty to disclose the information and the duty to disclose arises only where there is a relationship of trust and confidence between the parties to the transaction. See 445 U.S. at 230.

D. Tippee Liability

1. Although the Chiarella case did not deal directly with the liability of tippees, Justice Powell, writing for the Court, remarked that "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." See 445 U.S. at 230 n.12.
2. The Supreme Court attempted to clarify the issue of tippee liability in Dirks v. SEC, 463 U.S. 646 (1983).
3. The Dirks case grew out of an administrative proceeding which the SEC brought against Raymond Dirks, a New York broker-dealer, charging Dirks with aiding and abetting violations of section 10(b) and rule 10b-5 by revealing information about the Equity Funding fraud to investors before the information had been made public.
 - a. Dirks had received information from former officials of Equity Funding of America that the assets of the corporation, which consisted primarily of life insurance policies, had been greatly overstated, and through extensive investigation of his own, Dirks was able to substantiate the charges.
 - b. The SEC found Dirks to have engaged in unlawful insider trading activity, but only ordered Dirks censured in deference to his efforts in uncovering the Equity Funding fraud.
4. On review, the Court of Appeals for the District of Columbia Circuit accepted the judgment of the Commission, treating Dirks as a "tippee" who was subject to the same "disclose or abstain rule" as the Equity Funding officials who revealed the nonpublic corporate information to him.

5. The Supreme Court reversed the Court of Appeals, taking the position that "a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."
 - a. The test, the Court said, for determining whether the insider has breached a fiduciary duty "is whether the insider personally will benefit, directly, or indirectly, from his disclosure."
 - b. This means, the Court added, that "[a]bsent some personal gain, there has been no breach of duty to stockholders," and, "absent a breach by the insider, there is no derivative breach."
 - c. The Court explained that the required benefit on the part of the insider may result from the insider's own pecuniary gain "or a reputational benefit that will translate into future earnings."
 - d. Under the test thus enunciated, Dirks was exonerated of any wrongdoing, since the Equity Funding employees had not violated their fiduciary obligations to the shareholders of Equity Funding by informing Dirks of the Equity Funding fraud.

E. Insider Trading After Chiarella and Dirks

1. While Chiarella and Dirks put definite restrictions on the scope of insider trading liability, neither of these decisions appear to have guaranteed complete freedom from such liability on the part of outsiders trading on nonpublic information.

2. Two avenues of continued liability have emerged: (1) the "misappropriation" theory of liability, and (2) the "temporary insider" theory of liability.
3. The "misappropriation" theory of liability is based on the argument that when people, like Chiarella, trade on the basis of confidential information in the possession of their employer, they are guilty of having breached the trust and confidence placed in them by their employer (and their employer's clients).
4. The misappropriation theory was successfully used by the Government in a criminal indictment in United States v. Newman, 664 F.2d 12 (2d Cir. 1981, cert. denied, 464 U.S. 863 (1983)).
 - a. In that case, Newman had traded on confidential information regarding planned tender offers passed on to him by employees of the Morgan Stanley investment banking firm.
 - b. The Supreme Court had left open the viability of the "misappropriation" theory in Chiarella because the jury instructions had not embraced such a theory (opinion by Justice Powell).
5. After the decision in Newman, sellers of target company shares sought to sue Newman and those involved with him in private civil suits under the misappropriation theory but the Second Circuit Court of Appeals refused to extend the theory on their behalf. Moss v. Morgan Stanley, Inc., 719 F.2d 5 (2d Cir. 1983), cert. denied, 465 U.S. 1025 (1984).
 - a. The court said that nothing in its opinion in Newman suggested that an employee's duty to his employer should be stretched to encompass an employee's duty of disclosure to the general public.

- b. The court said that "[w]e find that plaintiff's misappropriation theory clearly contradicts the Supreme Court's holding in both Chiarella and Dirks and therefore conclude that the complaint fails to state a valid section 10(b) or rule 10b-5 cause of action."
6. However, since its decisions in the Newman and Moss cases, the Second Circuit Court of Appeals has upheld use by the SEC of the misappropriation theory in SEC enforcement actions, taking the position that suits by the Commission for injunctive relief were akin to criminal prosecutions making the case more like Newman than Moss, in that in such case the purpose was to deter future fraudulent conduct and to effectuate public policy. SEC v. Materia, 745 F.2d 197 (2d Cir. 1984), cert. denied, 105 S.Ct. 2112 (1985).
7. The temporary insider theory as a source of insider trading liability stems from footnote 14 in the Dirks case.
- a. In footnote 14, the Court said: "Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders."
- b. The court added: "The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes."
- c. The court cautioned: "For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship must imply such a duty."

8. The temporary insider concept was recognized in 1983 in a federal district court case from California. SEC v. Lund, 570 F. Supp. 1397 (C.D. Calif. 1983).
 - a. In this case, Horowitz, Chief Executive Officer of a corporation, had revealed to Lund, a business associate who held a similar position in another corporation, confidential information as to a joint venture in which his (Horowitz) corporation was planning to participate and he suggested to Lund that perhaps Lund's corporation might also like to become a participant.
 - b. The court concluded that Lund, because of his close ties with Horowitz, became "a temporary insider upon receipt of the information concerning the joint venture project and assumed an insider's duty to 'disclose or abstain' from trading on that information."

F. SEC Rule 14e-3

1. One of the more serious consequences of the Chiarella and Dirks decisions may be their effect on the validity of SEC Rule 14-3 which was adopted just after the Chiarella decision to combat insider trading in connection with tender offers.
2. Rule 14e-3 was adopted by the Securities and Exchange Commission under section 14(e) of the Securities Exchange Act of 1934.
 - a. Section 14(e), which was enacted by Congress in 1968 as a part of the Williams Act regulating tender offers, is an antifraud provision similar to rule 10b-5, condemning "fraudulent, deceptive, or manipulative acts or practices" in connection with a tender offer. (See Appendix D).

- b. Rule 14e-3 establishes a disclose or abstain rule for any person who possesses material nonpublic information relating to a tender offer. (See Appendix E).
3. The only relevant difference between section 10(b) and section 14(e) would appear to be that section 10(b) seeks to prevent fraudulent conduct "in connection with" the purchase or sale of securities whereas section 14(e) seeks to prevent fraudulent conduct "in connection with" the making of a tender offer.
- a. Since both section 14(e) and section 10(b) are antifraud statutes which proscribe fraudulent activity, it can be argued that they should both be construed in the same manner.
 - b. Furthermore, it has been pointed out that "Rule 14e-3 encompasses the 'in possession of' theory and specifically imposes a duty upon outsiders to the corporation, and therefore runs completely contrary to the motive and duty analysis under both Chiarella and Dirks." See Block & Hoff, Life After 'Dirks': Can Outsider Trading Constitute Fraud?, The National L.J., Sept. 19, 1983, at 22.

G. The Insider Trading Sanctions Act of 1984

1. This Act, which amended section 21(d) of the Securities Exchange Act by adding a new paragraph to that section, was signed by President Reagan on August 10, 1984. See 15 U.S.C.A. § 78u(d)(2) (Supp. 1985).
- a. Its purpose was to increase the sanctions against unlawful trading by insiders possessing material nonpublic information
 - b. Prior to the passage of the Act, the sole remedy available to the SEC in insider trading cases was an injunction against future violations, usually coupled with a "disgorgement order," whereby the defendant was required to return the profits resulting from his unlawful conduct.

2. Under the Act, a federal district court may now impose "a civil penalty" of up to "three times the profit gained or loss avoided" on "any person [who] has violated any provision of [the 1934 act] or the rules or regulations thereunder by purchasing or selling a security while in possession of material nonpublic information."
3. The amount of such penalty is to be determined by the court in light of the facts and circumstances, but is not to exceed three times the profit gained or loss avoided as a result of such unlawful purchase or sale, and is to be payable into the Treasury of the United States.
 - a. The Act provides that for the purpose of the Act "profit gained" or "loss avoided" is to be the difference between the purchase or sale price of the security and the value of that security as measured by the trading price of the security a reasonable period after public dissemination of the nonpublic information.
 - b. This standard for measuring recovery follows the standard adopted by the First Circuit Court of Appeals in SEC v. MacDonald, 699 F.2d 47 (1st Cir. 1983).
 - c. The court there held that the profits gained in insider-trading transactions should be fixed a reasonable time after disclosure of the information and should not include "windfall profits" realized by a defendant who held stock that later further increased in price.
4. Although the language of the Act covers not only persons directly involved in insider trading but also persons who aid and abet such violations, the aiding and abetting only applies to those communicating the material nonpublic information (i.e., tippers).

- a. The Act, by its own language, is not to apply to the controlling person section of the Securities Exchange Act, section 20(a), nor to a person solely because that person employs another person who is liable under the Act.
 - b. This provision in the Act was included to alleviate a concern in the brokerage industry as to the possible danger of secondary liability.
 - c. The industry had expressed concern that a securities salesperson who executed a transaction for a customer knowing (or having reason to know) that the customer had inside information could be subjected to a treble penalty under the Act on the theory that such person had "aided and abetted" the violation.
 - d. There was also concern that a brokerage firm might be charged under the Act on a theory of secondary liability if one of its registered representatives traded on inside information or passed such information on to a customer.
5. The Act includes a five-year statute of limitations on actions seeking the new treble damage penalty.
 6. The Act specifically provides that the legislation is not to be construed to bar or limit in any manner any action by the Commission or the Attorney General under any other provision of the Securities Exchange Act.
 7. The Act increases the criminal sanction of \$10,000 for violations of the Securities Exchange Act to \$100,000.

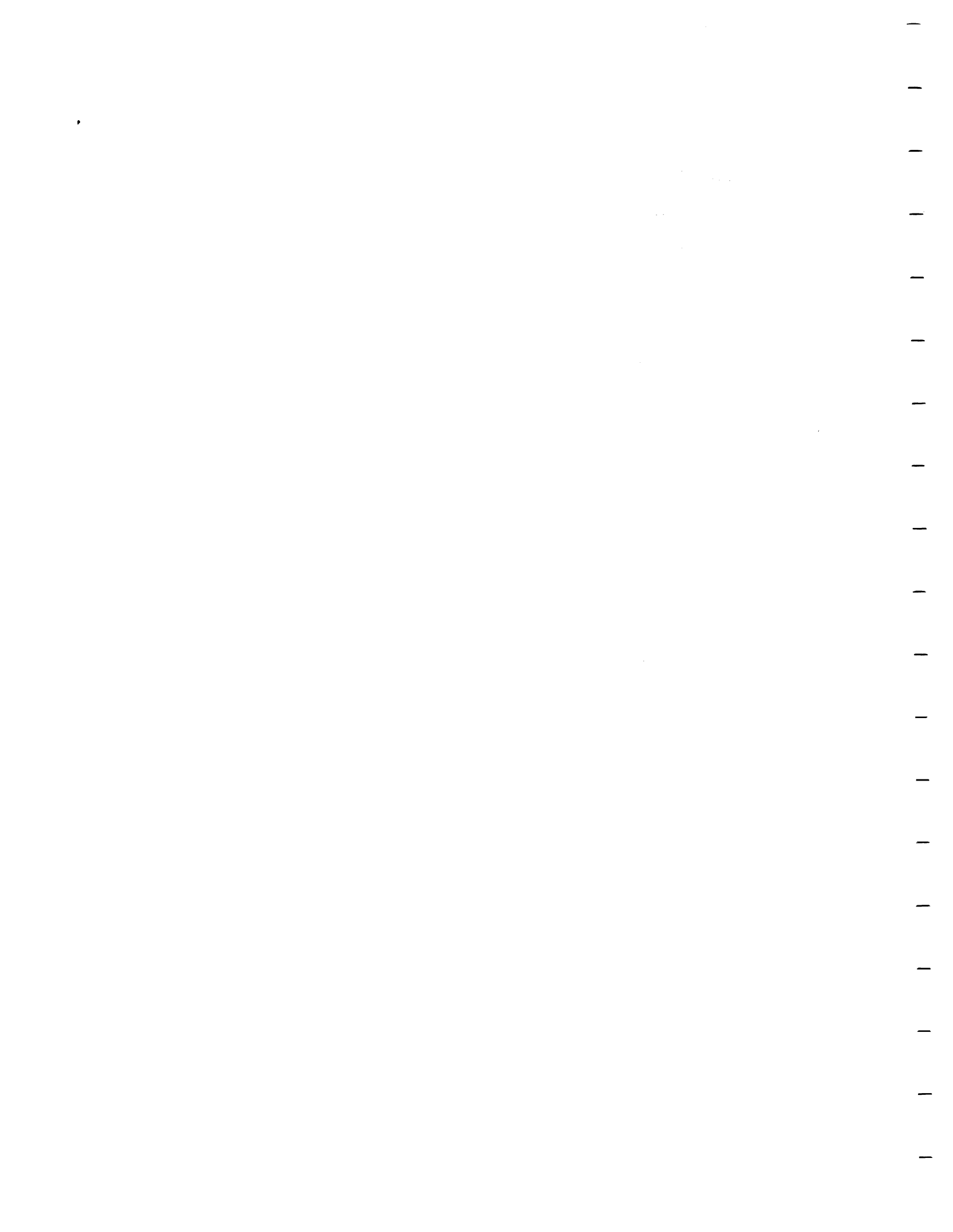
H. In Pari Delicto Defense

1. In the recent Supreme Court case of Eichler v. Berner, 105 S.Ct. 2622 (1985), the Court considered "whether the common-law in pari delicto defense bars a private damages action under the federal securities laws against corporate insiders and broker-dealers who fraudulently induce investors to purchase securities by misrepresenting that they are conveying material nonpublic information about the issuer."
2. Prior to the decision in Eichler, the lower federal courts had been divided on the question whether the in pari delicto defense was available in insider trading cases.
3. The Supreme Court agreed with the position taken by the Ninth Circuit Court of Appeals in Eichler that securities professionals and corporate officers should not be allowed to defend against their own fraudulent conduct by invoking the in pari delicto doctrine.
4. The Supreme Court said that while it might be true that a "tippee" of inside information who trades on such information could be subject to civil and criminal penalties for such conduct, nevertheless the Court did not believe that the conduct of such person was necessarily as blameworthy as the corporate insider or broker-dealer conveying the information and therefore, in the opinion of the Court, deterrence of insider trading would most frequently be maximized by focusing enforcement efforts on the sources of such information.
5. The Court added that it also believed that corporate insiders and broker-dealers would likely be more responsive to the deterrent pressure of potential sanctions and more knowledgeable than ordinary investors as to the allowable limits of their conduct.

III. Insider Trading Under Section 16(b)

A. The Purpose of Section 16(b)

1. Section 16(b) of the Securities Exchange Act of 1934 was designed to discourage corporate officers, directors, and beneficial owners of corporate stock from taking personal advantage of their access to corporate information by engaging in short-term trading in the securities of their corporation.
 - a. The section provides that any officer, director, or owner of more than 10% of any "equity security" of a corporation must account to the corporation for any profit resulting from the purchase and sale or sale and purchase of such security within any six month's period.
 - b. Suit to recover such profit may be instituted by the corporation or by a security holder of the corporation if the corporation fails or refuses to bring such suit within 60 days after request to do so.
2. An early case from the Second Circuit Court of Appeals, Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir. 1943), cert. denied, 320 U.S. 751 (1943), established two important doctrines relating to the application of section 16(b).
 - a. The court held that it was not necessary to show an actual unfair use of inside information to sustain a recovery under section 16(b), that the purpose sought in enacting the statutory provision was to set up an objective standard which would remove the necessity for ascertaining actual intent to benefit from the use of inside information.
 - b. In addition, the court held that the proper method for computing the profit to be recovered under the section should be the lowest price in, highest price out within any six month's period in order to carry out the purpose of the legislation to squeeze all possible profits out of the stock transaction.



B. Litigation Under Section 16(b)

1. A substantial amount of litigation under section 16(b) has involved the issue as to what constitutes a "purchase" or a "sale" within the meaning of those terms as used in the section.
 - a. Early cases in the lower federal courts favored an "objective" approach in which the broad position was taken that Congress meant "purchase" and "sale" to apply to all acquisitions and dispositions of stock. See, e.g., Park & Tilford v. Schulte, 160 F.2d 984 (2d Cir.), cert. denied, 332 U.S. 761 (1947).
 - b. Later cases have favored a "subjective" or "pragmatic" approach in which effort is made to determine if the transaction is of a kind which could lend itself to the speculation encompassed by section 16(b). See, e.g., Ferraiolo v. Newman, 259 F.2d 342 (6th Cir. 1958), cert. denied, 359 U.S. 927 (1959).
 - c. The Supreme Court of the United States has seemed to favor use of the "pragmatic" approach in what it calls "unorthodox" transactions, such as exchanges of stock pursuant to mergers or options to purchase stock. See Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973).
 - d. On the other hand, in ordinary "orthodox" cash-for-stock transactions, the Supreme Court has seemed to favor the "objective" approach as bringing the transaction within section 16(b) irrespective of whether the transaction was one which lent itself to speculative abuse under section 16(b). See Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418 (1972).

2. A second area of substantial litigation under section 16(b) has been as to the "persons" covered by the section.
 - a. The Supreme Court of the United States has held that as to 10% beneficial owners, such persons must have been 10% owners both at the time of purchase and at the time of sale for the section to apply. See Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232 (1976).
 - b. On the other hand, the lower federal courts have held that it is not necessary that directors or officers be such both at the time of the purchase and the sale involved. See Adler v. Klawans, 267 F.2d 840 (2d Cir. 1959) (director only at time of sale); Feder v. Martin Marietta Corp., 406 F.2d 260 (2d Cir. 1969), cert. denied, 396 U.S. 1036 (1970) (director only at time of purchase).
 - c. Under the "deputization" theory, a partnership or a corporation may be treated as the "director" of another corporation for purposes of section 16(b) if a member of the partnership or a director of the corporation represents the partnership or the corporation by sitting as a member of the board of directors of the other corporation. See Blau v. Lehman, 368 U.S. 403 (1962).
 - d. The Second Circuit Court of Appeals has applied the "deputization" theory to hold a corporation liable for profits received through trading in the stock of another corporation within a period of six months where a director of the corporation, who was also its Chief Executive Officer, was serving as a director of the other corporation. See Feder v. Martin Marietta Corp., 406 F.2d 260 (2d Cir. 1969), cert. denied, 396 U.S. 1036 (1970).

IV. Insider Trading Under State Law

A. Suits by Individual Shareholders

1. Under the common law, three views emerged as to the right of individual shareholders of a corporation to bring actions against the directors of the corporation for failure to reveal information possessed by them affecting the value of the corporation's stock when purchasing that stock from the individual shareholders.
 - a. Under what became known as the "majority" rule, it was said that the directors of a corporation were under no duty to speak in their dealings with individual shareholders since their fiduciary duties as directors were owed to the corporation and not to the shareholders of the corporation as individuals. See Carpenter v. Danforth, 52 Barb. 581 (N.Y. Sup. Ct. 1868).
 - b. The "majority" rule has been tempered considerably by the "special facts" doctrine, enunciated by the Supreme Court of the United States, in which it is said that while there is ordinarily no fiduciary obligation owed between a director and an individual shareholder, if the special circumstances involved would violate the principles of fair dealing should material information possessed by a director not be revealed in dealings with individual shareholders, then failure on the part of a director to disclose such material information can become a violation of the director's fiduciary duties to the individual shareholders. See Strong v. Repide, 213 U.S. 419 (1909).
 - c. Under what is referred to as the "minority" rule, a few state courts have completely broken away from the "majority" rule and place a firm fiduciary responsibility on the part of directors of a corporation to the individual shareholders of the corporation in dealings with respect to their stock. See Hotchkiss v. Fischer, 16 F.2d 531 (Kan. 1932).

B. Suit by the Corporation

1. The New York Court of Appeals has strengthened its state law of insider trading by recognizing the existence of a corporate cause of action to recover profits realized by corporate officers and directors from trading in their company's stock on the basis of inside information, rejecting the position that there must be a showing of damage to the corporation to sustain such a suit. See Diamond v. Oreamuno, 248 N.E. 2d 910 (N.Y. 1969).
 - a. The general theory used by the court to justify recovery of insider trading profits by the corporation was that the defendant officers in the case, as fiduciaries, had appropriated a corporate asset--inside information--to their own use and could therefore be required to disgorge the profits received by them from such use.
 - b. The decision involved an extension of traditional state fiduciary concepts since prior case law had been predicated on damage to the corporation growing out of such things as taking advantage of corporate opportunities, diverting corporate assets, competing with the corporation, or selling control of the corporation.
2. The view of the Diamond case was flatly rejected by the Supreme Court of Florida in Schein v. Chasen, 313 So. 2d 739 (Fla. 1975)
 - a. In rejecting Diamond, the Supreme Court of Florida said: "we adhere to previous precedent established by the courts in this state that actual damage to the corporation must be alleged in the complaint to substantiate a stockholder's derivative action."

- b. A similar view as to Indiana law was taken by the Seventh Circuit Court of Appeals in Freeman v. Decio, 584 F.2d 186 (7th Cir. 1978), in which the court remarked as to the decision by the New York Court of Appeals in Diamond that it could best be understood as an example of "judicial securities legislation."

V. The Future of Insider Trading

A. General Observations

1. There is little question that there has now developed a considerable body of "federal corporation law" dealing with the fiduciary responsibilities of management, particularly under the aegis of section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.
2. However, as the Supreme Court of the United States made clear in the Santa Fe Industries case, in the traditional areas of corporate mismanagement, where full disclosure has occurred, the primary source of the law still remains that of the states. See Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977).

B. Insider Trading

1. It is obvious that the exact contours of insider trading still remain somewhat tenuous and obscure, despite the recent rulings by the Supreme Court of the United States in the Chiarella and Dirks cases.
2. Certain trends, however, do seem evident:
 - a. The Securities and Exchange Commission has made it clear that it intends to continue to police insider trading vigorously and persistently.

- b. Whatever the exact contours of insider trading liability may turn out to be, it will likely include not only insider trading activity on the part of those inside the corporation who trade on confidential nonpublic corporate information but also, to some extent at least, outside persons who come into possession of nonpublic corporate or market information and attempt to take advantage of it.

Appendix A

Section 16(a) and (b)
Securities Exchange Act of 1934

(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange) a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

15 U.S.C. § 78p(a) & (b) (1982)

Appendix B

Section 10(b)

Securities Exchange Act of 1934

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--

. . . .

(b) 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, 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.

15 U.S.C. § 78j(b) (1982)

Appendix C

SEC Rule 10b-5

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.

17 C.F.R. §240.10b-5 (1985)

Appendix D

Section 14(e)

Securities Exchange Act of 1934

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

15 U.S.C. §78n(e) (1982)

Appendix E

SEC Rule 14e-3

(a) If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from (1) the offering person, (2) the issuer of the securities sought or to be sought by such tender offer, or (3) any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.

. . . .

(d)(1) As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act, it shall be unlawful for any person described in paragraph (d)(2) of this section to communicate material, nonpublic information relating to a tender offer to any other person under circumstances in which it is reasonably foreseeable that such communication is likely to result in a violation of this section except that this paragraph shall not apply to a communication made in good faith

(i) To the officers, directors, partners or employees of the offering person, to its advisors or to other persons, involved in the planning, financing, preparation or execution of such tender offer;

(ii) To the issuer, whose securities are sought or to be sought by such tender offer, to its officers, directors, partners, employees or advisors or to other persons, involved in the planning, financing, preparation or execution of the activities of the issuer with respect to such tender offer; or

(iii) To any person pursuant to a requirement of any statute or rule or regulation promulgated thereunder.

(d)(2) The persons referred to in paragraph (d)(1) of this section are:

(i) The offering person or its officers, directors, partners, employees or advisors;

(ii) The issuer of the securities sought or to be sought by such tender offer or its officers, directors, partners, employees or advisors;

(iii) Anyone acting on behalf of the persons in paragraph (d)(2)(i) or the issuer or persons in paragraph (d)(2)(ii); and

(iv) Any person in possession of material information relating to a tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from any of the above.

17 C.F.R. § 240.14e-3 (1985)

KENTUCKY REGULATIONS

Ronda S. Paul

DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF SECURITIES
911 LEAWOOD DRIVE
FRANKFORT, KENTUCKY 40601
(502) 564-2180



underlined and otherwise marked where there are changes from the last amendment filed.

[Last amended eff. 7-9-85.]

¶ 27,414

Rule 808 KAR 10:140. Registration statements to be kept current. Section 1. An issuer who files a registration statement pursuant to KRS 292.370 shall keep the registration statement current by filing the following:

(1) A balance sheet and an income statement of the issuer quarterly, except that no such statement need be filed for the quarter which ends the issuer's fiscal year. Such information shall be prepared in accordance with generally accepted accounting principles applied on a consistent basis, but may be unaudited.

(2) Certified financial statements of the issuer for each fiscal year subsequent to registration. Such statements shall be prepared in the same manner and shall contain the same information as would be required for initial registration.

(3) A verified statement setting forth any material change in the operation of the issuer.

Section 2. Material changes in the operation of the issuer reportable pursuant to subsection (3) of Section 1 above shall include but not be limited to:

- (1) Changes in control of the issuer;
- (2) Changes in officers and directors;
- (3) Acquisition or disposition of a significant amount of the issuer's assets otherwise than in the ordinary course of business;
- (4) Legal proceedings other than routine litigation incidental to the ordinary conduct of the issuer's business;
- (5) Modification of the relative rights of the holders of different classes of securities;
- (6) Changes in assets maintained as security for outstanding securities;
- (7) Any default in the payment of interest, principal, or sinking fund installments relative to any security;
- (8) Any increase in amount of options or warrants;
- (9) Any revaluation of assets or restatement of capital share account;
- (10) Any matter submitted to a vote of security holders;
- (11) Any change in the issuer's certifying accountant and a statement of the reasons therefor.

(12) Openings or closings of offices or plants.

Section 3. Information required under subsection (1) of Section 1 above shall be filed with the director no later than thirty (30) days following the end of the quarter. Information required under subsection (2) of Section 1 above shall be filed with the director no later than 120 days following the end of the fiscal year, and information required under subsection (3) of Section 1 above shall be filed not later than ten (10) days following the end of the month in which the material change occurred.

Section 4. Any prospectus or offering circular used or proposed to be used in connection with the sale of any security registered pursuant to KRS 292.370 shall be promptly amended to reflect the most recent annual financial statements of the issuer and any material changes reported under subsection (3) of section 1 above.

Section 5. Quarterly reports forwarded to the division pursuant to subsection (1), Section 1 above shall not be deemed to be "filed" for purposes of KRS 292.440.

[Last amended eff. 7-9-85.]

¶ 27,415

Rule 808 KAR 10:150. Registration exemptions. Section 1. Pursuant to KRS 292.410(1)(q), the director having found that registration under the Kentucky Securities Act is not necessary or appropriate in the public interest or for the protection of investors, securities issued under the following classes of transactions shall be exempt from KRS 292.340 to 292.390 and no claims of exemption need be filed with the division. However, any persons receiving commissions or other remuneration in connection with sales made pursuant to these exemptions are not relieved of compliance with the registration requirements of KRS 292.330.

(1) **Small business organization.** Where ten (10) or fewer persons organize a corporation, joint venture, or similar business organization other than a limited partnership, provided that:

(a) There are no more than twenty-five (25) offerees;

(b) The security acquired does not evidence an oil, gas or mineral interest;

(c) Each person purchases with investment intent;

(d) Each purchaser is an organizer on the date the issuer is formed;

(e) Each purchaser has access to information concerning the issuer;

(f) In connection with the organization, no commission or other remuneration is paid or given directly or indirectly to any person for soliciting any prospective buyer in this state;

(g) No public advertising through newspapers, television, radio, handbills, or other such solicitation will be employed in effectuating the proposed transaction.

(2) Professional service corporation. Any security issued by a professional service corporation organized under KRS Chapter 274 or substantially similar legislation of another state, provided:

(a) The professional service corporation complies with the ownership and retransfer restrictions set forth in KRS Chapter 274;

(b) The securities are sold to a professional person;

(c) The seller must reasonably believe that each buyer is purchasing for investment; and

(d) Each professional is provided access to information concerning the professional service corporation.

[Last amended eff. 7-9-85.]

[§ 27,416]

Rule 808 KAR 10:160. Definitions. Section 1. Definitions. When used in KRS Chapter 292 and the rules and regulations promulgated thereunder unless the context otherwise requires:

(1) "Current financial statement" means a balance sheet of the issuer as of a date within four (4) months prior to the filing of the claim of exemption, a profit and loss statement for the three (3) fiscal years preceding the date of the balance sheet and for any period between the close of the last fiscal year and the date of the balance sheet, or for the period of the issuer's and any predecessor's existence if less than three (3) years, and, if any part of the proceeds of the offering is to be applied to the purchase of any business, the same financial statements that would be required if that business were the issuer. The profit and loss statement shall be audited by an independent, certified public accountant for the latest fiscal year presented.

(2) "Investment intent" or "purchasing for investment" means that securities cannot be purchased with a view to, or for resale in connection with, any distribution. Securities purchased with investment intent cannot be disposed of unless the securities are registered under KRS Chapter 292 or an

¶ 27,415

exemption from the registration requirements of such chapter is available. As a result, the purchaser of these securities must be prepared to bear the economic risk of the investment for an indefinite period of time and have no need of liquidity of the investment. Where securities are purchased under KRS Chapter 292 for investment, investment intent shall be presumed if the purchaser retains such securities for two (2) years from the date of consummation of the sale. However, any disposition of the securities within two (2) years of the date of purchase, in the absence of an unforeseeable change of circumstances, shall create a presumption that the person did not purchase the securities with investment intent.

(3) "Promotional company" means:

(a) A corporation which has no substantial public market for its shares as evidenced by the number of market makers and the trading volume and also has no significant earnings; or

(b) A corporation which has no public market for its shares and no justification for its proposed public offering price on the basis of past earnings.

(4) "Subsidiary" means an affiliate controlled or significantly influenced by the issuer directly, or indirectly through one (1) or more intermediaries.

(5) "Significant subsidiary" means a subsidiary meeting any one (1) of the following conditions:

(a) The assets of the subsidiary, or the investments in and advances to the subsidiary by the issuer and the issuer's other subsidiaries, if any, exceed ten percent (10%) of the assets of the issuer and its subsidiaries on a consolidated basis;

(b) The sales and operating revenues of the subsidiary exceed ten percent (10%) of the sales and operating revenues of the issuer and its subsidiaries on a consolidated basis;

(c) The subsidiary is in control of or can significantly influence one (1) or more other subsidiaries and, together with such subsidiaries would, if considered in the aggregate, constitute a significant subsidiary.

[Eff. 10-7-81.]

[§ 27,417]

Rule 808 KAR 10:170. Exemption claims from securities registration—form:

Section 1. The following provisions shall apply to matters relating to an exemption

©1985, Commerce Clearing House, Inc.

000 12

(b) A declaration that the KRS 292.400(14) exemption will be relied upon; and

(c) A declaration as to how the issuer satisfies each of the specific requirements of KRS 292.400(14), which declaration shall be signed by a principal officer of the issuer.

(2) The director may require additional information, documentation or undertakings to be filed.

(3) The exemption shall be available for a period of five (5) years unless material changes regarding the issuer which relate to the statutory requirements of the exemption make the exemption unavailable. The \$100 filing fee shall be waived for the last four (4) years of the exemption period.

(4) The issuer will notify the director annually (approximately one (1) year from the effective date of the exemption) that the conditions of the exemption are still being complied with and that the issuer is still relying upon and claiming the exemption.

(5) If the exemption becomes unavailable at any time as a result of material changes affecting the issuer's statutory exemption, the issuer shall immediately notify the director.

[Last amended eff. 7-9-85.]

15 27,418

Rule 808 KAR 10-190 Securities registration exemptions for certain business transactions. Section 1. The following provisions shall apply to matters relating to an exemption from registration pursuant to KRS 292.410(1)(i). (1) The claim of exemption required to be filed with the director under KRS 292.415(1), where an offeror claims an exemption under KRS 292.410(1)(i), shall include the following:

(a) The filing fee of \$100 (payable to Kentucky State Treasurer);

(b) A letter containing: (1.) A declaration that the KRS 292.410(1)(i) exemption will be relied upon;

(2.) A representation that offers will be made to not more than twenty-five (25) persons in this state during the period of twelve (12) consecutive months from the effective date of the exemption;

(3.) A representation that no commission or other remuneration will be paid or given directly or indirectly for soliciting any prospective buyer in this state;

(4.) A representation that the seller believes that all the buyers in this state are purchasing for investment;

¶ 27,417

(5.) A representation that each buyer will sign an appropriate "investment intent letter," a copy of which shall be included in the claim of exemption, stating in part that the buyer is not taking with a view to distribution;

(6.) A representation that securities to be issued will bear an appropriate restrictive legend, a copy of which shall be submitted with the claim of exemption;

(7.) A representation that the offerees and purchasers shall have access to information concerning the issuer;

(8.) A representation that no public advertising or solicitation will be employed in effecting the proposed transaction; and

(c) A copy of the Articles of Incorporation, By-laws, limited partnership agreement, or other organizational document which reflects the security holders' rights;

(d) A prospectus, offering circular, or memorandum making full disclosure of material facts, including a discussion of all salient risk factors;

(e) Current financial statements of the issuer shall be filed with the director and contained in the disclosure document;

(f) If available, a sample copy of the security.

(2) The director may require additional information and undertakings or waive any of the above requirements. The director may require that the names and addresses of offerees, actual purchasers and the dates of such purchases be submitted to complete the claim of exemption.

Section 2. The following provisions shall apply to matters relating to an exemption from registration pursuant to KRS 292.410(1)(k).

(a) The filing fee of \$100 (payable to Kentucky State Treasurer);

(b) A letter containing: (1) A declaration that the KRS 292.410(1)(k) exemption will be relied upon;

(2) A statement disclosing the circumstances under which the outstanding shares were originally placed with the existing security holders, which statement shall indicate whether the shares were issued pursuant to a registration statement or in reliance upon an exemption from registration;

(3) The names, address, and number of shares or rights held by existing security holders in this state unless such information

is not readily available, in which event the director shall be so advised; and

(4) A representation as to whether or not a commission or other remuneration [(other than a standby commission)] is to be paid or to be given directly or indirectly for soliciting any security holder in this state.

(c) A prospectus, offering circular, or memorandum making full disclosure of material facts, including a discussion of all salient risk factors;

(2) The director may require additional information and undertakings or waive any of the above requirements.

[¶ 27,419]

Rule 808 KAR 10:200. Investment advisers' minimum liquid capitalization. Section 1. The minimum liquid net capital to be maintained by an investment adviser shall be \$5,000 unless the investment adviser charges prepaid fees or has custody of client funds, in which case the minimum liquid net capital to be maintained by such investment adviser shall be \$20,000

Section 2. The minimum capitalization established in Section 1 may be reduced or waived by the director upon a showing that such minimum capitalization is not necessary in the public interest given the limited nature of the adviser's activities.

[¶ 27,420]

Rule 808 KAR 10:210. Registration exemptions—Federal Regulation D. Section 1. Pursuant to KRS 292.410(1)(q), the director having found that registration is not necessary or appropriate in the public interest or for the protection of investors, the following transaction is determined to be exempt from the registration provisions of KRS 292.340 through KRS 292.390.

(1) Any offer or sale of securities offered or sold in compliance with Securities Act of 1933, Regulation D, Rules 230.501-230.503 and either 230.505 or 230.506 as made effective in Release No. 33-6389 and which satisfies the following further conditions and limitations:

(a) Persons receiving commissions, finders fees, or other remuneration in connection with sales of securities in reliance on this regulation are not relieved of compliance with KRS 292.390.

(b) No exemption under this rule shall be available for the securities of any issuer, if

any of the parties or interest described in Securities Act of 1933, Regulation A, Rule 230.252, Sections (c), (d), (e) or (f):

1. Has filed a registration statement which is the subject of a currently effective stop order entered pursuant to any state's law within five (5) years prior to the commencement of the offering.

2. Has been convicted within five (5) years prior to commencement of the offering on any felony or misdemeanor in connection with the purchase or sale of any security or any felony involving fraud or deceit including but not limited to forgery, embezzlement, obtaining money under false pretenses, larceny or conspiracy to defraud.

3. Is currently subject to any state's administrative order or judgment entered by that state's securities administrator within five (5) years prior to reliance on this exemption or is subject to any state's administrative order or judgment in which fraud or deceit was found and the order or judgment was entered within five (5) years of the expected offer and sale of securities in reliance upon this exemption.

4. Is currently subject to any state's administrative order or judgment which prohibits the use of any exemption from registration in connection with the purchase or sale of securities.

5. Is subject to any order, judgment or decree of any court of competent jurisdiction temporarily or preliminarily restraining or enjoining, or is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five (5) years prior to the commencement of the offering permanently restraining or enjoining, such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or involving the making of any false filing with any state.

6. The prohibitions of subparagraphs 1 through 3 and subparagraph 5 of this paragraph shall not apply if the party or interest subject to the disqualifying order is duly licensed to conduct securities related business in the state in which the administrative order or judgment was entered against such party or interest.

7. Any disqualification caused by this section is automatically waived if the state which created the basis for disqualification determines upon a showing of good cause that it is not necessary under the circumstances that the exemption be denied.

(c) The issuer shall file with the Division of Securities a notice on Form D (17CFR239.550).

1. No later than fifteen (15) days after the first sale of securities to an investor in this state which results from an offer being made in reliance upon this exemption.

2. No later than thirty (30) days after the completion date of the offering of the issue.

3. Every six (6) months after the first sale of securities from the issue made in reliance on this regulation unless the final notice required by subparagraph 2 of this paragraph has been filed.

4. Every notice on Form D shall be manually signed by a person duly authorized by the issuer.

5. Any information furnished by the issuer to offerees shall be filed with the notice required pursuant to subparagraph 1 of this paragraph and, if such information is altered in any way during the course of the offering, the Division of Securities shall be notified of such amendment within fifteen (15) days after an offer using such amended information.

6. If more than one (1) notice is required to be filed pursuant to subparagraphs 1 through 3 of this paragraph, notices other than the original notice need only report the information required by Part C and any material change in the facts from those set forth in Parts A and B of the original notice.

7. There is no filing fee.

(d) In all sales to nonaccredited investors the issuer and any person acting on its behalf shall have reasonable grounds to believe and after making reasonable inquiry shall believe that both of the following conditions are satisfied:

1. The investment is suitable for the purchaser upon the basis of the facts, if any, disclosed by the purchaser as to his other security holdings and as to his financial situations and needs. For the limited purpose of this condition only, it may be presumed that if the investment does not exceed ten (10) percent of the investor's net worth, it is suitable.

2. The purchaser either alone or with his/her purchaser representative(s) has such knowledge and experience in financial and business matters that he/she is or they are capable of evaluating the merits and risk of the prospective investment.

(2) Offers and sales which are exempt under this rule may not be combined with offers and sales exempt under any other rule or section of this Act, however, nothing in

¶ 27,420

this limitation shall act as an election. Should for any reason the offers and sales fail to comply with all of the conditions for this exemption, the issuer may claim the availability of any other applicable exemption.

(3) Nothing in this exemption is intended to or should be construed as in any way relieving issuers or persons acting on behalf of issuers from providing disclosure to prospective investors adequate to satisfy the anti-fraud provisions of this state's securities law.

4. In any proceeding involving this rule, the burden of proving the exemption or an exception from a definition or condition is upon the person claiming it.

(5) In view of the objective of this rule and the purpose and policies underlying the securities act, the exemption is not available to any issuer with respect to any transaction which, although in technical compliance with this rule, is part of a plan or scheme to evade registration or the conditions or limitations explicitly stated in this rule.

[Added eff. 7-9-85; amended eff. 10-8-85.]

[¶ 27,421]

→ PROPOSED RULE ←

808 KAR 10:220. Registration exemptions—NASDAQ/NMS exemption. Section 1. Pursuant to KRS 292.410(1)(q), the director having found that the registration is not necessary or appropriate in the public interest or for the protection of investors, the following class of transactions is determined to be exempt from the registration provisions of KRS 292.340 through KRS 292.390. The offer or sale of any security which is designated or approved for designation upon notice of issuance on the National Association of Securities Dealers Automated Quotations—National Market System (NASDAQ/NMS); any other security of the same issuer which is of senior or substantially equal rank; any security called for by subscription rights or warrants so designated or approved; or any warrant or right to purchase or subscribe to any of the foregoing.

[¶ 27,422]

→ PROPOSED RULE ←

808 KAR 10:230. Fee payment—KRS 292.380(5). Section 1. This regulation applies to registration of redeemable securities issued by open-end management companies as those terms are defined by the Investment Company Act of 1940. The purpose of this regulation is to outline

©1985, Commerce Clearing House, Inc.

000-58

GUIDELINES FOR OFFERING MEMORANDUM

(1) The director may require the filing of an offering memorandum along with any claim of exemption required to be filed under KRS 292.415(1), and may require that such offering memorandum be given to each offeree concurrently with the offer or before acceptance.

(2) Such offering memorandum shall contain, but not be limited to, the following information or documents:

(a) A description of the securities to be offered;

(b) A statement in bold face type disclosing that the securities to be offered have not been registered with either the Securities and Exchange Commission, Washington, D. C. or with the Division of Securities, Department of Banking and Securities, Frankfort, Kentucky;

(c) A statement in bold face type concerning the degree of risk involved;

(d) A statement disclosing any pending or past litigation, whether civil, criminal or administrative, in which the issuer is or has been involved;

(e) A statement concerning any costs, claims or other risk factors or liabilities which might arise out of the investment and which might be chargeable to the investors;

(f) The number of securities to be offered and the amount or percentage of interest which each such security represents in the total offering;

(g) The date of the offering memorandum, the date on which the information contained therein will be out of date, and the date the offering will expire;

(h) The offering price;

(i) Federal and state income tax consequences and relevant information about other taxes or tax issues involved, or a statement in bold face type that the offering memorandum makes no representation as to tax consequences and that offerees should consult their own tax advisors;

(j) Provisions for the sharing of revenue or income among investors;

(k) Transferability and liquidity of the securities;

Guidelines For
Offering Memorandum
Page Two

(l) Any disproportionate interest or number of securities to be held by the issuer, by any officer, director, promoter, sponsor, operator, organizer or agent of the issuer, or by any offeror or other authorized person participating in the process of offering or selling the securities;

(m) A description of any title, lease or assignment of any tract of land involved, any proposed development thereof, and any appraisals of such tract(s) by any third party;

(n) The manner in which the investment proceeds or capital are to be used or employed, including disclosures as to whether any of the proceeds are to be for loans to any subsidiaries or affiliates of the issuer;

(o) A statement disclosing payment of any commissions in connection with the sale of the securities, or a representation that no commission or other remuneration will be paid or given directly or indirectly in connection with the offer or sale of the securities;

(p) Conflicts of interest which might arise between the issuer and investors;

(q) History of the issuer, including its purpose, its prior success or failure, and its intentions for the future;

(r) Management of the issuer, including information about its officers and board of directors, their training, experience and overall qualifications;

(s) A copy of the Articles of Incorporation, By-Laws, limited partnership agreement, or other organizational document which reflects the securityholders' rights;

(t) Current financial statements of the issuer;

(u) Any contracts or agreements entered into or expected to be entered into by the issuer with others to meet the issuer's obligations;

(v) All other information necessary to make the offering not misleading, fraudulent or deceitful;

(w) Such other information as the director may by rule or order require.

(3) Such offering memorandum shall be kept updated during the period for which the offering is good; copies of such updates shall be filed with the director and shall be given to all offerees.

OFFERING CIRCULAR GUIDELINES

(1). Name and address of the issuer, the type of business entity, the state or jurisdiction of incorporation or formation, and the date of incorporation or formation.

(2). The following information in tabular form on the outside front cover page of the offering circular:

Offering Price To Public	Underwriters Discounts Or Commissions	Proceeds To Issuer or Other Persons
-----------------------------	---	---

(3). Amount of securities to be offered, aggregate offering price to the public, aggregate underwriting discounts or commissions, amount of expenses of the issuer and amount of expenses to the underwriters to be borne by the issuer, and the aggregate proceeds. If the securities are not to be offered for cash, state the basis upon which the offering is to be made.

(4). Describe the method by which the offering is to be made and, if the offering is to be made through an underwriter, name and address of underwriter and amount of participation of each underwriter, indicating the nature of any material relationships between issuer and underwriter.

(5). Statement of purposes for which the proceeds of the sale of securities will be used and the amount to be used for each purpose, indicating the present intention with respect to the order of priority in which the proceeds will be used for the purposes.

(6). Description of the background and expertise of the issuer in the particular business which is the subject of the offering.

(7). Description of the significant risk factors inherent in the particular offering.

(8). Description of securities.

(9). Description of business.

(a). Nature of issuer's present or proposed products or services, the principal market, and the length of time the issuer has been in commercial production.

(b). Location and character of plants or other physical property now held or to be acquired and the nature of title.

- (c). For new invention or process, state how it is to be used and whether covered by patent. Identify with appropriate serial numbers.

(10). Specify the following:

- (a). Names and residence addresses of all officers and directors and ten per cent shareholders of the issuer. If the issuer was incorporated or organized within the last year, give similar information as to all promoters.
- (b). Aggregate annual remuneration of all directors and officers as a group for the last year and annual remuneration of each of the three highest paid officers of the issuer for the last year.

(11). Financial statements must be provided. These statements need not be certified by a certified public accountant but they must be verified (as true in all material aspects) within the actual knowledge and belief of the verifier, the chief financial officer of the issuer.

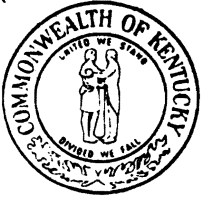
- (a). Balance sheet as of a date within ninety days prior to the filing of the application
- (b). Statements of income and statements of other shareholders equity shall be furnished for the two years prior to the date of the balance sheet provided in the paragraph above, or for the period of the issuer's existence, if less than the period specified above.

(12). For offerings of oil and gas interests only:

- (a). Information on the sponsor's production history including well locations, initial production, investor cost versus investor payout, and dry holes drilled;
- (b). The amount of administrative costs including salary and overhead expenses to be borne from the proceeds of the offering;
- (c). The source and amount of any additional funds to be secured for drilling the well;
- (d). Complete information on any dry hole money to be paid;

- (e). All appropriate and material tax considerations relevant to a decision to invest in the offering;
- (f). Information on oil and gas regulation including but not limited to availability of markets and pricing;
- (g). A summary of all materials contracts;
- (h). A summary of the geologist's opinion;
- (i). An opinion of counsel as to the validity of the lease;
- (j). Information on all forms of compensation paid or to be paid to the sponsor or affiliates including but not limited to profits on drilling, revenue interests, overriding royalties and operating fees; and
- (k). Such other information, not enumerated herein, as the Division may require.





COMMONWEALTH OF KENTUCKY

Department of Banking and Securities

911 LEAWOOD DRIVE
FRANKFORT 40601

PHONE
(502) 564-2180

November 8, 1982

Hon. James Strode
Sturgill, Turner and Truitt
700 Merrill Lynch Plaza
100 East Vine Street
Lexington, Kentucky 40507-1491

RE: Request for interpretation
of 808 KAR 10:150 Section
2.(1)(a)

Dear Mr. Strode:

This is in response to your letter of October 18, 1982, requesting an interpretation of the above-cited rule as it relates to a client's proposed offering (Poplar Grove Thoroughbred Partners-A) under the Uniform Limited Partnership Act of Kentucky. Your letter indicates that the offering will be conducted in accordance with the Securities Act of 1933, as amended, and Regulation D, Rules 230.501-.503 and 230.505 promulgated thereunder, and in reliance upon similar exemptions from registration under applicable state Blue Sky Laws.

Regulation 808 KAR 10:150 Section 2., the Uniform Limited Offering Exemption as adopted by Kentucky, provides at subparagraph (1)(a) that "persons receiving commissions, finders fees, or other remuneration, directly or indirectly, in connection with sales of securities in reliance on this regulation, are not relieved of compliance with KRS 292.330." Subsection (1) of KRS 292.330 makes it unlawful for any person to transact business in this state as a broker-dealer or agent, or for any broker-dealer or issuer to employ an agent, unless such person is appropriately registered.

Your question relates to the Division's interpretation (i.e., intent) in using the language "are not relieved of compliance with KRS 292.330" in the above cited regulation in view of the following:

Mr. James C. Strode
November 8, 1982
Page 2

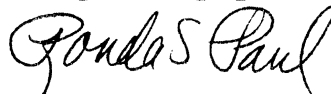
1. KRS 292.310(2)(b) excludes from the statutory definition of "agent" any individual who represents an issuer in effecting transactions exempted by KRS 292.410 unless otherwise required;
2. KRS 292.410 states that except as expressly provided, KRS 292.330 - 292.390 shall not apply to the transactional exemptions; and
3. KRS 292.410(1)(g) is the transactional exemption under which 808 KAR 10:150 was promulgated.

It was the Division's intent to "otherwise require" and "expressly provide" that individuals receiving compensation with respect to transactions in Kentucky under the exemption provided by Kentucky's version of the Uniform Limited Offering Exemption (808 KAR 10:150 Section 2.) must be registered if they would have been required to be registered but for the fact that this is a transactional exemption.

The reason that the Division did not expressly require that all individuals receiving compensation in connection with transactions relying on this regulation be registered as broker-dealers or agents is that we wanted to preserve exclusions from registration (other than the transactional exemption) that exist (e.g. the exclusion for a broker-dealer who has no place of business in this state and directs fewer than fifteen offers to sell or to buy into Kentucky in a twelve month period). We also did not want to require a Kentucky issuer paying commissions to a Tennessee agent for transactions involving only Tennessee residents to register that agent in Kentucky simply because he was relying on a Regulation D 505 or 506 exemption.

I hope that this letter sufficiently explains the Division's position.

Very truly yours,



Ronda S. Paul
Director
Division of Securities

RSP:tb



COMMONWEALTH OF KENTUCKY

Department of Banking and Securities

911 LEAWOOD DRIVE
FRANKFORT 40601

December 1, 1982

PHONE
(502) 564-2180

Mr. Frank Drane
800 Kentucky Home Life Building
239 South Fifth Street
Louisville, Kentucky 40202

RE: Preventacare, Inc. and 808
KAR 10:150

Dear Mr. Drane:

This is in response to your letter of November 29, 1982 with regard to the above-cited company and self-executing exemption from the registration requirements of KRS Chapter 292. 808 KAR 10:150 Section 1. (1) is intended to exempt from the registration provisions of the Kentucky Securities Act (KRS Chapter 292) any organization (other than a limited partnership) of ten(10) or fewer individuals with certain provisos.

Your letter requests confirmation of your understanding that this exemption applies to Preventacare, Inc. Since you do not detail information regarding most of the provisos (e.g., no commissions, investment intent, no advertising, etc.) I can only address the issue of what is intended by the proviso in (d)." Each person is an organizer on the date the issuer is formed." To be an organizer one does not have to be an incorporator. Neither does one have to be the originator or among the first individuals to discuss the general idea. It is sufficient that one be a part of the group during the final planning stages of the organization with sufficient understanding of the plan (either alone or through an agent) to make meaningful input and to make the decision as to whether or not to participate in the final product.

This registration exemption is intended to be self-executing; in the sense that it need not be claimed and the Division of Securities does not get involved in determining its availability. If the parties involved (or their counsel) are of the opinion that the exemption is available, then the Division of Securities will take a "no-action" position in the absence of fraud (untrue statements or material omissions).

Mr. Frank Drane
Page 2
December 1, 1982

I hope this letter adequately answers your questions.

Very truly yours,
Ronda S Paul

Ronda S. Paul
Director
Division of Securities

RSP:tb

cc: Hon. Diane Morris
General Counsel
Department of Insurance



COMMONWEALTH OF KENTUCKY

Department of Banking and Securities

*911 Leawood Drive
Frankfort 40601-3392*

Office of the Commissioner
Division of Financial Institutions
Division of General Administration
(502) 564-3390

November 18, 1983

Division of Securities
Office of General Counsel
(502) 564-2180

Hon. Charles C. Mihalek, Jr.
Suite 1406
First National Building
167 West Main Street
Lexington, KY 40507

Re: Coal Technology Corporation

Dear Mr. Mihalek:

This is in response to your letter of November 2, 1983 regarding a transaction in which your client, Coal Technology Corporation, a Delaware Corporation which maintains its principal place of business in Kentucky, sold 2,500,000 shares of common stock to another Delaware Corporation which maintains its principal place of business in Missouri. The transaction was effected in reliance on Section 4(6) of the Securities Act of 1933, as amended, and, as such, does not appear to fall within the literal language of the exemption provided in 808 KAR 10:150 Section 2 which is available for "...securities offered or sold in compliance with Securities Act of 1933, Regulation D, Rules 230.501-230.503 and either 230.505 or 230.506 ..." since compliance with Regulation D would entail filing Form D with the SEC.

Nevertheless, since the transaction would be eligible for the above cited Kentucky exemption (including the further conditions and limitations) save for this technical deficiency, you have filed a Form D and asked for consideration under 808 KAR 10:150 Section 2.

It is the intention of the Kentucky Division of Securities that this exemption be available for all transactions which meet the substantive requirements, including the further conditions and limitations. To require the filing of a Form D with the SEC signifying reliance on Regulation D at the federal level, would penalize a Kentucky issuer relying on the intrastate exemption federally with no perceptible improvement in protection for the citizens of Kentucky. Likewise, there is no significant improvement in public protection to be gained by denying the use

Hon. Charles C. Mihalek, Jr.
Re: Coal Technology Corporation
Page -2-

of 808 KAR 10:150 Section 2 in Kentucky for an issuer who has registered at the federal level. Therefore, since it is the policy of the Kentucky Division of Securities not to impose a cost or barrier to capital formation without enhancement of public protection, the Division will accept filings under our Regulation D tie-in without the technical requirement of a federal Form D filing so long as 808 KAR 10:150 Section 2 would be available except for this technical deficiency.

Your letter also claims an exemption under KRS 292.410(1)(i). However, this exemption must be claimed prior to the sale and must be made according to the format set out in 808 KAR 10:190. Therefore, it would not be available.

Very truly yours,



Ronda S. Paul
Director
Division of Securities

RSP:ts



COMMONWEALTH OF KENTUCKY

Department of Financial Institutions
911 Leeward Drive
Frankfort 40601-3392

Office of the Commissioner
Office of General Counsel
Division of Banking
Division of Thrift Institutions
(502) 564-3390

Division of Securities
Division of General Administration
(502) 564-2180

December 18, 1985

John A. Rebel, Esq.
Deardorff, Rebel & Bergman
Suite 406
Hibben Building
700 Walnut Street
Cincinnati, OH 45202

Dear Mr. Rebel:

This is in response to your inquiry of December 13, 1985. In your letter you ask for either a no-action position or an exemption from registration for a transaction involving the sale of a business.

My understanding of the facts is as follows. Your client, the purchaser, intends to acquire a small business engaged in the manufacture of book binding machines. The purchase is to be structured as a sale of stock with all (100%) of the shares being taken by your client. No sales commissions of any kind are to be paid or received for this transaction. It is also mentioned that the purchaser has had full disclosure of the financial condition of the company, that he is an experienced businessman, and that he has had ample opportunity to examine various financial records of the company. The purchase will be for investment purposes only with no plans on the part of the purchaser to resell.

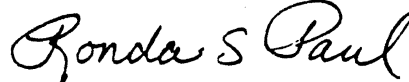
The transaction you describe clearly falls within the scope of both the Kentucky Securities Act and the federal securities laws. The fact that the entire business is sold to one individual or entity in a single transaction makes no difference. See Landreth Timber Co. v Landreth, 105 S.Ct. 2297 (1985) and Gould v Rufenacht, 105 S.Ct. 2308 (1985). See also KRS 292.530 which states that Chapter 292 shall be construed to coordinate the interpretation with related federal regulation.

John A. Rebel, Esq.
Page -2-
December 19, 1985

In general transactions such as you describe would fall within the exemption from registration provided by KRS 292.410(1)(i). This exemption requires a filing with the Division pursuant to KRS 292.415. Failure to file such claim of exemption does not, however, give rise to a private cause of action.

In a transaction such as the one you describe where a business is being sold and the purchase is structured as a sale of stock with all (100%) of the stock being sold to a single individual (or a single pre-existing entity) where that individual (entity) has had full disclosure of financial information and any other information material to ascertaining the risk of the business, the Division will take no action to enforce rescission of the transaction based solely on a failure to file the claim required by KRS 292.415. Take note, however, that the Division may bring an action should it find that KRS 292.410(1)(i) would not have been available for said transaction or that the transaction involved violations of KRS 292.320.

Sincerely yours,



Ronda S. Paul
Director
Division of Securities



SECRETARY OF STATE
EDWIN J. SIMCOX

SECURITIES DIVISION
ONE NORTH CAPITOL - SUITE 560
INDIANAPOLIS, INDIANA 46204

O. WAYNE DAVIS
SECURITIES COMMISSIONER
TELEPHONE (317) 232-6681

February 6, 1986

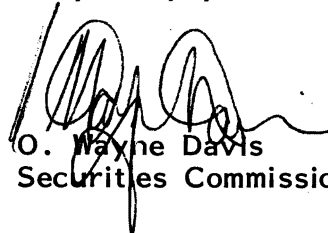
Ms. Anna C. Day
Administrative Assistant
University of Kentucky
College of Law
Continuing Legal Education Office
Suite 260 Law Building
Lexington, Kentucky 40506-0048

Dear Ms. Day:

Enclosed please find the Private Placement Exemption chart for Indiana which I would like included in the materials for the conference attendees.

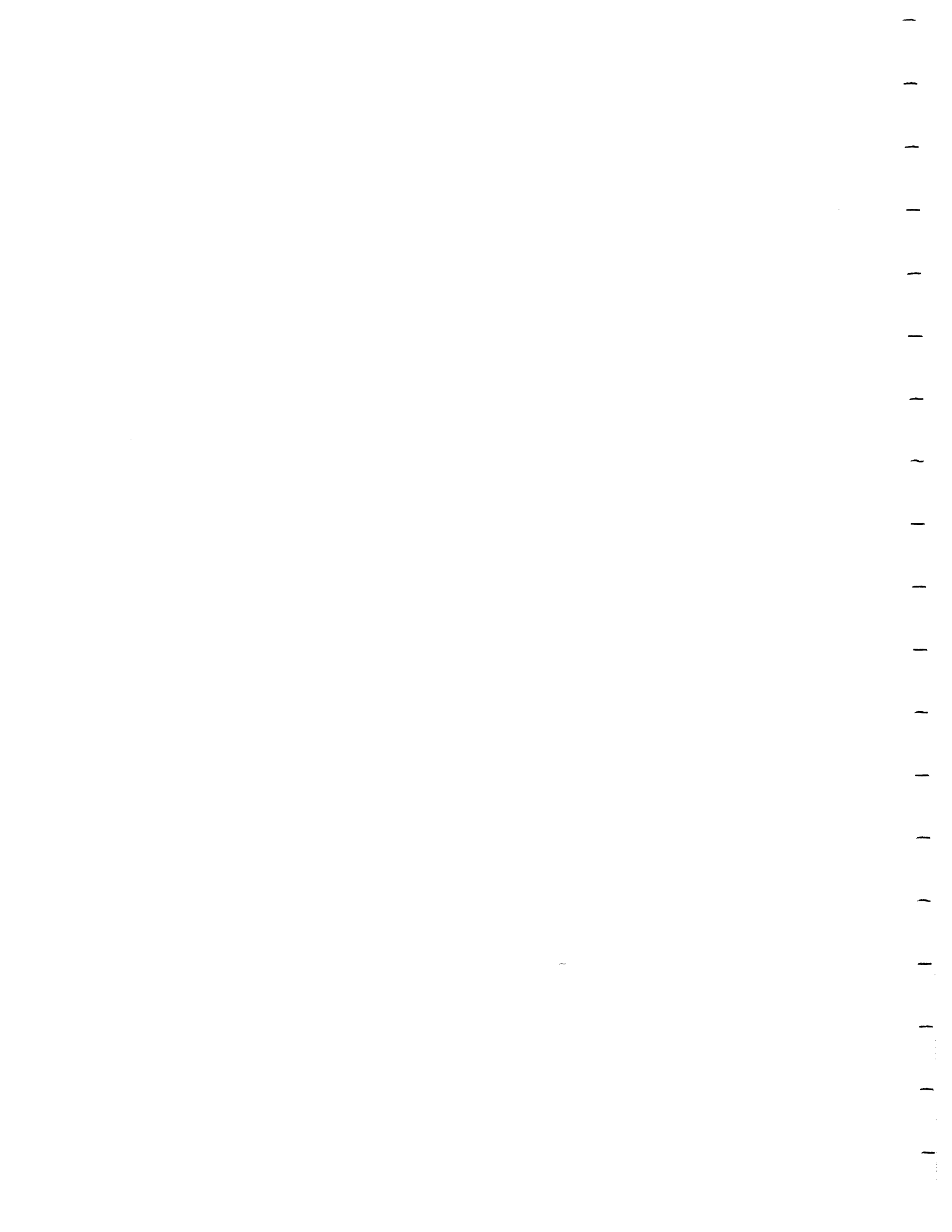
I appreciate your assistance in this matter.

Very truly yours,


O. Wayne Davis
Securities Commissioner

OWD/jas

Enclosure



THE PRIVATE PLACEMENT EXEMPTION

(G iii)

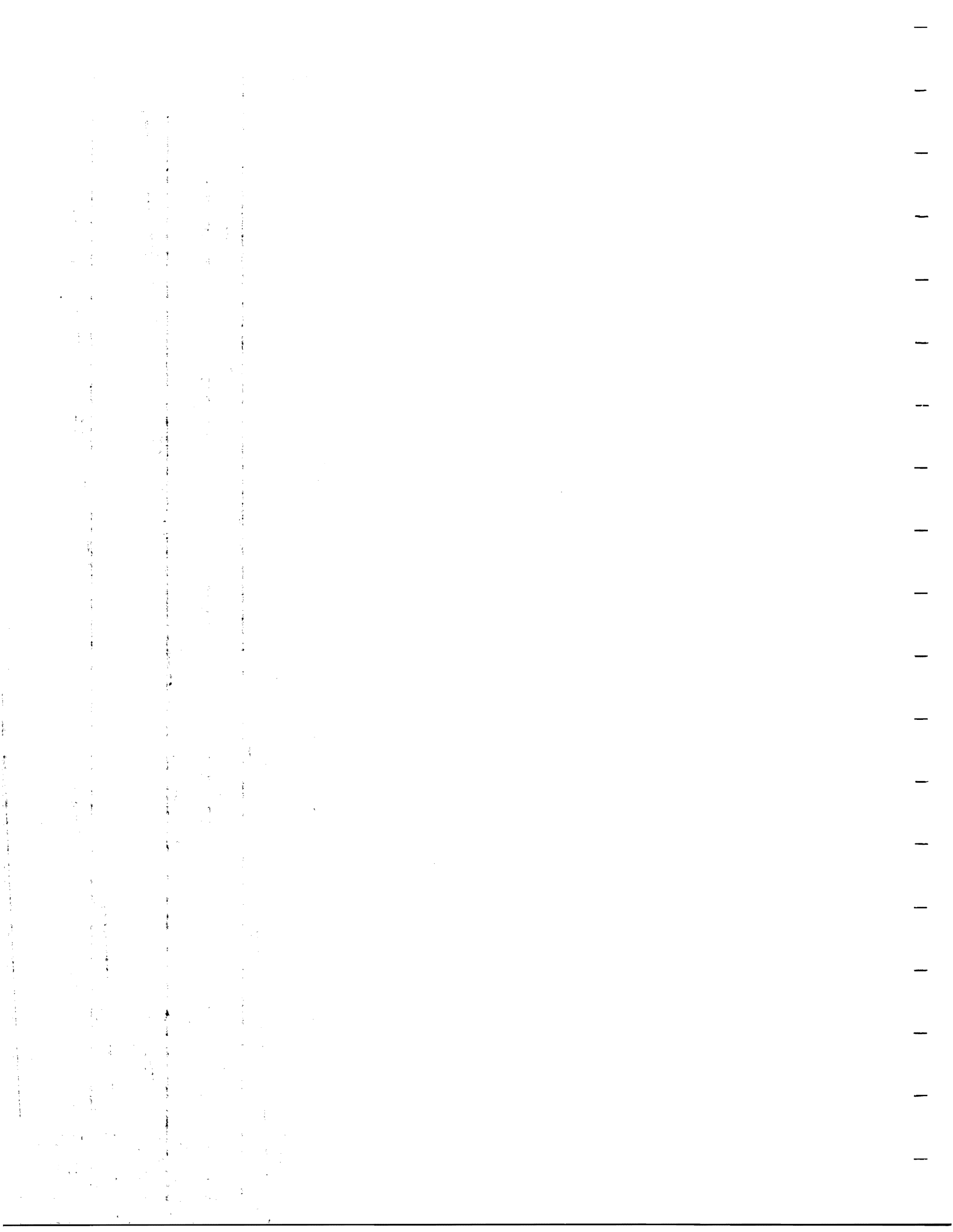
(G ii)

(G i)

(E)

(D)

NUMBER OF PURCHASERS	35 OR FEWER TOTAL PURCHASERS OR 15 INDIANA PURCHASERS PLUS ACCREDITED INVESTORS	35 OR FEWER TOTAL PURCHASERS OR 15 INDIANA PURCHASERS PLUS ACCREDITED INVESTORS ALL OF WHOM ARE INDIANA ACCREDITED OR ARE G (i) INVESTORS	15 OR FEWER PURCHASERS ALL OF WHOM ARE INDIANA ACCREDITED OR ARE G (i) INVESTORS	15 OR FEWER TOTAL PURCHASERS	35 OR FEWER TOTAL PURCHASERS OR 15 INDIANA PURCHASERS PLUS ACCREDITED INVESTORS ALL OF WHOM ARE INSIDERS OR FAMILY MEMBERS OF INSIDERS	15 OR FEWER PURCHASERS ALL OF WHOM ARE INDIANA ACCREDITED OR ARE G (i) INVESTORS	15 OR FEWER TOTAL PURCHASERS
TOTAL AGGREGATE OFFERING PRICE	NO LIMIT	NOT MORE THAN \$500,000	NOT MORE THAN \$500,000	NOT MORE THAN \$500,000	NO LIMIT	NO LIMIT	NOT MORE THAN \$250,000
PURCHASER QUALIFICATIONS	PURCHASER MUST BE SOPHISTICATED OR ACCREDITED	NONE	NONE	ACCESS TO ALL MATERIAL INFORMATION BECAUSE ARE INSIDERS OR FAMILY MEMBERS OF INSIDERS	ACCESS TO ALL MATERIAL INFORMATION BECAUSE ARE INSIDERS OR FAMILY MEMBERS OF INSIDERS	ACCREDITED INVESTOR RESIDING IN INDIANA OR ALL INVESTORS MEET QUALIFICATIONS OF (G i)	INVESTORS RECEIVE ALL MATERIAL INFORMATION OR BE ACCREDITED INVESTOR OR MEET (G i) REQUIREMENTS
MINIMUM DISCLOSURE OF INFORMATION TO INVESTORS	FULL OFFERING STATEMENT	ALL WRITTEN SALES MATERIALS AND CERTAIN OTHER DISCLOSURES	ALL WRITTEN SALES MATERIALS AND CERTAIN OTHER DISCLOSURES	NO WRITTEN DISCLOSURES	NO WRITTEN DISCLOSURES	NO WRITTEN DISCLOSURES	NO WRITTEN DISCLOSURES
FILING REQUIREMENTS WITH INDIANA SECURITIES DIVISION TO PERFECT EXEMPTION	OFFERING STATEMENT CONSENT TO SERVICE OF PROCESS \$100 FILING FEE	WRITTEN SALES MATERIALS CERTAIN DISCLOSURES CONSENT TO SERVICE OF PROCESS \$100 FILING FEE	WRITTEN SALES MATERIALS CERTAIN DISCLOSURES CONSENT TO SERVICE OF PROCESS \$100 FILING FEE	NONE	NONE	NONE	NONE
GENERAL ADVERTISEMENT AND SOLICITATION	NONE PERMITTED	NONE PERMITTED	NONE PERMITTED	NONE PERMITTED	NONE PERMITTED	NONE PERMITTED	NONE PERMITTED
INVESTMENT INTENT AND AWARENESS OF RESTRICTIONS	YES	YES	YES	YES	YES	YES	YES
POST SALE FILINGS WITH INDIANA SECURITIES DIVISION	FORM D	FORM D	FORM D	NONE	NONE	NONE	NONE



SEC REGULATION D PLACEMENTS VS. OHIO SECURITIES ACT PROVISIONS

Rodger A. Marting
Commissioner of Securities
Columbus, Ohio

	RULE 504	RULE 505	RULE 506
I. SEC Requirements Synopsis	3(b)	3(b)	4(2)
- Dollar Limitation	\$500,000	\$5,000,000	None
- Rule 502 Requirements			
(a) Integration	Yes	Yes	Yes
(b) Information Requirements	Yes	Yes	Yes
(c) Limitations on Manner of Offering	No*	Yes	Yes
(d) Limitation on Resale	No*	Yes	Yes
-Rule 503 Requirements	Yes	Yes	Yes
-Limitation on number of purchasers	None	35**	35**
-Miscellaneous			
	-No exemption for Rule 252 (c), (d), (e) or (f) securities - Commission can waive		If not an accredited investor, then the purchaser must himself or through a purchaser representative have knowledge and experience to deals of the type in question

* 504(b) - only if sales are made in states which require pre-sale disclosure

**501(e) - excludes spouses and members of household of purchaser, certain trusts and estates, certain corporations and accredited investors from the 35 limit.

ILLINOIS REGISTER

SECRETARY OF STATE

TEXT OF PROPOSED AMENDMENT(S)

aggregate dollar amount reported therein, but not less than the minimum nor more than the maximum fee specified in Section 130.102 of this Part \$100.00. The Report of Sale shall not be deemed to be filed until ~~unless~~ the proper filing fee therefor is submitted to the Springfield office of the Securities Department ~~Secretary of State in the time and manner described herein.~~

~~e) The Report of Sale and filing fee therefor shall be deemed filed with the Secretary of State on the date of delivery of the Report of Sale and filing fee to the Securities Department of the Secretary of State in Springfield or:~~

~~1) if transmitted through the United States mail, shall be deemed filed with the Secretary on the date shown by the post office cancellation mark stamped upon the envelope or other wrapper containing the Report of Sale or filing fee;~~

~~2) if mailed but not received by the Secretary of State, or if received but without a cancellation mark or with the cancellation mark illegible or erroneous, shall be deemed filed with the Secretary of State on the date it was mailed, but only if the sender establishes by competent evidence that the Report of Sale or filing fee was deposited, properly addressed, in the United States mail on or before the date on which it was required or was due. In cases in which the Report of Sale or filing fee was mailed but not received, the sender must also submit, or pay to, the Secretary of State a duplicate Report of Sale or filing fee, or both, as the case may be, within 30 days after written notification of nonreceipt of the Report of Sale or filing fee is given by the Secretary of State to the person claiming to have sent the Report of Sale or filing fee;~~

~~3) if a Report of Sale or filing fee is sent by United States registered mail, certified mail or certificate of mailing, a record authenticated by the United States Postal Service of such registration, certification or certificate shall be considered competent evidence that the Report of Sale or filing fee was mailed on the date shown on the record;~~

ILLINOIS REGISTER

SECRETARY OF STATE

Section 130.114 Procedures for Filing Reports of Sale under
Section 4.G of the Act

a)

1) The issuer, controlling person, or dealer shall file with the Springfield office of the Securities Department one copy of the Report of Sale on Form 4G manually signed by a person duly designated by the filing party, accompanied by the filing fee referred to below:

A) no later than 6 months after the first sale of securities made to an Illinois resident in reliance upon Section 4.G of the Act;

B) every 6 months after the first sale of securities made to an Illinois resident in reliance upon Section 4.G of the Act until all such sales have been concluded; and

C) no later than 30 days after ~~the earlier of-- (i) the date on which all securities being offered in reliance upon Section 4.G of the Act have been sold, or (ii)~~ the date on which the issuer, controlling person or dealer, as the case may be, determines that no further sales of securities will be made to Illinois residents in reliance upon Section 4.G of the Act; provided that such date shall be no later than the date of the last sale of securities pursuant to that offering of which the securities being offered in reliance upon Section 4.G. of the Act are a part.

2) Notwithstanding the foregoing, if the sales have been concluded within any 6 month period described in subparagraph (A) or (B) of paragraph (1) and the Report of Sale is filed no later than the end of that period but within the 30 day period described in subparagraph (C) of paragraph (1), then only one Report of Sale need be filed for that period.

b) The filing fee for each Report of Sale required under Section 4.G of the Act shall be 1/10th of 1% of the

ILLINOIS REGISTER

SECRETARY OF STATE

TEXT OF PROPOSED AMENDMENT(S)

c)d The Secretary of State will review a Report of Sale submitted under Section 4.G of the Act and notify the filing party of any deficiencies. A Report of Sale shall ~~may~~ not be deemed to be filed unless the information required by Section 4.G of the Act is included therein without any material deficiency.

d)e The Secretary of State may impose, in such cases where appropriate, a penalty for failure to file any Report of Sale required under Section 4.G of the Act in a timely manner. The penalty for the first failure to file timely shall be an amount equal to the filing fee for that Report of Sale ~~\$100.00~~. The penalty for any subsequent failure to file timely shall be \$500.00.

(Source: Amended at _____ Ill. Reg. _____, effective _____, 198_)

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32
33
34
35
36
37
38
39
40
41
42
43
44
45
46
47
48
49
50
51
52
53
54
55
56
57
58
59
60
61
62
63
64
65
66
67
68
69
70
71
72
73
74
75
76
77
78
79
80
81
82
83
84
85
86
87
88
89
90
91
92
93
94
95
96
97
98
99
100

Section 4. M
of Illinois Securities
Law

1	subscriptions for or shares of stock of cooperative	785
2	associations organized exclusively for agricultural,	786
3	producer, marketing, purchasing, or consumer purposes, if no	787
4	commission or other remuneration is paid or given directly or	788
5	indirectly for or on account of such subscription, sale or	789
6	resale, and if any person does not own beneficially more than	
7	5% of the aggregate amount of issued and outstanding capital	790
8	stock of such cooperative association;	791
9	L. Offers for sale or solicitations of offers to buy	793
10	(but not the acceptance thereof), of securities which are the	794
11	subject of a pending registration statement filed under the	795
12	Federal 1933 Act and:	
13	(1) Which are the subject of a pending application for	797
14	registration under this Act, or	798
15	(2) The sale of which would be exempt under subsection B	800
16	of Section 3 of this Act if registration under the Federal	801
17	1933 Act were then in effect;	802
18	M. Any offer or sale of preorganization subscriptions	804
19	for any securities prior to the incorporation, organization	805
20	or formation of any issuer under the laws of the United	806
21	States, or any state, or the issuance by such issuer, after	807
22	its incorporation, organization or formation, of securities	808
23	pursuant to such preorganization subscriptions, provided the	
24	number of subscribers does not exceed 25 and either (1) no	809
25	commission or other remuneration is paid or given directly or	810
26	indirectly for or on account of such sale or sales or	811
27	issuance, or (2), if any commission or other remuneration is	812
28	paid or given directly or indirectly for or on account of	813
29	such sale or sales or issuance, the securities are not	
30	offered or sold by any means of general advertising or	814
31	general solicitation in this State;	
32	N. The execution of orders for purchase of securities by	816
33	a registered dealer, provided such dealer acts as agent for	817
34	the purchaser, has made no solicitation of the order to	818
35	purchase the securities, has no direct interest in the sale	819



ILLINOIS SECURITIES DEPARTMENT
900 S. Spring Street
Springfield, Illinois 62704
Registration.....(217) 782-2256
Enforcement.....(217) 785-4940

Francesca Marciniak
ILLINOIS SECURITIES LAW
PRIVATE PLACEMENTS; OIL AND GAS PROGRAMS

Section 4.G of the Act (amended effective January 1, 1986)

G. (1) Any offer, sale or issuance of a security where:

(a) all sales of such security to residents of this State (including the most recent such sale) within the immediately preceding 12-month period have been made to not more than 35 persons or have involved an aggregate sales price of not more than \$100,000;

(b) such security is not offered or sold by means of any general advertising or general solicitation in this State; and

(c) no commission, discount, or other remuneration exceeding 20% of the sale price of the securities is paid or given directly or indirectly for or on account of the sale.

(2) In computing the number of resident purchasers or the aggregate sales price under paragraph (1) (a) above, there shall be excluded any purchaser or dollar amount of sales price, as the case may be, with respect to any security which at the time of its sale was exempt under Section 3 or was registered under Section 5, 6 or 7 or was sold in a transaction exempt under other subsections of this Section 4.

(3) A prospectus or preliminary prospectus with respect to a security for which a registration statement has been filed under the Federal 1933 Act shall not be deemed to constitute general advertising or general solicitation in this State as such terms are used in paragraph (1) (b) above, provided that such prospectus or preliminary prospectus has not been sent or otherwise delivered to more than 150 residents of this State.

(4) The Secretary of State shall by rule or regulation require and prescribe the form of a report to be filed upon the conclusion of all sales made in reliance upon the exemption provided by this subsection G and every six months after the first such sale unless the report due upon the conclusion of all such sales has been filed, but the failure to file any such report shall not affect the availability of

such exemption; provided that the failure to file any such report shall constitute a violation of subsection D of Section 12 of this Act, subject to the penalties enumerated in Section 14 of this Act, and provided further that the civil remedies provided for in subsection A of Section 13 of this Act and the civil remedies of rescission and appointment of a receiver, conservator, ancillary receiver or ancillary conservator provided for in subsection F of Section 13 of this Act shall not be available against any person by reason of the failure to file any such report or on account of the contents of any such report. Such report shall set forth the name and address of the issuer and of the controlling person, if the sale was for the direct or indirect benefit of such person, the total amount of the securities sold under this subsection G, the names and addresses of the resident purchasers, a representation that sales of such securities were not made in excess of those permitted by this subsection G, and any other information deemed necessary by the Secretary of State to enforce compliance with this subsection G. The fee for filing any such report shall be one-tenth of one percent of the total dollar amount of securities reported therein, but shall not be less than the minimum amount nor more than the maximum amount specified in Section 11a of this Act, and shall not be returnable in any event. The Secretary of State may impose, in such cases as he or she may deem appropriate, a penalty for failure to file any such report in a timely manner, but no such penalty shall exceed an amount equal to five times the filing fee. The contents of any such report shall be deemed confidential and shall not be disclosed to the public except by order of court or in court proceedings;

Rule 114 (underscored and stricken text reflect amendments by way of emergency rule effective through May 30, 1986; also proposed as a permanent rule)

a)

- 1) The issuer, controlling person, or dealer shall file one copy of the Report of Sale on Form 4G manually signed by a person duly designated by the filing party, accompanied by the filing fee referred to below:

- A) no later than 6 months after the first sale of securities made to an Illinois resident in reliance upon Section 4.G of the Act;
 - B) every 6 months after the first sale of securities made to an Illinois resident in reliance upon Section 4.G of the Act until all such sales have been concluded; and
 - C) no later than 30 days after the earlier of (i) the date on which all securities being offered in reliance upon Section 4.G of the Act have been sold, or (ii) the date on which the issuer, controlling person or dealer, as the case may be, determines that no further sales of securities will be made to Illinois residents in reliance upon Section 4.G of the Act.
- 2) Notwithstanding the foregoing, if the sales have been concluded within any 6 month period described in subparagraph (A) or (B) of paragraph (1) and the Report of Sale is filed no later than the end of that period but within the 30 day period described in subparagraph (C) of paragraph (1), then only one Report of Sale need be filed for that period.
- b) The filing fee for each Report of Sale required under Section 4.G of the Act shall be 1/10th of 1% of the aggregate dollar amount reported therein, but not less than the minimum nor more than the maximum fee specified in Section 130.102 of this Part \$100.00. The Report of Sale shall not be deemed to be filed unless the proper filing fee is submitted to the Secretary of State in the time and manner described herein.
- c) The Report of Sale and filing fee therefor shall be deemed filed with the Secretary of State on the date of delivery of the Report of Sale and filing fee to the Securities Department of the Secretary of State in Springfield or:
- 1) if transmitted through the United States mail, shall be deemed filed with the Secretary on the date shown by the post office cancellation mark stamped upon the envelope or other wrapper containing the Report of Sale or filing fee;
 - 2) if mailed but not received by the Secretary of State, or if received but without a cancellation mark or with the cancellation mark illegible or erroneous, shall be deemed filed with the Secretary of State on the date it was mailed, but only if the sender establishes by competent evidence that the Report of Sale or filing fee was deposited, properly addressed, in the United States mail on or before the date on which it was required or was due. In cases in which the Report of Sale or filing fee was mailed but not received, the sender must also submit, or pay to, the Secretary of State a

duplicate Report of Sale or filing fee, or both, as the case may be, within 30 days after written notification of nonreceipt of the Report of Sale or filing fee is given by the Secretary of State to the person claiming to have sent the Report of Sale or filing fee;

- 3) if a Report of Sale or filing fee is sent by United States registered mail, certified mail or certificate of mailing, a record authenticated by the United States Postal Service of such registration, certification or certificate shall be considered competent evidence that the Report of Sale or filing fee was mailed on the date shown on the record.
- d) The Secretary of State will review a Report of Sale submitted under Section 4.G of the Act and notify the filing party of any deficiencies. A Report of Sale may not be deemed to be filed unless the information required by Section 4.G of the Act is included therein without any material deficiency.
- e) The Secretary of State may impose, in such cases where appropriate, a penalty for failure to file any Report of Sale required under Section 4.G of the Act in a timely manner. The penalty for the first failure to file timely shall be an amount equal to the filing fee for that Report of Sale. \$100.00. The penalty for any subsequent failure to file timely shall be \$500.00.

(Source: Emergency amendment at _____ Ill. Reg. _____, effective January 1, 1986 for a maximum of 150 days)

Rule 115

Section 130.115 Calculation of Number of Persons Under Section 4G of the Act

- a) Each purchaser who acquires securities under Section 4G of the Act shall be deemed a "person" unless such securities are sold to more than one person as joint tenants with right of survivorship. Any sale of securities to purchasers as joint tenants with right of survivorship shall be deemed to be a sale to one person.
- b) The sale of securities under Section 4G of the Act to any relative, spouse or relative of the spouse of a purchaser who has the same principal residence or domicile as the purchaser shall not be deemed to be a sale to an additional person.

(Source: Added at 8 Ill. Reg. 13840, effective July 19, 1984)

Rule 118

Section 130.118 Report of Sale of Securities pursuant to Section 4.G of the Act

The Report of Sale of securities sold in reliance upon Section 4.G of the Act shall contain, but not be limited to:

- a) the name, address and telephone number of the issuer, and as applicable, of the controlling person and dealer;
- b) a description of the securities sold;
- c) the total amount of the securities sold in reliance upon Section 4.G of the Act for the period covered by the Report of Sale and to the date of the Report of Sale;
- d) for the sales covered by the Report of Sale, the names and addresses of the purchasers and the dates on which the sales were made; and
- e) a representation that sales of such securities were not made, commissions were not paid and prospectuses were not delivered, in excess of those permitted by Section 4.G of the Act.

(Source: Amended at 9 Ill. Reg. 208, effective December 20, 1984)

Rule 102 (underscored and stricken text reflect amendments by way of emergency rule effective through May 30, 1986; also proposed as a permanent rule)

- a) Fees under the Act are as follows:

Section 4.F.(2)
Application Filing Fee \$1,000

Section 4.G
Report of Sale Filing Fee \$10-\$100*

Section 4.P
Offering Sheet Examination Fee \$300
Report of Sale Filing Fee \$10-\$100*

*Section 5.A
General Registration or Renewal Fee \$500-\$1,500**

Registration or Renewal Fee
for Shelf Offerings \$500-\$6,000**

Registration or Renewal Fee
for Series Issuers \$500-\$3,000**

General Oversale Registration Fee \$500-\$1,000***

Oversale Registration Fee
for Shelf Offerings \$500-\$5,500***

Oversale Registration Fee
for Series Issuers \$500-\$2,500***

*Section 5.B	
Examination Fee	\$300
Registration Fee	<u>\$500-\$1,500**</u>
<u>Oversale Registration Fee</u>	<u>\$500-\$1,000***</u>
<u>Amendment Examination Fee</u>	<u>\$50</u>
 Section 6.A	
<u>Registration or Renewal Fee</u>	<u>\$1,000</u>
<u>Amendment Registration Fee for</u> <u>Additional Series, Types or</u> <u>Classes</u>	<u>\$100</u>
 Section 6.B	
Examination Fee	\$300
Registration or Renewal Fee	<u>\$1,000*</u>
Amendment Examination Fee	\$50
Amendment Registration Fee for	
Additional Series, Types or	
Classes Class-of	
<u>Securities</u>	<u>\$100*</u>
Transaction Charge	\$10
Annual Fee	1/30th of 1% of average of quarterly computation of aggregate principal amount of securities on deposit
 Section 7.A	
<u>Registration or Renewal Fee</u>	<u>\$1,000</u>
<u>Amendment Registration Fee for</u> <u>Additional Class or Classes</u>	<u>\$100</u>
 Section 7.B	
Examination Fee	\$300
Registration or Renewal Fee	<u>\$1,000\$1,500</u>
Amendment Examination Fee	\$50
<u>Amendment Registration Fee for</u> <u>Additional Class or Classes</u>	<u>\$100</u>
Renewal Examination Fee	\$200
 Section 8	
Dealer Registration or Renewal Fee	<u>\$200 plus \$20 for</u> <u>each office in</u> <u>this State in</u> <u>excess of 2 offices</u> ****
Dealer-Examination-Fee	\$50
Investment Adviser Registration or Renewal Fee	<u>\$200 plus \$20 for</u> <u>each office in</u> <u>this State in</u> <u>excess of 2 offices</u> ****
Investment Adviser Examination Fee	\$50
Salesperson Registration or Renewal Fee	\$30
Salesperson Transfer Fee	\$30

Section 10
Service of Process \$10

Sections 15.B and 15.C
Certificate of Compliance \$10
Certificate of Non-Compliance \$10
Certified Copy of Document \$10 plus
Each Page Certified \$.50

Section 15a
Non-binding statement \$75

* 1/10th of 1% of the aggregate dollar amount reported therein, but not less than the specified minimum nor more than the specified maximum.

** 1/20th of 1% of the maximum aggregate price, as defined in Rule 130.250, at which the amount of

securities registered for sale are to be offered for sale but not less than the specified minimum \$500 nor more than the specified maximum \$1,500.

*** Three times the difference between the initial registration fee paid and the fee required for the entire amount sought to be registered but not less than the specified minimum \$500 nor more than the specified maximum \$1,000.

**** Twice the amount indicated if renewal application is filed within 6 days preceding the expiration of the current registration.

b) All payments of fees in excess of \$100.00 shall be made by United States postal money order, certified check, bank cashier's check, or bank money order or indicia of forms of electronic transfer of funds payable to the Secretary of State. All payments of fees of \$100.00 or less may be made by personal or business firm check or money order payable to the Secretary of State.

~~c) Examination fees and registration fees under Sections 5, 6 and 7 of the Act shall be submitted by separate payments.~~

(Source: Emergency amendment at _____ Ill. Reg. _____, effective January 1, 1986 for a maximum of 150 days)

Section 4.H (amended effective January 1, 1986)

H. Any offer, sale or issuance of a security to any natural person (1) whose individual net worth, or joint net worth with that person's spouse, at the time of the offer, sale or issuance exceeds \$1,000,000, or (2) who had an individual income in excess of \$200,000 in each of the two most recent years and who reasonably expects an income in excess of \$200,000 in the current year; provided that such security is not offered or sold by means of any general advertising or general solicitation in this State;

Section 4.R (amended effective January 1, 1986)

R. Any offer, sale or issuance of a security to any person who purchases at least \$150,000 of the securities being offered, where the purchaser's total purchase price does not exceed 20 percent of the purchaser's net worth at the time of sale, or joint net worth with that person's spouse, for one or any combination of the following: (i) cash, (ii) securities for which market quotations are readily available, (iii) an unconditional obligation to pay cash or securities for which quotations are readily available, which obligation is to be discharged within five years of the sale of the securities to the purchaser, or (iv) the cancellation of any indebtedness owed by the issuer to the purchaser; provided that such security is not offered or sold by means of any general advertising or general solicitation in this State;

Section 4.M

M. Any offer or sale of preorganization subscriptions for any securities prior to the incorporation, organization or formation of any issuer under the laws of the United States, or any state, or the issuance by such issuer, after its incorporation, organization or formation, of securities pursuant to such preorganization subscriptions, provided the number of subscribers does not exceed 25 and either (1) no commission or other remuneration is paid or given directly or indirectly for or on account of such sale or sales or issuance, or (2), if any commission or other remuneration is

assets are located entirely within that municipality, provided: (1) no commission, discount or other remuneration is paid or given directly or indirectly for or on account of the sale or sales of such securities; (2) the aggregate

Rule 280 (underscored and stricken text reflect amendments to permanent rule proposed on January 3, 1986)

Section 130.280 Definition of the Terms "Fraudulent" and "Work or Tend to Work a Fraud or Deceit" as Used in Sections 11.E and 12.F of the Act for Purposes of the Payment of Completion Costs in Connection with the Offer to-Sell or the Sale of Securities Fractional-Undivided-Interests-in involving an Oil, Gas or Other Mineral Lease, Right or Royalty

- a) In connection with an offer to-sell or the sale of a security fractional-undivided-interests-in involving an oil, gas or other mineral lease, right or royalty, the terms "fraudulent" and "work or tend to work a fraud or deceit" shall include activities such as the failure to disclose to the offeree, prior to payment of any completion costs, all material geological and other material information regarding the oil, gas or and other mineral lease, right or royalty, including, without limitation, any of the following:
- 1) whether an issuer (or any controlling person of or dealer for an issuer, if such person or dealer has any share in such lease, right or royalty) has paid, and if not, whether such issuer (or such controlling person or dealer) is under an obligation to pay, a proportionate share of the completion costs, when completion costs have been or are to be included in the cost to the purchaser;
 - 2) whether any parts or equipment to be used for completion are being sold or otherwise furnished by or for the benefit of an issuer (or any affiliate or controlling person of or dealer for an issuer) and, if so, whether and the extent to which the sales price or other charge to the purchaser for those parts or equipment exceeds actual costs and the amount which would have been charged by unaffiliated parties selling or furnishing parts or equipment in arms-length transactions under comparable circumstances;
 - 3) whether upon resale of parts and equipment, the purchaser will receive his or her proportionate share of the proceeds of resale; and
 - 4) whether the purchaser will be charged an amount for completion costs that exceeds his or her proportionate share of the actual cost of completion incurred by the issuer.
- b) For purposes of this section, completion costs shall include, but not be limited to, the cost of all parts, equipment, labor and service to place an oil, gas or other mineral lease, right or royalty into production

G. To obtain money or property through the sale of securities 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 the light of the circumstances under which they were made, not misleading;

H. To sign or circulate any statement, prospectus, or other paper or document required by any provision of this Act knowing or having reasonable grounds to know any material representation therein contained to be false or untrue;

I. To employ any device, scheme or artifice to defraud in connection with the sale or purchase of any security, directly or indirectly.

J. When acting as an investment adviser, by any means or instrumentality, directly or indirectly:

(1) To employ any device, scheme or artifice to defraud any client or prospective client;

(2) To engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) To engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative. The Secretary of State shall for the purposes of this Paragraph (3) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive or manipulative.

(Ch. 121 1/2, par. 137.13)

Section 14 (amended effective January 1, 1986)

Sec. 14. Sentence. A. Any person who violates any of the provisions of subsection A, B, C, or D of Section 12 of this Act shall be guilty of a Class A misdemeanor; provided that if such person commits such offense with knowledge of the existence, meaning or application of the respective subsection as provided in Section 4-3(c) of the Criminal Code of 1961, or, in the case of a failure to comply with the terms of any order of the Secretary of State as provided

after drilling or other operation to reach the mineral deposit has been terminated.

- c) Disclosure of the information required by paragraph (a) above shall not affect the applicability of any limitation contained in the Act or this Part, including but not limited to Section 4.G.(1)(c) of the Act, upon the amount of commission, discount or other remuneration which may be paid or given directly or indirectly, for or on account of the sale of securities.

Section 12 (amended effective January 1, 1986)

Sec. 12. Violation. It shall be a violation of the provisions of this Act for any person:

A. To offer or sell any security except in accordance with the provisions of this Act;

B. To deliver to a purchaser any security required to be registered under Section 5, Section 6 or Section 7 hereof unless accompanied or preceded by a prospectus that meets the requirements of the pertinent subsection of Section 5 or of Section 6 or of Section 7;

C. To act as a dealer, salesperson or investment adviser unless registered as such, where such registration is required, under the provisions of this Act;

D. To fail to file with the Secretary of State any application, report or document required to be filed under the provisions of this Act or any rule or regulation made by the Secretary of State pursuant to this Act or to fail to comply with the terms of any order of the Secretary of State issued pursuant to Section 11 hereof;

E. To make, or cause to be made, (1) in any application, report or document filed under this Act or any rule or regulation made by the Secretary of State pursuant to this Act, any statement which was false or misleading with respect to any material fact or (2) any statement to the effect that a security (other than a security issued by the State of Illinois) has been in any way endorsed or approved by the Secretary of State or the State of Illinois;

F. To engage in any transaction, practice or course of business in connection with the sale or purchase of securities which works or tends to work a fraud or deceit upon the purchaser or seller thereof;

under subsection D of Section 12 of this Act, with knowledge of the existence of such order, such person shall be guilty of a Class 4 felony.

B. Any person who violates any of the provisions of subsection E, F, G, H, I, or J of Section 12 of this Act shall be guilty of a Class 3 felony.

C. No prosecution for violation of any provision of this Act shall bar or be barred by any prosecution for the violation of any other provision of this Act or of any other statute; but all prosecutions under this Act or based upon any provision of this Act must be commenced within 3 years after the violation upon which such prosecution is based; provided however, that if the accused has intentionally concealed evidence of a violation of subsection E, F, G, H, I or J of Section 12 of this Act, the period of limitation prescribed herein shall be extended up to an additional 2 years after the proper prosecuting officer becomes aware of the offense but in no such event shall the period of limitation so extended be more than 2 years beyond the expiration of the period otherwise applicable.

D. For the purposes of this Act all persons who shall sell or offer for sale, or who shall purchase or offer to purchase, securities in violation of the provisions of this Act, or who shall in any manner knowingly authorize, aid or assist in any unlawful sale or offering for sale or unlawful purchase or offer to purchase shall be deemed equally guilty, and may be tried and punished in the county in which said unlawful sale or offering for sale or unlawful purchase or offer to purchase was made, or in the county in which the securities so sold or offered for sale or so purchased or offered to be purchased were delivered or proposed to be delivered to the purchaser thereof or by the seller thereof, as the case may be.

E. Any person who shall be convicted of a second or any subsequent offense specified in subsection A, B, C, or D of

Section 12 of this Act shall be guilty of a Class 3 felony, and any person who shall be convicted of a second or any subsequent offense specified in subsection E, F, G, H, I or J of Section 12 of this Act shall be guilty of a Class 2 felony.

F. If any person referred to in this Section is not a natural person, it may upon conviction of a first offense be fined up to \$25,000, and if convicted of a second and subsequent offense, may be fined up to \$50,000, in addition to any other sentence authorized by law.

G. This Act shall not be construed to repeal or affect any law now in force relating to the organization of corporations in this State or the admission of any foreign corporation to do business in this State.

(Ch. 121 1/2, par. 137.15)

Sec. 15. Evidentiary matters. A. In any action, administrative, civil or criminal, where a defense is based upon any exemption provided for in this Act, the burden of proving such exemption shall be upon the party raising such defense.

B. In any action, administrative, civil or criminal, a certificate under the seal of the State of Illinois, signed by the Secretary of State, attesting to the filing of or the absence of any filing of any document or record with the Secretary of State under this Act, shall constitute prima facie evidence of such filing or of the absence of such filing, and shall be admissible in evidence in any such administrative, criminal or civil action.

C. In any action, administrative, civil or criminal, the Secretary of State may issue a certificate under the seal of the State of Illinois, signed by the Secretary of State, showing that any document or record is a true and exact copy, photostatic or otherwise, of the record or document on file with the Secretary of State under this Act; and such certified document or record shall be admissible in evidence

with the same effect as the original document or record would have if actually produced.

D. Any certificate pursuant to subsection B or C of this Section 15 shall be furnished by the Secretary of State upon application therefor in the form and manner prescribed by the Secretary of State by rule or regulation, and shall be accompanied by payment of a certification fee in the amount specified in Section 11a of this Act, which shall not be returnable in any event.

Chapter 38 - Illinois Criminal Code of 1961

ARTICLE 8. IMPRISONMENT

Par.

- 1005-8-1. Sentence of imprisonment for felony.
- 1005-8-1A. Repealed.
- 1005-8-2. Extended term.
- 1005-8-3. Sentence of imprisonment for misdemeanor.
- 1005-8-4. Concurrent and consecutive terms of imprisonment.
- 1005-8-5. Commitment of the offender.
- 1005-8-6. Place of confinement.
- 1005-8-7. Calculation of term of imprisonment.

1005-8-1. Sentence of imprisonment for felony

§ 5-8-1. Sentence of Imprisonment for Felony. (a) A sentence of imprisonment for a felony shall be a determinate sentence set by the court under this Section, according to the following limitations:

(1) for murder, (a) a term shall be not less than 20 years and not more than 40 years, or (b) if the court finds that the murder was accompanied by exceptionally brutal or heinous behavior indicative of wanton cruelty or that any of the aggravating factors listed in subsection (b) of Section 9-1 of the Criminal Code of 1961¹ are present, the court may sentence the defendant to a term of natural life imprisonment, or (c) if the defendant has previously been convicted of murder under any state or federal law or is found guilty of murdering more than one victim, the court shall sentence the defendant to a term of natural life imprisonment;

(2) for a person adjudged a habitual criminal under Article 33B of the Criminal Code of 1961, as amended,² the sentence shall be a term of natural life imprisonment.

(3) for a Class X felony, the sentence shall be not less than 6 years and not more than 30 years;

(4) for a Class 1 felony, the sentence shall be not less than 4 years and not more than 15 years;

(5) for a Class 2 felony, the sentence shall be not less than 3 years and not more than 7 years;

(6) for a Class 3 felony, the sentence shall be not less than 2 years and not more than 5 years;

(7) for a Class 4 felony, the sentence shall be not less than 1 year and not more than 3 years.

(b) The sentencing judge in each felony conviction shall set forth his reasons for imposing the particular sentence he enters in the case, as provided in Section 5-4-1³ of this Code. Those reasons may include any mitigating or aggravating factors specified in this Code, or the lack of any such circumstances, as well as any other such factors as the judge shall set forth on the record that are consistent with the purposes and principles of sentencing set out in this Code.

(c) The trial court may reduce or modify a sentence, but shall not increase the length thereof by order entered not later than 30 days from the date that sentence was imposed. This shall not enlarge the jurisdiction of the court for any other purpose.

(d) Except where a term of natural life is imposed, every sentence shall include as though written therein a term in addition to the term of imprisonment. For those sentenced under the law in effect prior to February 1, 1978, such term shall be identified as a parole term. For those sentenced on or after February 1, 1978, such term shall be identified as a mandatory supervised release term. Subject to earlier termination under Section 3-3-8,⁴ the parole or mandatory supervised release term shall be as follows:

- (1) for murder or a Class X felony, 3 years;
- (2) for a Class 1 felony or a Class 2 felony, 2 years;
- (3) for a Class 3 felony or a Class 4 felony, 1 year.

(e) A defendant who has a previous and unexpired sentence of imprisonment imposed by another state or by any district court of the United States and who, after sentence for a crime in Illinois, must return to serve the unexpired prior sentence may have his sentence by the Illinois court ordered to be concurrent with the prior sentence in the other state. The court may order that any time served on the unexpired portion of the sentence in the other state, prior to his return to Illinois, shall be credited on his Illinois sentence. The other state shall be furnished with a copy of the order imposing sentence which shall provide that, when the offender is released from confinement of the other state, whether by parole or by termination of sentence, the offender shall be transferred by the Sheriff of the committing county to the Illinois Department of Corrections. The court shall cause the Department of Corrections to be notified of such sentence at the time of commitment and to be provided with copies of all records regarding the sentence.

(f) A defendant who has a previous and unexpired sentence of imprisonment imposed by an Illinois circuit court for a crime in this State and who is subsequently sentenced to a term of imprisonment by another state or by any district court of the United States and who has served a term of imprisonment imposed by the other state or district court of the United States, and must return to serve the unexpired prior sentence imposed by the Illinois Circuit Court may apply to the court which imposed sentence to have his sentence reduced.

The circuit court may order that any time served on the sentence imposed by the other state or district court of the United States be credited on his Illinois sentence. Such application for reduction of a sentence under this subsection (f) shall be made within 30 days after the defendant has completed the sentence imposed by the other state or district court of the United States.

Amended by P.A. 82-717, § 2, eff. July 1, 1982.

¹ Paragraph 9-1 of this chapter.

² Paragraph 33B-1 et seq. of this chapter.

³ Paragraph 1005-4-1 of this chapter.

⁴ Paragraph 1003-3-8 of this chapter.

1005-8-3. Sentence of imprisonment for misdemeanor

§ 5-8-3. Sentence of Imprisonment for Misdemeanor

(a) A sentence of imprisonment for a misdemeanor shall be for a determinate term according to the following limitations:

(1) for a Class A misdemeanor, for any term less than one year;

(2) for a Class B misdemeanor, for not more than 6 months;

(3) for a Class C misdemeanor, for not more than 30 days.

(b) The good behavioral allowance shall be determined under Section 3 of the Misdemeanant Good Behavior Allowance Act.¹

Amended by P.A. 81-1050, § 6, eff. Sept. 24, 1979.

¹ Chapter 75, § 32.

ANTI-FRAUD PROVISIONS OF THE SECURITIES ACT OF 1933
AND THE SECURITIES EXCHANGE ACT OF 1934

OSCAR N. PERSONS*
Atlanta, Georgia

A. The statutory provisions:

Section 12(2) of the Securities Act of 1933 (15 U.S.C. §§77a et seq.) ("1933 Act") provides recourse to one purchasing a security sold to him:

"... by means of a prospectus or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission...."

15 U.S.C. §771(2).

Section 17(a) of the 1933 Act, 15 U.S.C. §77q provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly

(1) to employ any device, scheme, or artifice to defraud, or

*A litigation partner with Alston & Bird, 100 Galleria Parkway, Atlanta, Georgia 30339, (404) 955-8407. Section 14 of the 1934 Act, relating to proxies and tender offers, and Section 11 of the 1933 Act and Section 18 of the 1934 Act relating to registration statements are beyond the scope of this presentation. © 1986.

(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."

Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §§77b et seq. and 78a et seq.) ("1934 Act") provides:

"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 ...

(b) 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, 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."

15 U.S.C. §78j(b).

Rule 10b-5 of the Securities and Exchange Commission, promulgated under Section 10(b) of the 1934 Act provides:

"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."

17 C.F.R. §240-10b(5).

B. Elements of 10b-5 Claim:

1. A misrepresentation or omission or other fraudulent device,
2. Plaintiff's purchase or sale of "securities" in connection with the fraud,
3. The materiality of the misrepresentation or omission,
4. Requisite state of mind: defendant's scienter (or severe recklessness) in making the misrepresentation or omission,
5. Plaintiff's actual reliance,
6. Justifiability of the reliance; i.e., due diligence,
7. Damages resulting from the fraud.

Mansbach v. Presscot, Ball & Turbin, 598 F.2d 1017 (6th Cir. 1979); Cameron v. Outdoor Resorts of America, Inc., 608 F.2d 187, 193-94 (5th Cir. 1979), aff'd. in part, vacated and remanded in part on rehearing, 611 F.2d 105 (5th Cir. 1980); Dupuy v. Dupuy, 551 F.2d 1005, 1014 (5th Cir.), cert. denied, 434 U.S. 911 (1977); White v. Sanders, 689 F.2d 1366, 1367 (11th Cir. 1982); Cavalier Carpets, Inc. v. Caylor, 746 F.2d 749 (11th Cir. 1984); Diamond v. Lamotte, 709 F.2d 1419, 1422 (11th Cir. 1983).

8. Assuming either broker or dealer, or use of mails or interstate commerce, or a facility of a national securities exchange. Exclusive jurisdiction in federal court (Section 27 of 1934 Act). Even a telephone call is sufficient to place venue. Myzel v. Fields, 386 F.2d 718, 727 (8th Cir. 1967) cert. denied, 390 U.S. 951 (1968). Sufficient if defendant had "minimum contacts with the forum such that maintenance of a suit in that district does not offend traditional notions of fair play and substantial justice", Jordan v. Global National Resources, Inc., 564 F.Supp. 59, 69 (S.D. Ohio 1983). Extraterritorial service of process, (Section 27 of the 1934 Act); Hooper v. Mountain States Securities Corp., 282 F.2d 195, 204 (5th Cir. 1960), cert. denied, 365 U.S. 814 (1961).

C. Fraudulent Representation or Omission Element.

1. Mere breach of fiduciary duty (such as failure of directors to make a proper investigation) without fraudulent representation or omission is not sufficient. Herm v. Stafford, 663 F.2d 669 (6th Cir. 1981); Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977) (freeze-out merger); Marsh v. Armada Corp., 533 F.2d 978 (6th Cir. 1976), cert. denied, 430 U.S. 954 (1977). (fiduciary duty of majority to minority stockholders); Brown v. Ivie, 661 F.2d 62 (5th Cir. 1981), cert. denied, 455 U.S. 990 (1982); Nash v. Farmers New World Life Insurance Co., 570 F.2d 558, 562 (6th Cir.), cert. denied, 439 U.S. 822 (1978).

2. Predictions, opinions, or representations made to prospective purchasers without a basis in fact and designed to induce the sale. R.A. Holman & Co. v. SEC, 366 F.2d 446, 449-50 (2d Cir. 1966), cert. denied, 389

U.S. 991 (1967); Denny v. Barber, 576 F.2d 465, 469-70 (2d Cir. 1978) (forecasts not fraudulent). See Jacobs, What is a Misleading Statement or Omission Under Rule 10b-5?, 42 Fordham L.Rev. 243 (1973). Not required to make speculative projections. Marsh v. Armada Corp., 533 F.2d 978, 986 (6th Cir. 1976); Biechele v. Cedar Point, Inc., 747 F.2d 209, 216 (6th Cir. 1984); Radol v. Thomas, 772 F.2d 244, 252 (6th Cir. 1985) (tender offer).

3. Have to plead with specificity. Ingram Industries, Inc. v. Nowicki, 502 F.Supp. 1060 (E.D.Ky. 1980); Rich v. Touche Ross & Co., 68 F.R.D. 243 (S.D.N.Y. 1975); Consumers Power Company Securities Litigation, 105 F.R.D. 583, 591 (E.D.Mich. 1985); Rogers v. Lehman Bros. Kuhn Loeb, Inc., 604 F.Supp. 222, 225 (S.D.Ohio 1984). Keep Rule 11, F.R.Civ. Proc. in mind. Rule 11 provides in part:

"The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation... If a pleading, motion or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an

appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee."

4. "Factors to be considered in determining the scope of a defendant's duties [to disclose information] are: (1) the relationship of the defendant to the plaintiff, (2) the defendant's access to information, compared to that of the plaintiff, (3) the benefit to the defendant derived from the relationship with the plaintiff, (4) the awareness by the defendant of the plaintiff's reliance on him or her, and (5) the defendant's activity in initiating the securities transaction in question."

Kirkland v. E. F. Hutton and Co., Inc.; 584 F.Supp. 427 (E.D. Mich. 1983).

5. No duty to disclose information to one who should be aware of it. SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974); Kirkland v. E. F. Hutton and Co., at 441.

D. In connection with the purchase or sale element.

1. Sufficient if the deceptive practices "touch" the purchase or sale. Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971); James v. Microwave Communications, Inc., 461 F.2d 525, 529 (7th Cir. 1972); St. Louis U. Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, 562 F.2d 1040 (8th Cir. 1977), cert. denied, 435 U.S. 925 (1978); Issen v. GSC Enterprise

Inc., 538 F. Supp. 745 (N.D.Ill. 1982) (the false proxy statement which dealt with election of directors failed to disclose loans to directors); McGrath v. Zenith Radio Corp., 651 F.2d 458, 467 (7th Cir.), cert. denied, 454 U.S. 835 (1981); Smallwood v. Pearl Brewing Co., 489 F.2d 579, 595 (5th Cir.), cert. denied, 419 U.S. 873 (1974).

2. Putting it another way, there must be a "nexus" between the defendant's fraud and the securities sale. Brown v. Ivie, 661 F.2d 62 (5th Cir. 1981), cert. denied, 455 U.S. 990 (1982); Ketchum v. Green, 557 F.2d 1022 (3d Cir. 1977), cert. denied, 434 U.S. 940 (1978); Buffo v. Graddick, 742 F.2d 592, 596 (11th Cir. 1984).

3. Sale or contract for sale is sufficient. 15 U.S.C. §78c(9)(ix); 15 U.S.C.A. §77b(3).

4. Sale of 100% of stock of business is not covered by federal securities laws. See cases cited in Smgyi v. Butler, [Current] Fed. Sec. L.Rep. (CCH) ¶98,281, p.91799 (D.N.J. 1981).

5. Plaintiff must have actually purchased or sold (not decided not to). Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975); Roger v. Lehman Bros. Kuhn Loeb, Inc., 604 F.Supp. 222, 224 (S.D.Ohio 1984).

E. The Materiality Element.

1. Defendant required to disclose the information if there was "a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder." TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); Radol v. Thomas, 772 F.2d 244, 253 (6th Cir. 1985); McGrath v. Zenith Radio Corp.

F. Requisite State of Mind Element.

Either recklessness or scienter. Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1023 (6th Cir. 1979); Ingram Industries, Inc. v. Nowicki, 502 F.Supp. 1060, 1064 (E.D.Ky. 1980); Ohio Drill & Tool Co. v. Johnson, 625 F.2d 738 (6th Cir. 1980); S.E.C. v. Blavin, 760 F.2d 706, 711 (6th Cir. 1985).

1. "Recklessness" is "highly unreasonable conduct which is an extreme departure from the standards of ordinary care. While the danger need not be known, it must at least be so obvious that any reasonable man would have known of it." Mansbach, at 1025.

2. Scienter. Actions under 10b-5 require allegations of an "intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976). "Constructive" knowledge or negligence is not sufficient. Hochfelder. Scienter may be inferred from surrounding circumstances. Huddleston v. Herman & MacLean, 640 F.2d 534 (5th Cir. 1981).

G. The Justifiable Reliance Element.

1. Reliance - would the investor have taken a different action even if he had known the full truth?

a. Sufficient reliance is shown if the fraud was a substantial or significant contributing cause of the purchase or sale. Wilson v. Comtech Telecommunications Corp., 648 F.2d 88, 92 (2d Cir. 1981).

b. Justifiable reliance, or reasonable reliance, is tested on a subjective standard - not a "reasonable man" objective basis, and some due diligence is required. Huddleston.

2. In a misrepresentation case, proof by plaintiff of his reliance is a prerequisite to recovery, whereas in a nondisclosure (omission) case, non-reliance is an affirmative defense. Huddleston, at 548; Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972).

a. Assuming materiality, there is a presumption of reliance in a non-disclosure case, but affirmative proof of non-reliance may rebut the presumption. Biechele v. Cedar Point, Inc., 747 F.2d 209, 214 (6th Cir. 1984); Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981); cert. denied, 454 U.S. 1092 (1981); Rochez Brothers, Inc. v. Rhoades, 491 F.2d 402, 410 (3d Cir. 1973), cert. denied, 425 U.S. 993 (1976); Jordan v. Global Natural Resources, Inc., 564 F.Supp. 59, 66 (S.D.Ohio 1983).

b. Where have a mixed case involving both misrepresentations and omissions, may not have the presumption of reliance. Is it a case involving "primarily" a failure to disclose? Cavalier Carpets, Inc. v. Caylor, 746 F.2d 749, 756 (11th Cir. 1984).

c. Partial disclosure of a fact renders the statement a positive misrepresentation (not an "omission"), so presumption of reliance not available. Maiden v. Biehl, 582 F.Supp. 1209 (S.D.N.Y. 1981) (text of offering circular describing properties failed to disclosure mortgages, but balance sheet included in circular indicated mortgages payable).

3. "Fraud on the market" theory. In fraud which affects market of publicly traded stock, whether omission or misrepresentations, presumptions of reliance, if the fraud is material. Theory is that a purchaser believes the market price is validly set and no unsuspected fraud has affected the price, and there is a presumed effect of material fraud on the "information heard on the street" and on the market price. Lipton v. Documation, Inc., 734 F.2d 740 (11th Cir. 1984).

4. Insider trading. Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, 495 F.2d 228 (2d Cir. 1974) (insider trading, must either disclose or abstain from trading, if not, liable to entire class of persons buying or selling on open market, during relevant period). Note, The Reliance Requirement in Private Actions Under SEC Rule 10b-5, 88 Harv. L.Rev. 584 (1975). But see, Fridrich v. Bradford, 542 F.2d 307 (6th Cir. 1976), cert. denied, 429 U.S. 1053 (1977) which rejects the Shapiro reasoning and requires a causal connection between the insider trading and the loss. If would have traded in any event, no causation. See also, Braun v. Northern Ohio Bank, 430 F.Supp. 367 (N.D.Ohio 1977) and Rapp, Fridrich v. Bradford and the Scope of Inside Trading Liability Under SEC Rule 10b-5; A Commentary, 38 Ohio St. L.J. 67 (1977). But see also, as to "disclose or abstain" rule, discussion in Section K(1)a, infra.

H. The Damage Element.

1. Damages must have been proximately caused by the fraud. Even if the investor would have acted otherwise but for the fraud, determine if the misrepresented fact was the proximate cause of the loss; i.e., did the misrepresented material fact "touch upon" the reasons for the investment's decline in value? Huddleston v. Herman & MacLean.

Example: Investor purchases stock in a shipping venture involving a single vessel, in reliance on the misrepresentation that the vessel had a certain capacity, when, in fact, it had less capacity. Investor is told that there is no insurance. Vessel sinks in storm, and stock becomes worthless. Reliance but no causation. See also cases cited in Section G, since reliance and causation elements are sometimes hard to separate.

2. Allowable damage for defrauded purchaser is the difference between the real value of the consideration paid and the real value received, plus consequential damages that can be proved with certainty to have resulted from the fraud. Foster v. Financial Technology, Inc., 517 F.2d 1068, 1071 (9th Cir. 1975); Smith v. Manausa, 385 F.Supp. 443 (E.D.Ky. 1974) ("out of pocket rule", not "benefit of bargain"); accord, Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d 1004, 1013 (11th Cir. 1985). See also, Harris v. American Investment Co., 523 F.2d 220, 224-25 (5th Cir. 1975), cert. denied 423 U.S. 1054 (1976); Madigan, Inc. v. Goodman, 498 F.2d 233, 239 (7th Cir. 1974); Mullaney, Theories of Measuring Damages in Security Cases and the Effects of Damages on Liability, 46 Fordham L.Rev. 277 (1977). See Silverberg v. Paine, Webber, Jackson & Curtis, Inc., 710 F.2d 678 (11th Cir. 1983) for an example of jury confusion on damages and, at footnote 15, p. 687, for a survey of damage cases.

a. "Real value" is the fair market value absent the misrepresentation, normally determined by the market price of the security after discovery of the fraud. Huddleston; Esplin v. Hirschi, 402 F.2d 94, 104 (10th Cir. 1968), cert. denied, 394 U.S. 928 (1969).

b. There is a duty to mitigate damages; i.e., damages limited to difference between what paid and value would have received if plaintiff had acted to preserve the value when he first learned, or had reason to know, of the fraud. Arrington v. Merrill Lynch, Pierce, Fenner & Smith, 651 F.2d 615 (9th Cir. 1981).

c. No exemplary damages under 10b or 12(2). Jones v. Miles, 656 F.2d 103, 107 (5th Cir. 1981); Huddleston. No attorneys fees, unless bad

faith as part of the litigation itself, not sufficient if bad faith in the underlying fraud. Woods v. Barnett Bank of Fort Lauderdale, at 1014. But beware of pendent claims of fraud, breach of fiduciary duty, or blue sky.

d. Prejudgment interest is in discretion of court. Huddleston.

3. If violate 12(2) "shall be liable to the person purchasing such security from him... [who may] recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security." 15 U.S.C. §771(2). Rescission within discretion of court in appropriate circumstances. Foster; Miller v. San Sebastian Gold Mines, Inc., 540 F.2d 807 (5th Cir. 1976), but not apply in open market purchases. Huddleston.

4. Section 12(2), have rescission, if the security is still owned. Davis v. AFCO Financial Services, Inc., 739 F.2d 1057, 1068 (6th Cir. 1984). But see, Gannett Co., Inc. v. The Register Publishing Co., 428 F.Supp. 818 (D.Conn. 1977) (where undue delay barred rescission remedy). If sold, receive difference between the purchase price and the amount received on resale, plus interest, less any return. Gerity v. Cable Funding Corp., 372 F.Supp. 679 (D.Del. 1973).

5. In "churning" claims the customer recovers commissions, and interest and taxes resulting from churning transactions. He does not recover trading losses (but, by same token, making a profit is no defense). Stevens v. Abbott, Proctor & Paine, 288 F.Supp. 836, 846 (E.D.Va. 1968).

6. Right of contribution among co-defendants? Probably, but not settled. See list of decisions in Huddleston.

I. How Section 12(2) Claim Under Securities Act of 1933 Differs from 10b-5.

1. Plaintiff must prove that defendant sold or offered to sell securities to plaintiff; i.e., only purchasers have standing to sue. Kellman v. ICS, Inc., 447 F.2d 1305, 1308 (6th Cir. 1971). Whereas under 10b-5, purchasers or sellers have standing. Roger v. Lehman Bros. Kuhn Loeb, Inc., 604 F.Supp. 222, 224 (S.D.Ohio 1984).

2. Defendant seller used a written "prospectus" (a defined term, 15 U.S.C. §77b(10)) or oral communication, which misrepresented or omitted material facts (those intended or perceived to be instrumental in effecting the sale) of which plaintiff buyer had no knowledge ("reasonable investor"). Alton Box Board Co. v. Goldman Sachs & Co., 560 F.2d 916 (8th Cir. 1977).

3. No requirement that plaintiff prove scienter by defendant. Goodweather v. Thompson & McKinnon; Sanders v. John Nuveen & Co., 619 F.2d 1222 (7th Cir. 1980), cert. denied, 450 U.S. 1005 (1981). So mere negligence is sufficient. Hochfelder, at 208; Basile v. Merrill Lynch, Pierce, Fenner & Smith, 551 F.Supp. 580, 590 (S.D.Ohio 1982). Even a negligent opinion. Franklin Savings Bank v. Levy, 551 F.2d 521 (2d Cir. 1977). However, scienter might be required to impose secondary liability under 12(2). Lanza v. Drexel & Co., 479 F.2d 1277, 1298, n.67 (2d Cir. 1973); Hill York Corp. v. American International Franchises, Inc., 448 F.2d 680, 695 (5th Cir. 1971). But see, Davis v. AVCO Financial Services, Inc., 739 F.2d 1057, 1067 (6th Cir. 1984), where denominating person as a "seller" under the "proximate cause" theory puts burden on him to establish lack of negligence.

4. Statute of limitations is one year from when discovered or should have discovered, but not more than three years from sale. Plaintiff must affirmatively plead and prove compliance.

5. No liability if defendant can establish that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. Section 12(2).

6. Reliance not required. Davis v. AVCO Financial Services, Inc., at 1068; Hill York Corp., at 689; Alton Box Board Company, at 924; Johns Hopkins University v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970), cert. denied, 416 U.S. 916 (1974); Sanders v. John Nuveen, at 1225, 1229. But have to show causation between misrepresentation and the sale; i.e., the communication must have been intended or perceived as instrumental in effecting the sale. Jackson v. Oppenheim, 533 F.2d 826, 830, n.8 (2d Cir. 1976).

7. State court has concurrent jurisdiction with federal. (Section 22 of 1933 Act).

J. Section 17(a) of 1933 Act Claims.

1. Is there a private right of action, or only one which the SEC can bring?

a. Supreme Court has not ruled, and the Circuits are split. See survey in Basile v. Merrill Lynch, Pierce, Fenner & Smith, 551 F.Supp. 580, 585 (S.D.Ohio 1982). The Ohio court found no private action, as did the Kentucky court in Ingram Industries, Inc. v. Nowicki, 502 F.Supp. 1060 (E.D.Ky. 1980).

2. Prohibits essentially same conduct as 10b, but available only to purchasers. Kellman v. ICS, Inc., 447 F.2d 1305, 1308 (6th Cir. 1971).

3. Is scienter required? Sixth Circuit: "It is not clear" in a private rights of action. Herm.

4. No control person provisions (Section 15 of 1933 Act).

5. Concurrent jurisdiction federal and state courts. (Section 22 of 1933 Act).

K. Secondary Liability.

Person may be secondarily liable under the securities laws as an aider and abettor, through a conspiracy, or by virtue of being a controlling person. Herm.

"Determining secondary liability has long been a thorny problem in implementing the securities laws. Particularly is this true with regard to §12(2). Section 10b ...and Rule 10b-5 provide a private action remedy roughly equivalent to that existing for fraud at common law. This remedy is not limited to "sellers" but also to persons collaterally involved in the transaction who made misrepresentations to promote the sale of securities with the requisite scienter."

Davis v. AVCO Financial Services, Inc., 739 F.2d 1057, 1063 (6th Cir. 1984).

1. Aiding and Abetting.

a. Liable as an aider and abettor under 10b-5:

(1) If some other person has committed a securities law violation (primary liability);

(2) If the accused party had "general awareness" that his role was "part of an overall activity that is improper"; and

(3) If the accused (i) knowingly assisted, and (ii) substantially assisted the violation.

Davis v. AVCO Financial Services, Inc., at 1065. See survey of Circuits, all of which adopt substantially this test, in Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d 1004, 1009 (11th Cir. 1985). Not yet considered by Supreme Court. See also SEC v. Coffey, 493 F.2d 1304, 1315-18 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975); SEC v. Washington County Utility Dist., 676 F.2d 218, 224 (6th Cir. 1982); Woodward v. Metro Bank of Dallas, 522 F.2d 84 (5th Cir. 1975); Little v. Valley National Bank of Arizona, 650 F.2d 218 (9th Cir. 1981) (bank knowingly assisted in reissuance of debentures in broker's street name, which concealed that real owner was an insider); Stokes v. Lokken, 644 F.2d 779 (8th Cir. 1981) (attorney not liable as aider and abettor when his qualified opinion that sale of coins did not involve a "security" when given in good faith and with no intent to defraud). One commentator argues, in light of Chiarella v. United States, 445 U.S. 222 (1980), that have to find a duty to plaintiff in order to impose aiding and abetting liability for silence. Branson, Discourse on the Supreme Court Approach to SEC Rule 10b-5 and Insider Trading, 30 Emory L.J. 263, at 283 (1981). Chiarella held that a non-insider who had material information but no relationship to investors had no duty to speak and no duty to abstain from trading. (a printer).

b. Sixth Circuit adopts "proximate cause" theory under Section 12(2) of the 1933 Act. This theory rejects view of only holding in parties to the sale (too narrow) or view of holding in any who

participated (too broad) and asks instead "did the injury to the plaintiff flow directly and proximately from the actions of the particular defendant, and was that defendant's efforts a 'substantial factor' in the sale?" Davis v. AVCO Financial Services, Inc., at 1065. Accord, Foster v. Jesup and Lamont Securities Co., Inc., 759 F.2d 838, 843 (11th Cir. 1985).

c. Is recklessness sufficient for second liability? Yes in Third, Sixth, Seventh and Eighth Circuits. Herm v. Stafford; Mansbach v. Prescott, Ball & Turben; Sunstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033 (7th Cir.), cert. denied, 434 U.S. 875 (1977); Stokes v. Lokken; McLean v. Alexander, 599 F.2d 1190 (3d Cir. 1979). No in Second Circuit, where reckless failure to discover a fraud is not sufficient in the absence of a special relationship to plaintiff that is fiduciary in nature. Edwards & Hanly v. Wells Fargo Securities Clearance Corp., 602 F.2d 478, 485 (2d Cir.), cert. denied, 444 U.S. 1045 (1980); Maiden v. Biehl. See also, Branson, Discourse on the Supreme Court Approach to SEC Rule 10b-5 and Insider Trading; Woodward v. Metro Bank of Dallas, at 95. (Scienter requirement scales upward the more remote the activity.)

d. Directors. Mere fact one is a director not sufficient to impose secondary liability. The director must have exercised some control over the corporation, or been aware he was participating in a fraudulent scheme. Herm v. Stafford (director who read a press release containing false statements about the company may have been aware that he was participating in a fraudulent scheme); Lanza v. Drexel; Maiden v. Biehl.

e. Employer may be liable under "respondeat superior". Holloway v. Howerdd, 536 F.2d 690 (6th Cir. 1976) (which summarizes cases, including those reaching a different conclusion).

2. Control Person.

Section 15 of the 1933 Act, 15 U.S.C. §770, provides that:

"Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist."

As to the defense of lack of "knowledge of or reasonable ground to believe", see Mader v. Armel, 461 F.2d 1123 (6th Cir. 1982) (outside directors proved defense); see also Holloway v. Howerdd, at 694.

Section 20(a) of the 1934 Act provides that:

"Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such

controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."

15 U.S.C. §78t(a).

a. Director not automatically liable as a control person. Must actually participate in corporate affairs or exercise influence. Herm v. Stafford; Holloway v. Howerdd. See also, Mader v. Armel.

b. Counsel. Westlake v. Abrams, 504 F.Supp. 337 (N.D.Ga. 1980) (general counsel for broker might be found to be control person where had sufficient involvement with day-to-day operations).

L. 10b-5 Stockbroker Claims.

1. "Churning occurs when a securities broker buys and sells securities for a customer's account, without regard to the customer's investment interest, for the purpose of generating commissions... To establish a cause of action for churning under section 10(b) ... an investor must establish that (1) the trading in his account was excessive in light of his investment objectives; (2) the broker in question exercised control over the trading in the account; and (3) the broker acted with the intent to defraud or with willful and reckless disregard for the investor's interest."

Thompson v. Smith Barney, Harris Upham & Co., Inc., 709 F.2d 1413, 1416 (11th Cir. 1983).

"Churning occurs 'when a broker, exercising control over the volume and frequency of trading, abuses his customer's confidence for personal gain by initiating transactions that are excessive in view of the character of the account'."

Leib v. Merrill Lynch, Pierce, Fenner & Smith, 461 F.Supp. 951, 952 (E.D. Mich 1978).

2. "Unsuitability" claim, prove that the broker believed that the securities traded were unsuitable in light of the investment objectives and needs of the client, but that the broker nonetheless traded those securities.

Zaretsky; E. F. Hutton and Co., 509 F.Supp. 68 (S.D.N.Y. 1981).

3. As to duties of a broker handling a discretionary account, see Leib, at 953.

4. Customer may be liable. Customer entering into a contract to purchase stock with undisclosed intent not to perform the agreement commits 10b-5 fraud. Lehman Brothers Kuhn Loeb, Inc. v. Lawrence, [Current] Fed. Sec. L.Rep. (CCH) ¶98,314 (S.D.N.Y. 1981) (customer speculating price would rise before had to pay); A. T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967).

5. In Section 12(2) claim against broker, may defend on basis of repeated failure to object to confirmations. Ocrant v. Dean Witter & Co., 502 F.2d 854 (10th Cir. 1974).

6. On broker disclosure, see Thompson v. Smith Barney, Harris Upham & Co., Inc., at 1418.

7. For a thorough discussion of churning damages see Miley v. Oppenheimer & Co., Inc., 637 F.2d 318 (5th Cir. 1981).

M. Insider Trading in Violation of Rule 10b-5.

Rule 10b-5 is violated if a corporate insider uses non-public material information for trading for his own benefit, or for that of tippees. Either disclose, or abstain from trading, at risk of liability for damages to uninformed outsiders who trade during the period of such inside or tippee trading. SEC v. Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969); Elkind v. Liggett Myers, 635 F.2d 156 (2d Cir. 1984); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, discussion and cases cited in In the matter of Raymond L. Dirrs, [1981] Fed.Sec. L.Rep. (CCH) ¶82,812. But in Sixth Circuit see Fridrich v. Bradford. See also Section G3, and Chiarella.

N. Miscellaneous Considerations.

1. Waiver and estoppel defenses not available. Jones v. Miles. But see Ocrant v. Dean Witter & Co.

2. In pari delicto defense may bar.

"The elements of the defense require that the parties be mutually, simultaneously, and relatively equally at fault, that the plaintiff have acted knowingly in the illegal activity, and that the application of the defense protect the interest of the investing public and not frustrate the objectives of the securities laws."

Kirkland v. E. F. Hutton and Co., Inc., 564 F.Supp. 427, 435 (E.D.Mich. 1983); See also Lawler v. Gilliam, 569 F.2d 1283 (4th Cir. 1978); James v. DuBreuil, 500 F.2d 155 (5th Cir. 1984); Roger v. Lehman Bros. Kuhn Loeb, Inc.,

604 F.Supp. 222 (S.D.Ohio 1984). But see, Can-Am Petroleum Co. v. Beck, 331 F.2d 371 (10th Cir. 1964) and Shick v. Steiger, 583 F.Supp. 841 (E.D.Mich. 1984) (where tippee not allowed to assert defense against investors since his culpability greater).

3. Contributory negligence or lack of diligence by plaintiff is no defense. Straub v. Valisman and Co., 540 F.2d 591 (3d Cir. 1976); Dupuy v. Dupuy; Sunstrand Corp. v. Sun Chemical Corp.; Holdsworth v. Strong, 545 F.2d 687 (10th Cir. 1976), cert. denied, 430 U.S. 955 (1977). But see, Hirsch v. DuPont, 553 F.2d 750 (2d Cir. 1977).

4. Quantum of proof. Preponderance of the evidence. But see Huddleston ("clear and convincing").

5. Shareholder may bring derivative action to invoke 10b-5 right of corporation. Shell v. Hensley, 430 F.2d 819 (5th Cir. 1970).

6. No private right of action for violations of NASD and NYSE rules, but may be considered as evidence under the antifraud provisions of the federal securities laws. Miley v. Oppenheimer & Co., Inc., at 824; Kirkland v. E. F. Hutton and Co., Inc., 564 F.Supp. 427, 443 (E.D.Mich. 1983).

0. Statute of Limitations.

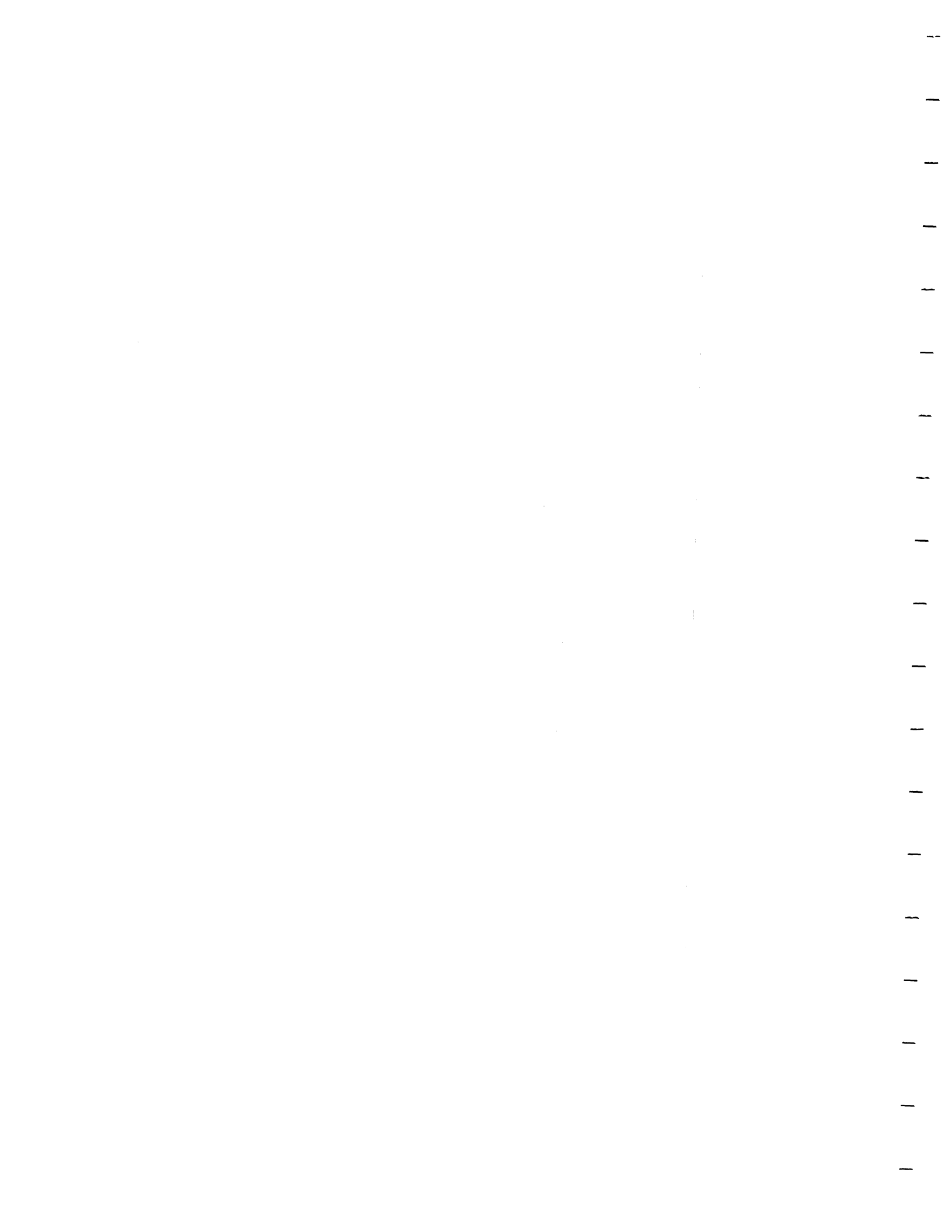
1. Three years in Kentucky, for 10b-5, looking at state blue sky. Carothers v. Rice, 633 F.2d 7 (6th Cir. 1980), cert. denied, 450 U.S. 998 (1981); Herm v. Stafford. See also Diamond v. Lamotte, 709 F.2d 1419 (11th Cir. 1983) (looked at state cause of action which is most closely analogous, so followed Georgia's blue sky statute). For other jurisdictions, see summary in Hill v. Der, 521 F.Supp. 1370 (D.Del. 1981).

3. Statute begins to run when the fraud is, or should have been, discovered ("equitable tolling" doctrine). Herm; Vanderboom v. Sexton, 422 F.2d 1233, 1240 (8th Cir. 1970); Hill v. Der. This issue may be decided on summary judgment. Herm (facts must be such as to enable court to conclude as a matter of law that "a reasonably diligent person should have discovered the participation by the particular defendant by the date the fraud should have been discovered").

a. Investor has duty to exercise reasonable care and diligence in discovering. Dayco Corp. v. Goodyear Tire & Rubber Co., 523 F.2d 389 (6th Cir. 1975); Gaudin v. KDI Corp., 576 F.2d 708 (6th Cir. 1978) (assuming the investor is "at least a person of ordinary intelligence").

b. Fraudulent concealment will toll. Tomera v. Galt, 511 F.2d 504, 510 (7th Cir. 1975).

ONP:2/86



SALE OF SECURITIES BY CONTROL PERSONS:
DEFINITION OF CONTROL, REALES
AND OTHER PROBLEMS UNDER
THE 1933 ACT

Rutheford B Campbell, Jr.
Professor of Law
University of Kentucky
Lexington, Kentucky

I. The Problems of Control Persons Under the Securities Act of 1933.

A. Section 5 of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. Section 77e (1982), prohibits the sale of securities by "any person", unless either a registration statement is effective with regard to such securities, or an exemption from the registration requirement is available with regard to such securities.

B. Section 4(1) of the 1933 Act, 15 U.S.C. Section 77d(1) (1982), however, exempts from the requirements of Section 5 "transactions by any person other than an issuer, underwriter, or dealer". Except for provisions of Section 2(11) of the 1933 Act, 15 U.S.C. Section 77b(11) (1982), Section 4(1) would exempt sales by control persons.

C. Section 2(11) of the 1933 Act defines "underwriter" as one who "has purchased from . . . or sells for an issuer in connection with" a distribution of securities. The Section defines "issuer", "as used in this paragraph", to include "any persons . . . controlling or controlled by . . . or . . . under common control with the issuer."

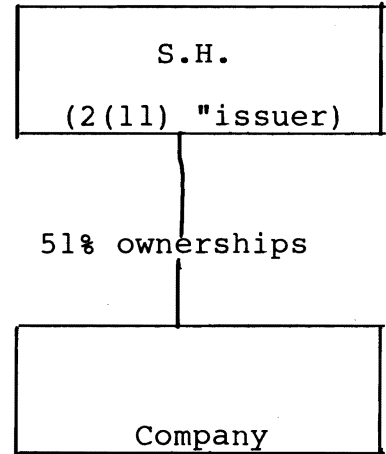
1. A control person, therefore, is defined as an "issuer" for the purposes of Section 2(11). Although Section 2(11) indicates that the definition of a control person as an issuer is limited to Section 2(11) only, a control person

becomes subject to the requirements of Section 5, since the exemption otherwise available through Section 4(1) is destroyed.

2. There are three configurations in which a control person gets caught under the "issuer" definition in Section 2(11).

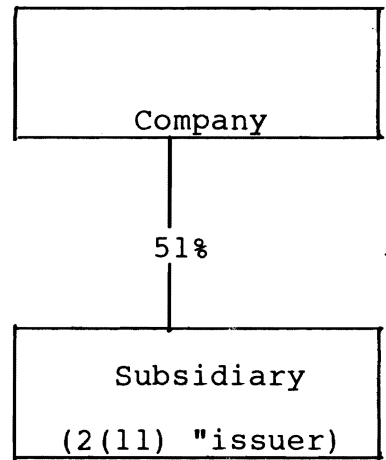
a. A person "controlling".

This includes the situation, diagrammed to the right, in which a person owns, for example, 51% of the Company. Thus, if S.H. sells stock in the Company, he may be caught by the Section 5 requirements.

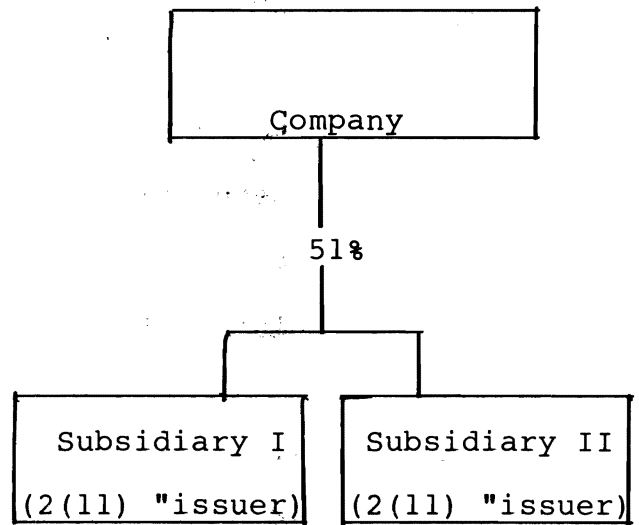


b. A person "controlled by".

This includes the situation diagrammed at the right. It means, therefore, that if the subsidiary of the Company sells securities in the Company, it may get caught by Section 5.



c. A person "under common control with". This includes the situation diagramed at the right. It means that if Subsidiary I sells stock in Subsidiary II, it may be subject to the requirements of Section 5.



D. It is, therefore, necessary to be able to judge the existence of "control", since only persons having some "control" relationship get caught under the foregoing analysis.

II. The Definition of "Control" Under the 1933 Act.

A. The formulation of the definition itself is unclear. There is no definition in the 1933 Act.

1. Rule 405 promulgated under the 1933 Act defines control as follows: ". . . the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. Section 230.405 (1984). Certain commentators have advocated this test. See, e.g., Sommer, Who's In Control?, 21 Bus. Law. 559, 582 (1966). The following are examples of courts' using this test: SEC v. American Beryllium & Oil Corp., 303 F. Supp. 912, 915 (S.D.N.Y. 1969); SEC v. Computronic Indus.

Corp., 294 F. Supp. 1136, 1139 (N.D. Tex. 1968); SEC v. Franklin Atlas Corp., 154 F. Supp. 395, 400 (S.D.N.Y. 1957).

2. Some commentators and courts have defined "control" in terms of one's ability to obtain registration. 2 L. Loss, Securities Regulation 780-81; E. McCormick, Understanding the Securities Act and the SEC 69 (1948); SEC v. International Chem. Dev. Corp., 469 F.2d 20, 28, 30-31 (10th Cir. 1972); Pennuluna & Co. v. SEC, 410 F.2d 861, 865, 866 (9th Cir. 1969); SEC v. American Beryllium & Oil Corp., 303 F. Supp. 912, 915 (S.D.N.Y. 1969); SEC v. North Am. Research & Dev. Corp., 280 F. Supp. 106, 121 (S.D.N.Y. 1968); SEC v. Micro-Moisture Controls, Inc., 148 F. Supp. 558, 562 (S.D.N.Y. 1957).

3. This writer is convinced that the "ability to obtain registration" test is a better test of control, because it is philosophically consistent with the apparent reason for requiring a control person to comply with Section 5, see H.R. Rep. No. 85, 73d Cong., 1st Sess. 13-14 (1933) (stating that an offering by a control person ". . . may possess all the dangers attendant upon a new offering of securities. Wherever such a redistribution reaches significant proportions, the distributor would be in the position of controlling the issuer and thus able to furnish the information demanded by the bill"), and would be a more understandable and fairer norm. See, Campbell, Defining Control in Secondary Distributions, 18 B.C. Com. & Ind. L. Rev. 37, 38-41 (1976).

B. The cases establish three bases for control. First is the ownership of voting securities; second is a significant management position, and third is a relationship with one owning voting stock or having a significant management position.

1. The most obvious basis for control of a corporation is the ownership of voting stock. ("The power of management is ultimately . . . in the hands of the holders of voting securities." Sommer, Who's In Control?, 21 Bus. Law. 559, 567 (1977)). Although it is impossible to quantify the amount of voting control necessary to establish control, it is possible to draw certain conclusions in that regard.

a. It is clear, for example, that ownership of 51% of the voting power of a corporation establishes control. See, e.g. SEC v. North Am Research & Dev. Corp., 280 F. Supp. 106, where the court found control because one shareholder "owned more than 50% of the outstanding shares . . ." of a corporation. Id., at 121.

b. It is equally clear that one with less than 51% of the voting shares of a corporation may nonetheless be classified a control person (the Commission, in In re Thompson Ross Securities Co., 6 S. E.C. 1111, 1119 (1940), stated that "[c]ontrol is not synonymous with the ownership of 51 percent of the voting stock of a corporation."), although it is impossible to draw an unwavering line defining control. Persons with 40% to 50% of voting stock were held to be control persons in United States v. Wolfson, 405 F.2d 779 (2d Cir. 1968),

and in S.E.C. v. Micro-Moisture Controls, Inc., 167 F.Supp. 716 (S.D.N.Y. 1958), aff'd sub nom., S.E.C. v. Culpepper, 270 F.2d. 241 (2d Cir. 1959); an individual who owned 18 percent was held to be a control person in In re Thompson Ross Securities Co., 6 S.E.C. 1111 (1940); in United States v. Sherwood, 175 F.Supp. 480 (S.D.N.Y. 1959), however, the court refused to find an 8% shareholder as a control person. In each of the foregoing cases, other factors of control (or the absence of other factors of control) were relevant to the court's decision.

c. It has been suggested that 10% ownership should be considered something of a "red light", signaling that one may be considered in danger of being a control person. Enstam & Kamen, Control and the Institutional Investor, 23 Bus. Law. 289, 315 (1968); Sommer, Who's In Control, 21 Bus. Law. 559, 56 (1966). One commentator has even suggested that 5% is the relevant figure. S.E.C. Problems of Controlling Stockholders and in Underwritings 19 (C. Israels, ed. 1962).

d. The 10% level of ownership should be considered, at best, a crude rule of thumb regarding control. Other bases of control (discussed infra) are obviously relevant, as are factors such as the distribution of company's voting stock (a 10% shareholder is more likely to be considered a control person if his is the largest block of stock and the other 90% is widely scattered) and the actual amount of ownership involved (one with 10% ownership is, obviously, less likely to be considered a control person than is one with 40%).

See Campbell, Defining Control In Secondary Distributions,
18 B.C. Com. & Ind. L. Rev. 37, 43-44 (1976).

2. A management position with a company is a factor courts consider in determining control. In that regard, courts have emphasized positions as officers and directors as important (see, e.g., SEC v. International Chem. Dev. Corp., 469 F.2d 20, 31 (10th Cir. 1972); SEC v. National Bankers Life Ins. Co., 334 F.Supp. 444, 449, 450, 452 (N.D. Tex. 1971); SEC v. North Am. Research & Dev. Corp., 280 F.Supp. 106, 121 (S.D.N.Y. 1968); U.S. v. Sherwood, 175 F.Supp. 480, 483 (S.D.N.Y. 1959); In re Thompson Ross Sec. Co., 6 S.E.C. 1111, 1119 (1940)), as well as untitled, de facto management positions (see U.S. v. Wolfson, 405 F.2d 779 (2d Cir. 1968); SEC v. Franklin Atlas Corp. 154 F.Supp. 395 (S.D.N.Y. 1947)).

a. Although it is difficult to generalize, most commentators and courts appear to consider a substantial management position as significant but not determinative to the matter of control. 2 L.Loss, Securities Regulation 781 (1961) ("a sort of red light"); Enstam & Kamen, Control and the Institutional Investor, 23 Bus. Law. 289, 306 (1968) ("Representation on the board has been held to be one factor which will be weighed . . ."); Wilko v. Swan, 127 F.Supp. 55, 56-58 (S.D.N.Y. 1955). There is some authority, however, indicating that a position as an officer or director is determinative of control. See, e.g., SEC v. National Bankers Life Ins. Co., 334 F.Supp. 444, 452, 458 (N.D. Tex. 1971); SEC v. Computronic Indus. Corp., 294 F.Supp. 1136, 1139 (N.D. Tex. 1968).

3. Relationships can be the basis for control. This, essentially, involves the concept of attribution. Thus for example, in certain instances Adams' control bases (e.g., either stock ownership by Adams or a management position of Adams) may be attributed to Begley. Courts seem willing to utilize such attribution concepts in instances where there is some significant relationship between Adams and Begley. See, Campbell, Defining Control in Secondary Distributions, 18 B.C. Ind. & Com. L. Rev. 37, 46-49 (1976).

a. The relationship can be based on a contractual arrangement. Sommer, Who's In Control?, 21 Bus. Law. 559, 571 (1966); In re Thompson Ross Sec. Co., 6 S.E.C. 1111, 1121 (1940) (emphasizing that the control person "held proxies of over 50 percent of the outstanding shares").

b. The relationship can also be based on non-contractual factors. S.E.C. v. North American Research & Development Corp., 280 F.Supp. 106 (S.D.N.Y. 1968) (business relationship); S.E.C. v. Antoine Silver Mines, Ltd., 229 F.Supp. 414 (N.D. Ill. 1968) (father-son relationship); S.E.C. v. National Bankers Life Insurance Co., 334 F.Supp. 444 (N.D. Tex. 1971) (father-in-law and son-in-law relationship).

c. The relationship question is often characterized as a "group control" question. See, Campbell, Defining Control in Secondary Distribution, 18 B.C. Com. Ind. L. Rev. 37, 53-58 (1976). This writer would suggest that however the matter is framed, whether as a "relationship" question or a

"group" question, both the analysis and the result is the same. The ownership characteristics of one person are attributed to another if there is a significant relationship between the two or if they are both members of a group. The following court and administrative cases recognize that one may become a control person through his affiliation with a "group". U.S. v. Wolfson, 405 F.2d 779, 781-82 (2d Cir. 1968); U.S. v. Dardi, 330 F.2d 316, 325 (2d Cir. 1964); SEC v. American Beryllium & Oil Corp., 303 F.Supp. 912, 915 (S.D.N.Y. 1969); SEC v. Micro-Moisture Controls, Inc., 167 F.Supp. 716, 718, 738 (S.D.N.Y. 1958); aff'd sub nom. SEC v. Culpepper, 270 F.2d 241 (2d Cir. 1959); In re Thompson Ross Sec. Co., 6 S.E.C. 1111, 1119-20 (1940).

4. In attempting to evaluate the cases in this area, this writer previously concluded:

The cases indicate that if none of the three factors -- ownership interest, management position and personal or business relationship -- is present, a selling shareholder is unlikely to be declared a control person. If, however, one of these factors is present, there is a substantial risk that a selling shareholder will be declared a control person. The presence of two or more factors usually results in a determination that a particular individual is a control person.

Campbell, Defining Control in Secondary Distributions, 18 B.C. Com. & Ind. L. Rev. 37, 49-50 (1976).

a. It is clear, however, that the foregoing is an overly simplistic formulation, which omits consideration of essential factors. For example, the intensity of each factor is important (one with 40% voting interest is more likely to be considered a control person than is one with a

10% voting interest; the CEO is more likely to be considered a control person than is an assistant vice-president).

b. This writer continues to rely on a touchstone: can the shareholder obtain registration. Asking this question is often helpful to evaluate whether a shareholder's control is sufficient to require compliance with Section 5 of the 1933 Act.

III. Alternatives for Sales of Securities by Control Persons.

A. One becomes an "issuer" within the meaning of Section 2(11) only if engaged in a "distribution" through an "underwriter". Otherwise, the control person has a Section 4(1) exemption available, since the control person would be neither an issuer, underwriter nor a dealer.

1. A control person selling even a limited amount of securities in a normal market transaction, therefore, would become an "issuer" within Section 2(11). The broker executing the sale on behalf of the control person would be an "underwriter" for the purposes of the transaction, and the sale on the market would be considered a "distribution", since it is, in effect, an offer of the securities to all bidders. See In the Matter of Ira Haupt & Co., 23 S.E.C. 589 (1946).

2. A control person who sells securities on its own behalf, therefore, should not be considered an "issuer" within Section 2(11), since there is no "underwriter" involved in the transaction. Accordingly, such a control person should retain an exemption from registration pursuant

to the terms of Section 4(1). I have always suspected, however, that if the offering got too large or too "public", the Commission would look hard for someone who is "selling for" the control person.

3. A control person who sells securities without becoming involved in a "distribution" should retain an exemption under Section 4(1), even if such control person engages the services on a broker-dealer or some other professional to act on his behalf.

a. Rule 144, 17 C.F.R. Section 230.144 (1984), is one mechanism available that allows a control person to sell securities while remaining outside the definition of a "distribution". The Rule is effective for the sale of securities held by control persons in larger companies that are actively traded. It is, unfortunately, unavailable for persons holding securities in smaller companies. See Campbell, The Plight of Small Issuers (And Others) Under Regulation D, Vol. 74 Ky. L.J. (1985).

(1) Each three months, a control person can sell an amount of securities equal to the greater of 1% of the company's outstanding stock or the average weekly trading volume in the stock for the last four weeks. Rule 144(e)(1), 17 C.F.R. Section 230.144(e)(1) (1984).

(2) In addition to the foregoing volume limitations, the requirements for a Rule 144

transaction are that current public information must be available, Rule 144(c), 15 C.F.R. Section 230.144(c) (1984) (typically, this provision is met in instances where larger corporations are involved, since it is satisfied if the company has complied with the periodic reporting and proxy solicitation requirements of the Securities Exchange Act of 1934 (the "1934 Act")), that the sales be effected in "brokers' transactions", Rule 144(f) and (g), 15 C.F.R. Section 230.144(f) and (g) (1984) (typically these provisions can be met, at least within certain amount limits, so long as the stock is traded on an exchange or in the over the counter market), and that a notice of the proposed sale be filed with the Securities and Exchange Commission, Rule 144(h), 15 C.F.R. Section 230.144(h) (1984). There is a lot of literature on Rule 144, including the following books and articles: T. Hazen, *The Law of Securities Regulation* 152-57; D. Goldwasser, *The Practitioner's Comprehensive Guide to Rule 144* (1975); Fogelson, Rule 144 -- A Summary Review, 37 *Bus. Law* 1519 (1981-82); Linden, Resale of Restricted and Control Securities Under Rule 144: The First Five Years, 8 *Seton Hall L. Rev.* 157 (1977); Lipton, Fogelson & Warnken, Rule 144 -- A Summary Review After Two Years, 29 *Bus. Law.* 1183 (1973-74).

(3) Rule 144 is unavailable for a control person in a small issuer, since it is impossible to meet the brokers' transaction requirements. See Campbell, The Plight of Small Issuers (And Others) Under Regulation D, Vol. 74 Ky. L.J. (1985).

(4) Sales meeting the requirements of Rule 144 do not involve "distributions", thus such sales by a control person are exempt under Section 4(1).

b. Control persons can also utilize the so called "Section 4(1½) exemption as a basis to sell their securities.

(1) This "exemption" requires a private sale by the control person. If the control person makes a private sale of his securities (even though such control person uses the services of a paid broker or intermediary), he would not be involved in a "distribution". Because no "distribution" is involved, no "underwriter" is involved, and the selling shareholder is not considered an "issuer" under Section 2(11). As a result, the transaction should be exempt under Section 4(1) of the 1933 Act (these are called "Section 4(1½)" transactions because of the confusion as to whether the exemption is a Section 4(2) exemption (the non-public offering exemption) or the Section 4(1) exemption). For an excellent discussion of "Section 4(1½)", see The Section "4(1½) "Phenomenon, Private

Resales of "Restricted Securities", 34 Bus. Law. 1961 (1979).

(2) This writer is convinced that to sell under the Section 4(1½) exemption, the selling shareholder must meet all the requirements for a Section 4(2) transaction. Generally, therefore, the following requirements must be met: (i) The purchaser must be sophisticated (i.e., must be able to evaluate the merits and risks of the particular investment); (ii) the purchaser must have access to the same type of information that would be found in a registration statement; (iii) and the selling shareholder cannot utilize any general advertising in connection with the sale.

B. The Intrastate exemption is, theoretically, available for sales of securities by a control person.

1. Unfortunately, Rule 147 is not available for sale of securities by a control person. Rule 147 (Preliminary Note 4), 17 C.F.R. Section 230.147 (Preliminary Note 4) (1984).

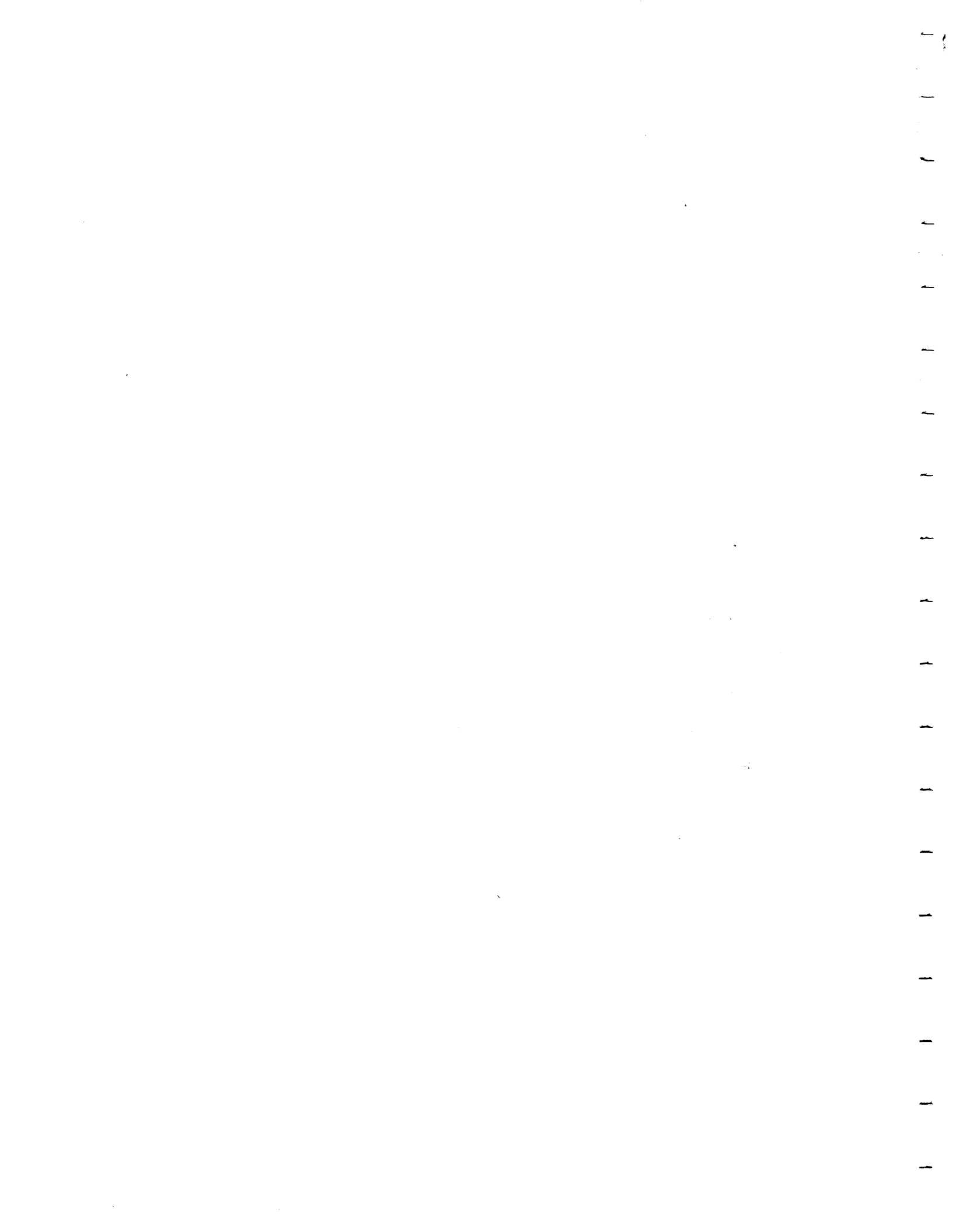
2. An offering pursuant to the common law of Section 3(a)(11) (the statutory intrastate exemption) can be made by a control person. "A secondary offering by a controlling person in the issuer's State of Incorporation may be made in reliance on section 3(a)(11) exemption provided the exemption would be available to the issuer for a primary offering in that state. It is not essential that the controlling person be a resident of the issuer's State

of incorporation." Securities Act Release No. 4434 (December 6, 1961). The restrictions and unpredictability of the common law of Section 3(a)(11), however, make it difficult and dangerous to rely on the exemption. See Kant, SEC Rule 147 -- A Further Narrowing of the Intrastate Offering Exemption, 30 Bus. Law. 73, 74-75 (1974); Gadsby, The Securities Exchange Commission and the Financing of Small Business, 14 Bus. Law. 144, 148 (1958) (that author characterized Section 3(a)(11) as "laced with dynamite").

C. Regulation D is not available for the sale of securities by a control person. Regulation D (Preliminary Note 4), 17 C.F.R. Section 230.501-.506 (Preliminary Note 4) (1984).

D. Section 4(2) of the 1933 Act, the exemption for non-public offerings (private placements), is by its terms available only to an "issuer". It is possible, however, for a control person to make non-public sales pursuant to the exemption provided by Section 4(1). See the discussion of the "Section 4(1½)" exemption, supra.

E. Section 4(6), the exemption for sales made only to accredited investors, is by its terms limited to transactions by an "issuer". 15 U.S.C. Section 77d(6) (1982).



SEMINAR ON
SECURITIES LAW
Pre-registration*

Phillip E. Allen Louisville, KY	Kevin J. Hable Louisville, KY	Eileen M. O'Brien Lexington, KY
William W. Allen Lexington, KY	Robert A. Heath Louisville, KY	J. R. Oexmann Lexington, KY
John M. Anderson Cincinnati, OH	William R. Hilliard, Jr. Lexington, KY	Wendell H. Overcash Louisville, KY
Randall R. Aubrey Lexington, KY	Lewis Kelly Frankfort, KY	Ronda S. Paul Lexington, KY
Kenton Ball Lexington, KY	Roberta K. Kiser Lexington, KY	James Paxton, Jr. Paducah, KY
Frank T. Becker Lexington, KY	R. David Lester Lexington, KY	John E. Pence Frankfort, KY
John Bickell Owensboro, KY	Robert Lindwall Cincinnati, OH	Roger L. Peterman, Esq. Cincinnati, OH
C. Craig Bradley, Jr. Louisville, KY	Robert E. Maclin, III Lexington, KY	William A. Rees Lexington, KY
Bing I. Bush Lexington, KY	Thresa Marcel Jagnow Frankfort, KY	Edwin T. Robinson Cincinnati, OH
Stephan Charles Manchester, KY	Thomas C. Marks Lexington, KY	Douglas R. Sharps Louisville, KY
James L. Clear Frankfort, KY	Karen Marple Lexington, KY	James A. Shuffett Lexington, KY
C. Johnston Cramer, III Lexington, KY	Ben G. Matthews Shelbyville, KY	Laura Shuffett Lexington, KY
Frank G. Dickey, Jr. Lexington, KY	Gary R. Matthews Lexington, KY	Jan Smith Frankfort, KY
Charles W. Dobbins, Jr. Louisville, KY	Judge N. M. Meade Lexington, KY	J. David Smith, Jr. Lexington, KY
William E. Doyle Frankfort, KY	Joel C. Morgan Lexington, KY	William L. Stevens Danville, KY
Wesley A. Gersh Louisville, KY	James D. Moyer Louisville, KY	Cynthia L. Stewart Louisville, KY

*As of February 11, 1986

Page Two
Pre-registration
Seminar on Securities Law
February 14-15, 1986

Septtimous Taylor
Owensboro, KY

Joseph H. Terry
Lexington, KY

J. Montjoy Trimble
Lexington, KY

Stephen E. Wolff
Louisville, KY

Cynthia W. Young
Louisville, KY

Joel C. Zwemer
Louisville, KY

HANDOUT MATERIALS OF SEMINARS AVAILABLE FROM
THE OFFICE OF CONTINUING LEGAL EDUCATION
UNIVERSITY OF KENTUCKY COLLEGE OF LAW

<u>SUBJECT</u>	<u>DATE</u>	<u>PRICE</u>
Kentucky Municipal Law	Jan. 23-24, 1981	15.00
Estate Planning	July 17-18, 1981	10.00
Recent Changes In Criminal Procedure	Aug. 14, 21, 28, 1981	10.00
Ky. Uniform Building Code & Aspects of Code Adm.	May 7, 1982	5.00
Estate Planning	July 23-24, 1982	15.00
Computers, Law & Practice	Aug. 20-21, 1982	10.00
Products Liability (Regional one-day program)	Aug. 27 thru Nov. 5, 1982	10.00
Tax Institute	Sept. 17-18, 1982	15.00
Mineral Law	Oct. 15-16, 1982	15.00
Workers' Compensation	Nov. 12-13, 1982	15.00
Real Property Practice	Dec. 10-11, 1982	15.00
Kentucky Municipal Law	Jan. 21-22, 1983	15.00
Securities Law	Feb. 25-26, 1983	15.00
Legal Issues For Bank Counsel	Mar. 25-26, 1983	15.00
Commerical Law	Apr. 15-16, 1983	15.00
Civil Practice & Procedure	May 13-14, 1983	15.00
Estate Planning	July 15-16, and 29-30, 1983	15.00
Bankruptcy Law	Aug. 12 & 26, 1983	15.00
Evidence & Trial Practice	Sept. 9 & 16, 1983	15.00
Domestic Relations (Regional one-day program)	Sept. 23, 1983 thru Feb. 3, 1984	15.00
Closely-Held Corporations	Nov. 18-19, 1983	15.00

Kentucky Hospital Law	Dec. 16-17, 1983	15.00
Construction Contract Law	Jan. 20-21, 1984	15.00
Securities Law	Feb. 17-18, 1984	20.00
Legal Issues For Bank Counsel	Mar. 23-24, 1984	15.00
Buying & Selling A Business	Apr. 20-21, 1984	15.00
Agricultural Law	June 15-16, 1984	15.00
Agricultural Law Glossary		3.00
Legal Ethics & Law Office Management	June 29, 1984	10.00
Estate Planning	July 13-14, 1984	15.00
Kentucky Practice & Procedure (Regional one-day program)	Aug. 17 thru Nov. 2, 1984	15.00
Local Government Law	Sept. 14-15, 1984	15.00
Workers' Compensation	Nov. 16-17, 1984	15.00
Business Litigation	Dec. 14-15, 1984	15.00
Labor & Employment Law	Jan. 18-19, 1985	15.00
Securities Law	Feb. 15-16, 1985	15.00
Legal Issues For Bank Counsel	Mar. 15-16, 1985	20.00
Domestic Relations	Apr. 19-20, 1985	15.00
Social Security Disability Claims	June 21-22, 1985	20.00
Estate Planning	July 19-20, 1985	15.00
Bankruptcy Law	Aug. 16-17, 1985	20.00
Evidence & Trial Practice (Regional one-day program)	Aug. 30, 1985 thru Feb. 28, 1986	15.00
Construction Law	Sept. 20-21, 1985	15.00
Federal Practice	Oct. 18-19, 1985	20.00
Tax Advantaged Real Estate Transactions	Nov. 15-16, 1985	20.00
Business Litigation	Dec. 6-7, 1985	15.00

Prejudgment & Post Judgment
Collections

Jan. 17-18, 1986

15.00

Securities Law

Feb. 14-15, 1986

20.00



ORDER FORM

Please send _____ copy (copies) of:

_____	\$ _____	each
_____	\$ _____	each
_____	\$ _____	each
_____	\$ _____	each

Subtotal	\$ _____
5% Sales Tax	\$ _____
Add \$1.00 per copy for postage and handling	\$ _____
TOTAL DUE	\$ _____

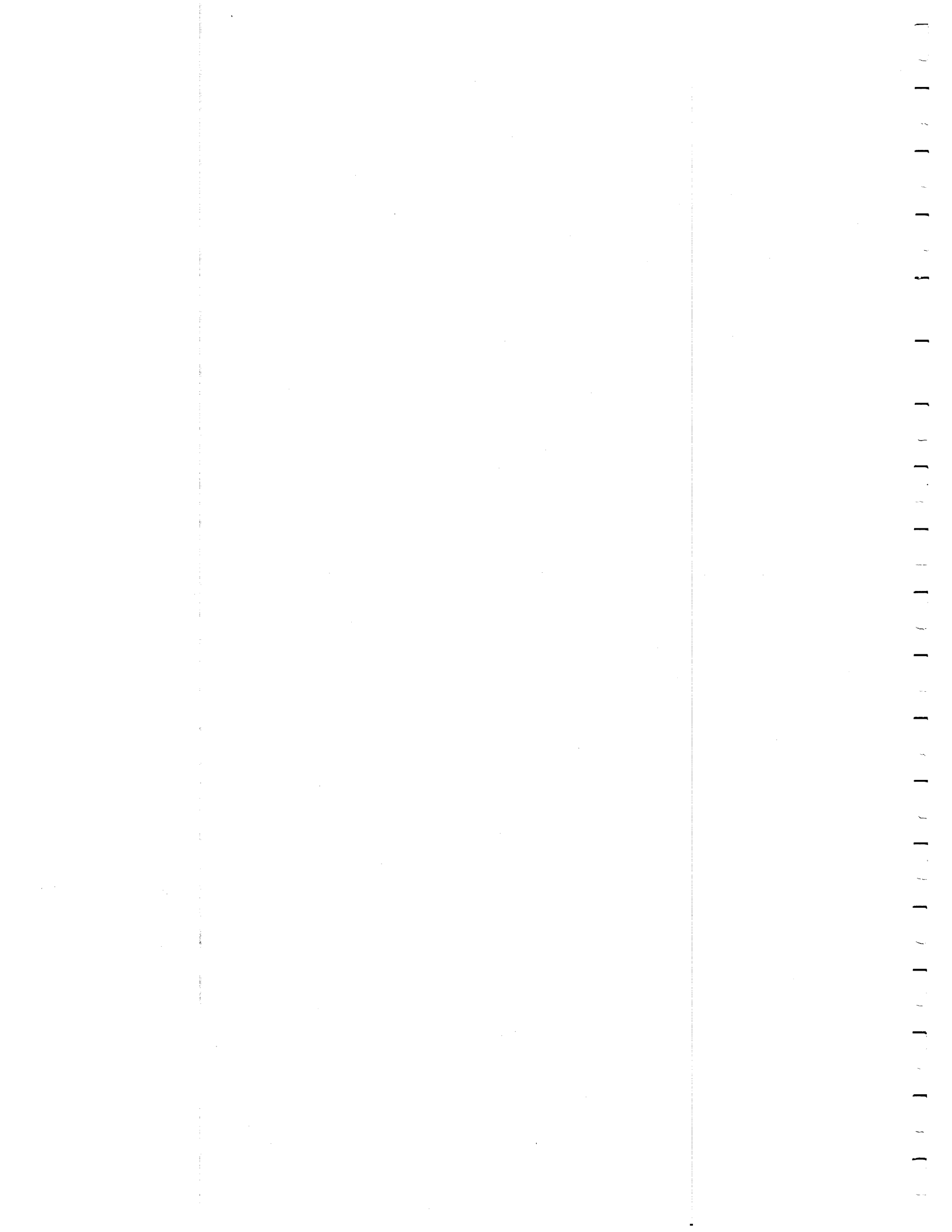
Name: _____

Address: _____

City, State & Zip: _____

Make checks payable to: UNIVERSITY OF KENTUCKY

Mail your order to: Office of Continuing Legal Education
University of Kentucky
College of Law - Law Building
Lexington, Kentucky 40506-0048



FUTURE
CONTINUING LEGAL EDUCATION
PROGRAMS SCHEDULED

1986

February 14-15	Securities Law
*February 28	Evidence & Trial Practice (Louisville)
March 14-15	Legal Issues for Bank Counsel
**April 11-12	Environmental & Natural Resources Law
May 1-2	Equine Law (Radisson Plaza Lexington)
May 14-23	Trial Advocacy (Intensive)
June 20-21	Health Services Law

*Regional Programs

**Presented by the Mineral Law Center, University of Kentucky, Tel.
(606) 257-1161.

Except as indicated, all programs will be held in the Courtroom, College
of Law, University of Kentucky.