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THE NEW COLORADO SECURITIES ACT – A QUEST FOR UNIFORMITY

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INTRODUCTION

There appears to be little doubt that state regulation of the security markets is as inevitable as the proverbial "death and taxes." Today, almost every state has some type of regulation over new security offerings, investment advisers, brokers and dealers.[1] These state laws operate concurrently with the jurisdiction of the United States Securities and Exchange Commission.[2]

Anyone concerned today with floatation of a new offering of securities, organization as a broker or dealer in securities, or investment advising must comply with state as well as federal regulations. In fact, where offerings are multi-state and encompass many participating underwriters or security dealers, the problems involved in coordinating all the various facets of state "blue sky" laws are by far more troublesome than registration with the United States Securities and Exchange Commission. One need only attempt a study of all the various state statutes and security department regulations to recognize the need for a uniform securities act which would, to a great extent, coordinate with federal registration and acknowledge the regulations of other jurisdictions.

Because of this obvious maze of multiple regulations and desperate need for uniformity, the House of Delegates of the American Bar Association in 1947 determined that the National Conference of Commissioners on Uniform State Laws should consider the drafting of a uniform sale of securities act.[3]

From this directive, after much work and research, came the suggested Uniform Securities Act approved by the conference in 1956.[4]

Recent legislation in the State of Colorado, effective July 1, 1961, recognized the need for uniformity, the necessity for strengthening the powers and rule making authority of the commissioner of securities, and the importance of federal-state coordination.

The purpose of this article will be to discuss and analyze the new Colorado Securities Act and to comment on the various important provisions which substantially modify prior existing law.

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**Explanatory note: As the Colorado Securities Act of 1961 has not yet been assigned an official session law or statute number, citations to the act will be to the applicable section of H.B. 379, as enacted. (Chapter 232 is the tentative session law number, assigned by the Revisor of Statutes.)

1 Only Delaware and Nevada today have no regulations over securities, brokers and dealers. The District of Columbia is regulated by the U.S. Securities and Exchange Commission. See Loss & Cowett, Blue Sky Law (1958) for a full discussion concerning the various types of security and broker regulations in the various states.

2 See Loss, Security Regulation, (1951, Supp. 1955). No discussion in this article will cover the statutes, rules and regulations of the Federal Securities and Exchange Commission. Much, however, has been written on federal requisition of the securities market. See generally *Securities and Exchange Commission, Silver Anniversary Commemorative Symposium*, 28 Geo. Wash. L. Rev. 1 (1960); *Symposium Contemporary Problems in Securities Regulation*, 45 Va. L. Rev. 787 (1960); See a multitude of citations in Loss, Securities Regulation, (1951, Supp. 1955).

3 72 A. B. A. Rep. 98, 297 (1947). For a history of the work of the various committees in the drafting of the Uniform Securities Act, see Loss & Cowett, Blue Sky Law 233 (1958).

4 Nat'l Conference of Commissioners on Uniform State Laws, Handbook and Proceedings, 83, 84, 88 (1956).

No attempt will be made to compare this legislation with the suggested Uniform Securities Act, variations thereof, or other state security laws.

I. REGISTRATION OF BROKERS, DEALERS AND SALESMEN

Similar to its predecessor, the new law makes it unlawful for persons to transact business in the State of Colorado as a broker-dealer, issuer-dealer or salesman unless such persons have first obtained a license from the securities commissioner.[5] The statute specifically excludes from the general definition of "broker-dealer" a person who has no place of business in the State of Colorado and who engages in a minimum amount of security trading.[6] Likewise, all salesmen must be licensed prior to engaging in, effecting or attempting to effect purchases or sales of securities. The licensing procedure is detailed and specifies the method to obtain either an initial or renewal license. An application must be filed with the securities commissioner, together with a consent to service of process on the securities commissioner in the event suit is subsequently instituted. The securities commissioner is given the power to develop applications and forms calling for basic information necessary for a determination of whether a license should be granted.

The "basic information" contained in the forms promulgated by the securities commissioner, includes such items as, (1) the applicant's form and place of organization, (2) the applicant's proposed method of doing business, (3) qualifications and business history of the applicant, (4) disclosure of any injunction or administrative action which may have been taken against him concerning security matters and (5) a financial condition and history of the applicant. If the commissioner of securities takes no further action, the license becomes effective on the 30th day after filing. However, the commissioner does have authority to make the license effective prior to that time if he deems it advisable. The commissioner also has a statutory directive to require a minimum capital of $10,000 for all licensed broker-dealers and issuer-dealers. The term "capital" is not defined in the statute; however, prior administrative interpretations by the securities commissioner indicates that $10,000 of liquid assets is necessary to comply with the spirit and letter of this statutory language. In addition to the aforementioned, the securities commissioner has authority by rule, to require registered broker-dealers to post a surety bond in an amount up to $10,000 and to place such other conditions on the bond as the commissioner in his discretion deems advisable and necessary for the protection of the public. It should be noted that any appropriate deposit of cash or securities is acceptable in lieu of the bond requirement. However, the commissioner has no authority to require a bond of any applicant for an issuer-dealer or broker-dealer license whose net capital, as subsequently defined by rule of the securities commissioner, exceeds $10,000. The net result of the aforementioned statutory language would indicate that an applicant for broker-dealer license would have an alternative

5 H. B. 379, 43rd Gen. Ass., 1st Reg. Sess. § 2 (1961).
6 *Id.* § 12 (3).
7 *Id.* § 3.

of posting a bond in the amount of $10,000 or having in lieu thereof $10,000 of liquid assets. This was the interpretation given the prior Colorado securities act with respect to a similar financial requirement.[8]

After a license has been issued, broker-dealers and issuer-dealers are required to keep such accounts, correspondence, memoranda and other records and data as the securities commissioner may prescribe by rule and regulation. These records are required to be preserved for three years unless otherwise prescribed. In addition, the securities commissioner has the authority by rule to require broker-dealers and issuer-dealers to file other financial reports and information which he feels necessary to the protection of the investing public. The statute further permits the securities commissioner to make such reasonable periodic, special or other examinations of the books and records of any broker-dealer or issuer-dealer as he deems necessary. The commissioner has authority to cooperate in such examinations with security commissioners of other states, the United States Securities and Exchange Commission, and any national securities exchange or national securities association registered under the Securities Exchange Act of 1934.[9]

The statute provides the security commissioner with broad authority to deny, revoke, suspend or cancel registration of a broker-dealer if he finds that it is in the public interest or if he finds that the application, the broker-dealer himself or any partner,

8 Interpretation given Colo. Rev. Stat. § 125-2-3 (6) (1953) by the Colorado Securities Commissioner.
9 75 Stat. 881 (1934), 15 U.S.C. § 78(a) (1958).

officer or director of the broker-dealer has in any way fallen within the scope of the denial or revocation provisions of the act. [10]

The statute is very broad with respect to the right to deny, revoke, suspend or cancel registration. In the event an application for license is incomplete in any material respect or contains any statement which is false or misleading, the commissioner may deny the application or revoke the effectiveness of the registration and license. In addition, denial or revocation is permitted if the broker-dealer has willfully violated or willfully failed to comply with any provision of the securities act or prior law; has been convicted within the past ten years of any felony or misdemeanor involving a security or any aspect of the security business; is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in or continuing any conduct or practice involving any aspect of the security business; is the subject of an order of the securities commissioner denying, suspending or revoking his license as a broker-dealer, issuer-dealer or saleman; has been the subject of an order in the past five years by the security administrators of any other state or of the United States Securities Exchange Commission denying or revoking his license; has been expelled or suspended from a national securities exchange or national securities association registered under the Securities Exchange Act of 1934; or is the subject of any United States Post Office fraud order. The commissioner also has power to deny or revoke registration if the broker-dealer or any partner or officer thereof has engaged in dishonest or unethical practices in the securities business; is insolvent either in the bankruptcy or equity sense; is not qualified on the basis of training, experience and knowledge of the business; has failed to supervise his salesmen properly; or has failed to pay the appropriate filing fees. There are other general restrictive clauses governing the powers of the securities commissioner with respect to denial or revocation of a broker-dealer license which, in any specific case or circumstance, should be carefully examined to determine whether the commissioner has acted within the scope of his statutory authority.

It has been the custom of the securities commissioner and his predecessors in the State of Colorado to require written examinations of applicants for sales licenses. It has also been customary to test at least one of the principals of an applicant for registration as a broker-dealer. The purpose of such examination is to make some determination as to whether the applicant has any familiarity with corporation finance or the security business in general. It is the author's belief that such examinations serve little purpose since they are of a general nature, are usually taken from other examinations which have been discussed in the security field by other salesmen or applicants, and are not determinative of the applicant's knowledge. It would appear that a careful oral examination of the applicant, a closer check of his background, and constant supervision of salesmen by the broker-dealer and the securities commissioner would be more effective in protecting the investing public. It may be that only the threat of continued investigation and super-

10 H.B. 379, 43rd Gen. Ass., 1st Reg. Sess. § 5 (1961).

vision will deter a salesman from making misrepresentations to his customers or clients.

In the event the securities commissioner either postpones or suspends a license, then, upon the entry of an order, the commissioner is obligated by statute to promptly notify the applicant or licensee as well as the employer (or prospective employer) and immediately set the matter down for hearing. Hearings are to be held within fifteen days of a written request for such hearing. If no hearing is requested and none is ordered by the securities commissioner, the order remains in effect until it is subsequently modified or vacated. After the hearing has been held, if one is requested, then the securities commissioner may either modify or vacate the order, or extend it until final determination.

A broker-dealer or salesman may withdraw his registration and surrender his license by giving written notice to the securities commissioner. Such withdrawal becomes effective thirty days after receipt thereof, unless a revocation or suspension proceeding is pending or one is subsequently instituted by the commissioner within the thirty day period.[11] This procedure is generally identical to the procedure utilized by the United States Securities and Exchange Commission in handling applications for withdrawal of registered broker-dealers under the Securities Exchange Act of 1934.[12]

The new statute clearly indicates that no order may be entered under the aforementioned section of the securities act without appropriate prior notice to the applicant or licensee and opportunity for hearing with written findings of fact and conclusions of law.[13] The right of hearing is essential to preserve the constitutional rights of all applicants and licensees under this statute.

The need for comprehensive regulation of brokers, dealers and salesmen is apparent, for in the great majority of cases the investing public relies directly upon the oral representation of these persons in making investment decisions. Only through a thorough and strict administration of these registration and licensing powers can the purposes of the statute become meaningful, since most persons who cannot or will not analyze their own investment needs will look to the broker or registered representative for such advice.

II. REGISTRATION OF SECURITIES

The new statute prohibits any person from offering or selling any security in the State of Colorado until it is registered under the securities act, unless the security or transaction thereof is exempt from registration as provided in the act.[14]

The new statute has made some radical changes with respect to the method of handling registration of securities and is fashioned somewhat after the Uniform Securities Act in providing three separate methods of registering securities for public sale. Securities under the new act may be registerd by notification,[15] by coordina-

11 *Id.* § 5 (4).
12 Securities Exchange Act § 15 (b), 75 Stat. 895 (1934), 15 U.S.C. § 78 (6) (1958).
13 H.B. 379, 43rd Gen. Ass., 1st Reg. Sess. § 5 (5) (1961).
14 *Id.* § 6.
15 *Id.* § 7.

tion,[16] and by qualification.[17] Each of the aforementioned methods of registering securities for public sale will be discussed in detail. Special emphasis is placed upon registration by coordination and qualification since these grant various "merit" powers to the securities commissioner. These merit provisions are a departure from the prior securities act which followed the federal theory of disclosure. They were promulgated by the legislature in an attempt to provide additional statutory powers to the securities commissioner for use in regulating highly promotional issues which in the past had caused financial losses to the investing public and embarrassment to the securities department through the wide publicity received.

A. Registration by Notification[18]

Registration by notification is restricted to securities of issuers or predecessors who have been in continuous operation for at least a five year period. There must not have been a default in the payment of any principal, interest or dividends, or any fixed maturity, fixed interest or fixed dividend securities of the issuer or its predecessors within the current fiscal year of filing or the three preceding fiscal years. In addition, the issuer or predecessors of such issuers during the three years prior to filing, must have had average net earnings, determined in accordance with generally accepted accounting practices, equal to at least five per cent of the amount of such outstanding securities. The statute carefully defines the measure of the amount to which the five per cent will apply, as the maximum offering price or the market price on a day selected by the issuer within a specified period prior to the filing of the registration statement.

The act provides that any security, other than a certificate of interest or participation in an oil, gas or mining title, lease or payments out of production under such title or lease, may be registered for a non-issuer distribution (a secondary distribution) if the security is of the same class as that which has been registered under the Securities Act or a prior securities act. If the security was issued originally pursuant to an exemption under the present act or prior securities act, the same provision will apply.

16 *Id.* § 8.
17 *Id.* § 9.
18 *Id.* § 7.

The statute requires basic minimum information to be filed with the securities commissioner. Requirements include a statement demonstrating eligibility for registration by notification, the name and address of the issuer, the basic organization thereof, and the general character and location of its business. In addition, a financial statement is required together with other basic items such as the description of the securities being registered and a consent to having legal process served on the securities commissioner in the event of subsequent litigation. This registration statement, assuming that no stop order is in effect and that no proceeding is pending thereunder, becomes effective the afternoon of the second full business day after filing the registration statement, or the last amendment thereto, or at such earlier time as the securities commissioner, in his discretion, determines.

It should be noted, therefore, that registration by notification is generally restricted to "seasoned" or "blue chip" security offerings, and those in which the members of the investing public need no basic disclosure requirement (prospectus) or other protective feature of the act. As a practical matter, those issuers who can qualify for registration by notification may also utilize the provisions of registration by coordination (as described hereafter). Since most offerings will be registered or qualified from an exemption registration under Regulation A with the United States Securities and Exchange Commission, registration by coordination will more likely be used, thus, registration by notification is rarely used; however, there are certain issuers and certain types of security offerings which may find the provisions set forth in this type of registration to be helpful and less cumbersome than registration by coordination or qualification.[19]

B. Registration by Coordination[20]

This type of registration may only be used if a security has been registered with the United States Securities and Exchange Commission, or has been exempted from registration pursuant to filings made under section 3(b) or 3(a) of the Securities Act of 1933, as amended.[21]

The prior Colorado Securities Act[22] permitted registration by coordination for any security for which a registration statement had been filed with the United States Securities and Exchange Commission. In this respect, this portion of the new statute makes no variation on prior existing law. This portion of the new act generally covers the same provisions set forth in the Uniform Securities Act. However, with respect to the right to utilize registration by coordination, applicable to filings made pursuant to sections 3(b) or 3(a) of the Securities Act of 1933, as amended, and

19 These would include local companies sufficiently seasoned and having no need for going through the S.E.C. procedures.

20 H.B. 379, 43rd Gen. Ass., 1st Reg. Sess. § 8 (1961).

21 *Id.* § 8. With respect to discussions on filings under section 3(b) of the Securities Act of 1933, as amended, and, in particular, Regulation A thereunder, see Hertz, *The Federal Securities Act of 1933, Revised Regulation A*, 33 DICTA 307 (1956); Erickson, *The Federal Securities Act of 1933—Some Recurring Problems Found In Regulation A*, 36 DICTA 402 (1959). With respect to exemptions under the intra-state section of the Securities Act of 1933, as amended, see Hertz, *Federal Securities Act of 1933—The Intra-State Exemption of Section 3(a)(11)—Fact or Fiction?*, 34 DICTA 289 (1957). For a general discussion of Regulation A, see Loss, Security Regulation, 380 (1951); Loss, Security Regulation, (Supp. 1955 at 165).

22 Colo. Rev. Stat. § 125-1-5 (1957).

in particular, Regulation A filings thereunder, the new law is a departure from recommendations of the Uniform Securities Act. This provision permits all securities which are offered to the public pursuant to any filing with the United States Securities and Exchange Commission to be registered with the securities commission by coordination, whether it be under a registration statement, Regulation A or other such filings made under the Securities Act of 1933, as amended. The provision permits those issuers who utilize the exemption of Regulation A, rather than registration, to take advantage of registration by coordination; this procedure is considerably more simple than registration by qualification (described hereafter).

In addition, those securities which are registered by coordination do not come under the "merit" provisions of the new securities act; and the securities commissioner has no power to pass upon the merits of the offering, or the entire venture, if the securities have been registered or qualified from exemption under Regulation A.

A registration by coordination becomes effective the same moment the federal registration statement becomes effective, or at the time the offering may otherwise be commenced in accordance with rules, regulations or orders of the United States Securities and Exchange Commission. This assumes that no stop order or suspension order is in effect or pending and that the registration statement has been on file with the securities commissioner for at least ten days. It further assumes that the price of the securities to be offered has been on file with the securities commissioner for at least two business days or such shorter period as the securities commissioner by rate or otherwise may indicate. Other basic information is required of the registrant. This includes primarily, copies of the prospectus, offering circular, or other offering sheets together with all amendments thereto filed with the United States Securities and Exchange Commission under the Securities Act of 1933, as amended. Once the securities commissioner has received the copies of the filings made with the Federal Commission, whether it be under a registration statement or pursuant to the Regulation A exemption, the securities commissioner will have the basic information required to afford disclosure to members of the investing public. This procedure simplifies the registration of securities in the State of Colorado when filings have been made with the United States Securities and Exchange Commission. The rationale of this legislation seems to be basic, and places the burden for processing the detailed information on the federal commission. The staff and funds available to the federal agency for enforcement and processing work are far more extensive than that of the state commission. Therefore, all filings which are made pursuant to registration statements, or pursuant to regulation A, or such similar exemptions are not examined by the securities commissioner of the state except to see that the formalities of the statute and regulations have been complied with; the burden is thereupon shifted to the United States Securities and Exchange Commission where it rightfully belongs.

In light of this discussion it is important once again to point out that the power of the United States Securities and Exchange Commission does not carry with it a right to pass on the merits of the

entire venture, but merely to provide basic disclosure to enable the investing public to determine the investment merits of the securities offered. However, as a practical matter, those who practice before the United States Securities and Exchange Commission, and those who have had experience with this regulatory agency are aware that the basic disclosure requirements are very much inter-woven with the merits of offering. The type of disclosure required goes to the very essence of the venture to the extent that one cannot help but think that the federal agency is passing on the investment merits of the proposed offering. Naturally, any such discussion with the staff of the United States Securities and Exchange Commission would bring a resounding denial, but in many instances "what they do speaks louder than what they say."

C. Registration by Qualification[23]

The new statute provides that any security may be registered by qualification even though it may also be registered by either notification or coordination. As a practical matter, however, no issuer would attempt to register by qualification where the facilities of registering by notification or coordination were available.

The statute requires that a great deal of material be submitted when filing by qualification. Included are many exhibits to be filed along with the required documents. In the future it would appear that those offerings made only to residents of Colorado, and offered pursuant to exemption from the registration provisions of section 3 (a) (11) of the Securities Act of 1933, as amended, will be registered by qualification under the new law.[24]

One of the most significant departures from prior existing law can be found in the area surrounding registration by qualification.

These departures include the "merit" powers placed in the commissioner of securities to not only pass upon the adequacy of the disclosure of the documents filed, but to also require, by rule or order, that any securities issued within the past three years to be issued to a promoter for a consideration substantially different from the public offering price, or to any person for a consideration

23 H.B. 379, 43rd Gen. Ass., 1st Reg. Sess. § 9 (1961).

24 For a discussion of the intra-state exemption of Section 3(a)(11) see Hertz, *Federal Securities Act of 1933—The Intra-State Exemption of Section 3(a)(11)—Fact or Fiction?* 34 DICTA 289 (1957).

other than cash, be deposited in escrow; and that that the proceeds from the sale of the registered securities be impounded or escrowed until the issuer receives a specified amount. The securities commissioner has also been given the authority to determine, by rule or order, all conditions of any escrow or impounding provision.[25]

This section provides that the commissioner may deny, suspend, or revoke any registration filed by qualification if the issuer's enterprise or methods of business includes or would include activities which are illegal where performed; would have worked or tended to work a fraud upon purchasers; the offering is made with unreasonable amounts of underwriters' and sellers' discounts, commissions or other compensation; promoters profits or participation are excessive; unreasonable amounts or kinds of option are exacted; or where the issuer failed to escrow not less than eighty per cent of the funds collected from any registration of securities with an escrow holder if the commissioner ordered the impoundment or escrow of such funds.[26]

As can be readily seen, this registration by qualification portion of the securities act gives vast powers to the commissioner of securities to examine not only the disclosure set forth in the prospectus and other documents filed, but affords to the commissioner a right to examine the entire merits of the offering. He becomes the sole judge as to whether the offering is fair and equitable to the investing public. In effect his judgment on the merits of the offering are, to a certain extent, substituted for that of the investing public. Thus, if he believes that officers, directors and promoters of the company have received securities or options in excess of value paid the issuer, that the underwriter's or seller's commissions are excessive, or that such other conditions as would be encompassed within the language "worked or tended to work a fraud upon purchasers" exist, he may deny registration of the securities and the issuer will be denied the right to go to the public for equity capital.

It appears that those issuers who do not intend to utilize any of the filing methods prescribed by the United States Securities and Exchange Commission for public offering and who may decide to make an offering only to residents of the State of Colorado, based upon the section 3(a)(11) exemption of the Securities Act of 1933, as amended, are now faced with an additional burden of complying with the merit provisions promulgated by the securities commissioner. In the organization of any venture it must take into consideration that which the commissioner may think is meritorius and will not tend to work a fraud upon purchasers. This will certainly be a factor in encouraging issuers or underwriters to utilize either registration process or the Regulation A exemption.

The writer has always opposed any merit type provision where a commissioner or his staff would have the right to sit in judgment as to what investment securities the public should be offered. The fact that the offerings are those which are normally exempt from federal registration, as being offered only within the state, does not in any way make the merit determination by the securities com-

25 H.B. 379, 43rd Gen. Ass., 1st Reg. Sess. § 10(7) (1956).
26 *Id.* §§ 11(1)(d), (e), (f) and 11(2).

missioner any more desirable. However, there is a great tendency today, based upon the attitude of the United States Securities and Exchange Commission towards intra-state exemptions, as well as general expediency in equity financing, to avoid the use of the intra-state exemptions.[27] These provisions in the new securities act would certainly implement the attitude of the United States Securities and Exchange Commission as well as encourage, to say the least, filing with the federal agency.

As one examines the new statute, it becomes readily apparent that to avoid the merit provisions imposed by the securities commissioner, and especially the impounding of funds, one need only file with the United States Securities and Exchange Commission. Although the Federal Commission has the power to impose an indirect type of merit provision through its disclosure requirement, it is doubtful whether federal law would support such imposition by the United States Securities Exchange Commission or its staff.[28]

Denial or revocation under registration by qualification provides the issuer with appropriate hearing, and would certainly appear to afford him his "day in court." However, in the area of public financing, constitutional rights afforded by the right of hearing and appeal are relatively meaningless. As Professor Davis has wisely stated, "If what the Commission finally requires of the Registrant is thought to be arbitrary or unreasonable, the Registrant has no practical recourse except to comply."[29]

III. NON-ISSUER DISTRIBUTION

The prior securities law was, at best, ambiguous with respect to transactions involving the offer and sale of securities where the issuer of those securities was not directly affected or involved. From a literal reading of the prior statute it would appear that it was unlawful or prohibited for *any person* to offer or sell any securities unless registered with the securities commissioner, or unless an exemption from registration was available. What then would be the result with respect to an offer by brokers or dealers or other such persons who did not control the issuer where such offerings were generally made through public distribution methods?[30]

Because of this ambiguity and uncertainty, and particularly because of problems raised by investment bankers, an effort was made to write into the new securities law the right of a broker-dealer to file a registration statement.

Pursuant to this, the new statute appears quite clear in stating that a registration statement may be filed by not only the issuer or licensed broker-dealer in securities, but by any other person on whose behalf the offering is to be made.[31] In addition, the statute relieves the broker-dealer or such other persons from filing all the documents and information generally required when such information is not available. Therefore, a broker-dealer concerned with the problem of whether registration would be required, may now file

27 The Federal Commission has sought to discourage the use of the Intra-State Exemption.
28 In the strict sense, the federal act permits only disclosure powers.
29 I Davis, Administrative Law § 4.01 (1958).
30 For an able discussion of the prior Colorado law with respect to non-issuer transactions see Lohf, *The Colorado Securities Law*, 35 DICTA 271 (1958).
31 H.B. 379, 43rd Gen. Ass., 1st Reg. Sess. § 10 (1961).

his statement registering the securities he proposes to offer through public distribution methods and therefore avoid the possibility of a technical violation of the state securities laws.

All registration statements, whether filed by the issuer or other persons, remain effective until revoked by the securities commissioner or until the termination upon request by the registrant with the consent of the securities commissioner. In addition, all outstanding securities of the same class as registered securities are considered to be registered for the purpose of any non-issuer transaction, so long as the registration statement is effective between the 30th day after the entry of a stop order suspending or revoking the effectiveness of the registration statement (if the registration statement itself did not relate in whole or in part to a non-issuer distribution) and one year from the effective date of the registration statement.[32]

This section further provides that a registration statement may not be withdrawn for one year from its effective date if the securities of the same class are outstanding. A statement may be withdrawn otherwise only on the order of the securities commissioner. During the effectiveness of a registration statement, the securities commissioner may, by rule or otherwise, require written reports to be filed, no more often than quarterly, to keep the information contained in the registration statement reasonably current and to disclose the progress of the offering.[33] However, in the event that the offering is a non-issuer distribution, written reports may not be required by the securities commissioner unless the information is known to the person making the non-issuer distribution or can be furnished by them without unreasonable effort or expense.

Thus, the new law has clarified substantially the prior existing gray area concerning non-issuer distributions and the right of broker-dealers and other persons to file registration statements with the securities commissioner. This entire provision had the blessing of the investment banking fraternity and was most welcome.

IV. EXEMPTIONS

Similar to the prior law are two basic types of exemptions which exist in the new Securities Act. The first type of exemption covers the nature and type of the security itself and the second

32 *Id.* § 10(9).
33 *Id.* § 10(10).

covers the transaction which is involved rather than the type of security offered or sold.

With respect to the security exemptions,[34] the new law exempts from the registration requirements those securities issued or guaranteed by governmental bodies such as the federal government, state, or any political subdivision, agency, or instrumentality thereof. This section also exempts any security issued or guaranteed by the Province of Canada and securities of any foreign government with which the United States currently maintains diplomatic relations. The act exempts securities of any bank organized under the laws of the United States or any bank or savings institution organized under the laws of any state. Also exempt from the registration provisions are securities of any company which has been continuously in business in the State of Colorado for more than twenty years and holds first mortgages on real estate located in Colorado, securities of the United States, or cash or a combination thereof equal to one hundred per cent of the amount of the securities issued. Also, securities issued by and representing interests in, or debt of, any federal savings and loan association or any building and loan or similar association organized under the laws of a state are exempt. All securities of insurance companies organized under the laws of any state and insurance companies having a Certificate of Authority from the Insurance Commissioner of the State of Colorado to do business in this state are also exempt. Securities of any federal credit union or any credit union, industrial loan association or similar association; securities issued or guaranteed by any railroad or any other common carrier, public utility or holding company subject to the jurisdiction of the Interstate Commerce Commission; securities of any registered holding company under the Public Utility Holding Company Act of 1935 or a subsidiary of such a company within the meaning of that act are listed as exempt. In addition, securities listed or approved for listing upon notice of issuance on the New York Stock Exchange, the American Stock Exchange, the Pacific Coast Stock Exchange or the Midwest Stock Exchange or any other security of the same issuer which is of senior or substantially equal rank to those securities listed on national stock exchanges fall within the exemption provision. And finally, all securities which are issued by eleemosynary institutions operated not for private profit but for religious, educational, benevolent, charitable, fraternal, social, athletic or reformatory purposes or as a chamber of commerce or trade or professional association are likewise exempt from registration.

In addition to those securities which are exempt, certain transactions involving the offer and sale of securities are also excused from the registration provisions of the act.[35] Most notable of these are isolated non-issuer transactions, whether effected through a broker-dealer or not, and any transaction pursuant to an offer directed by the offeror to not more than twenty-five persons in the State of Colorado during any period of twelve consecutive months, whether or not the offeror or any of the offerees is then present in the State of Colorado. This latter exemption is conditioned on

34 *Id.* § 13(1)(a)—(i).
35 *Id.* § 13(2)(a)—(1).

the fact that the seller must reasonably believe that all purchasers in the State of Colorado. This latter exemption is conditioned on mission or other remuneration is paid or given directly or indirectly for soliciting any prospective purchasers in the State. The commissioner, with respect to the latter exemption, has the authority to make rules or issue orders concerning any security or transaction of securities and to withdraw or further condition the exemption by increasing or decreasing the number of offerees permitted. Exemption conditions may be waived altogether. A discussion of what may or may not be a private offering or an "isolated transaction" could compass an entire article by itself and the reader is cautioned that attention must be given not only to the provisions of the new law, but also to the Federal Securities Act of 1933, as amended. The provisions permitting private transactions must be carefully analyzed.[36]

Suffice it to say that anyone attempting to rely upon the private offering exemption under the new Colorado law or the Federal Securities Act of 1933, as amended, or both, should carefully examine the substantive law concerning these transactions and make every effort to comply with both the substantive elements and the procedural form of the exemptions.[37]

Non-issuer distributions or transactions effected by registered broker-dealers pursuant to unsolicited offer or offers to buy are included in the long registration exemption list of the new act; however, the securities commissioner may promulgate rules or regulations requiring that the customer acknowledge upon a specified form that the sale was unsolicited and that a signed copy of each form be preserved by the broker-dealer for a specified period.[38]

Offers to sell securities to banks, savings institutions, trust companies, insurance companies, and investment companies as defined in the Investment Company Act of 1940 are likewise exempt from registration provisions. It can be readily seen that these persons do not need the protection of the registration provisions as does the general unsophisticated investor, and in most cases, such organizations have their own specialized departments to analyze the investment merits of securities.

The new statute contains other exemptions and the reader is directed to a thorough examination of this section. It is suggested that before any exemption is utilized prior notification be given to the securities commissioner, if at all possible, so that he may, in effect, review the transaction and advise as to whether the trans-

36 For an article discussing the "private offering" exemption see Mehler, *The Securities Act of 1933: "Private or Public" Offering*, 32 DICTA 359 (1955). See also S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953); Federal Securities Act. § 4, 48 Stat. 77 (1933), 15 U.S.C. § 77d (1958).

37 For restriction of the private offering exemption under the Federal Securities Act of 1933, as amended, see Repass v. Rees, 174 Fed. Supp. 898 (D.C. Colo. 1959). This case held that assignments of certain fractional undivided interests in oil and gas leases sold by the defendants were not exempt from the registration provisions of the Federal Securities Act as "non-public" offering securities where the defendant failed to show the lack of public need for protection with respect to the securities. The court granted the right of the purchasers to rescind the transaction and ruled that although the plaintiffs were experienced investors and did not require the protection of the act, it was incumbent upon the defendants to establish that purchasers and offerees other than the plaintiff were similarly experienced. Such burden had not been sustained. This case goes a long way in narrowing the private offering exemption under the Federal Securities Act of 1933, as amended, and might very well have serious impact with respect to the attempt of sellers of securities to rely on the "isolated transaction" language of the new Colorado Securities Act.

38 At the time of this writing no such rules or regulations have been made and no forms have been promulgated for this purpose by the securities commissioner.

action, or the type or nature of the security falls within the exemptions. It should be carefully noted that the burden of proving an exemption from the registration provisions is on the person claiming it and not upon the department of securities nor any other person.[39]

V. GENERAL PROVISIONS

The new act, similar to the prior act, gives the securities commissioner authority to promulgate rules and direct orders requiring the filing of any sales literature or other material intended for distribution to prospective investors, unless the security or transaction itself is exempt from the registration provisions.[40] By statute, it is unlawful to make any false or misleading statements or omissions in any document filed with the commission.[41] An application for registration or a registration statement effectively registered with the commission does not constitute a finding by the securities commissioner that any documents filed under the act are true, complete and not misleading.[42] Moreover, the fact that a document is filed or that an exemption is available does not mean that the commissioner has in any way passed upon the merits of or given approval to the issue. Indeed, the act makes it unlawful for any person to represent that the commissioner has in any way passed upon the merits of, recommends or has given approval to any security or transaction.[43]

The reader is cautioned that under no circumstances should any issuer, broker-dealer or any other person offering securities for sale indicate or intimate that either the securities commissioner or the United States Securities and Exchange Commission has passed upon the merits of any security offering or upon the investment quality of that security. Naturally, it is impossible for any regulatory agency to adequately advise itself concerning all the

39 H.B. 379, 43rd Gen. Ass., 1st Reg. Sess. § 13(3) (1961).
40 *Id.* § 14.
41 *Id.* § 15.
42 *Id.* § 16.
43 *Id.* § 16(2).

merits of the venture, and regulatory agencies in themselves do not purport to make investment decisions. This is true in spite of the fact that under the new law the securities commissioner with respect to registration by qualification, is given "merit" powers.

The new law also provides that the securities commissioner at his discretion may make such public or private investigations as he deems necessary to determine whether any person has violated or is about to violate any provisions of the act or any rule or order promulgated thereunder. The commissioner is also given authority to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of books, records, papers and such other documents as the commissioner in his discretion deems relevant or material to the general inquiry. In the event any person fails or refuses to obey a subpoena, the commissioner may make application to the district court of the City and County of Denver to enforce the subpoena and require the person to appear or produce certain documentary evidence. Failure to obey the order of the Court is contempt and such a person may be punished accordingly.[44]

In addition, the statute provides that no person is excused from attending or testifying or producing documents solely because it may tend to incriminate him or subject him to a penalty or forfeiture. However, similar to federal practice, no individual may be prosecuted or made subject to penalty concerning anything upon which he has been compelled to testify after claiming his privilege against self-incrimination. This exempts, however, the prosecution and punishment for perjury or contempt in such testimony.[45]

The commissioner has authority to make application to the district court of the City and County of Denver to enjoin acts or practices that would constitute a violation of any of the provisions of the new act or any rule or order promulgated under it.[46]

The act provides that any person who willfully violates any of the provisions of the act or who willfully files any material knowing it to be false or misleading shall, upon conviction, be fined not more than $5,000 or imprisoned not more than three years or both. The securities commissioner may refer such evidence as is available concerning violations of the act to the attorney general or the proper district attorney who may, with or without such reference, institute the appropriate criminal proceedings under the act.[47]

The new act also contains civil liability provisions which provide that an action may be brought against any person who offers or sells a security in violation of the registration provisions of the act, or any person who offers or sells a security by means of any untrue statement of material facts. Also subject to liability is one who fails to state material facts necessary to make his statements not misleading. These civil liability provisions permit the purchaser to rescind a transaction where registration was required, or where false or misleading statements or omissions were made with respect to security transactions, and to recoup the considera-

44 *Id.* § 18.
45 *Id.* § 18(4).
46 *Id.* § 19.
47 *Id.* § 20.

tion paid for the security. In addition, interest at the rate of six per cent per annum from the date of payment and reasonable costs and attorneys fees, less any income received from the security are recoverable. This provision also permits a suit for damages if the purchaser is no longer the owner of the securities. In addition to permitting the purchaser to bring suit against the immediate seller, any person who directly or indirectly controls the seller is also subject to suit and liable under the act. Thus, all principals and agents are likewise controlled by these provisions and may find themselves liable for violations of the act and subject to civil suits for rescission or damages.[48]

It should also be noted that all suits under this provision of the securities act must be brought within two years after the contract of sale. There are other general provisions with respect to bringing civil liability suits under the act, and the reader is cautioned to carefully examine the provisions of this section before the institution of any suit. The Securities Act of 1933, as amended, contains similar provisions and thus, perhaps, a choice may be afforded to a prospective plaintiff who finds himself aggrieved.[49]

All final orders of the securities commissioner may be reviewed by application to the district court of the City and County of Denver and thereafter appeal may be made to the supreme court.[50] This section sets forth the method and procedure for handling such applications and the reader is directed to the specific language in the event such application is ever necessary.

CONCLUSION

The new act takes an important step forward with respect to federal-state coordination, and the simplicity of registering securities registered or qualified with the United States Securities and Exchange Commission is most welcome.

The clarification of non-issuer distributions and, in particular, the right of registered broker-dealers to file registration statements in order to avoid technical violations of the act is indeed helpful and puts an end to the plight of the investment banking fraternity in this area.

Problems of interpretation and administration will naturally arise, but only time and history will bear out our ultimate conclusion that the act is sound and was very much needed in a state which has had a multitude of public offerings. The approach to the public for equity capital seems to be a growing trend, and a law with adequate protection to the investing public as well as flexibility for issuers and broker-dealers is indeed essential to continued public confidence in our equity markets. The writer believes that Colorado now has such a law.

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48 *Id.* § 21.
49 Federal Securities Act. §§ 12, 13, 15, 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77 (1958).
50 H.B. 379, 43rd Gen. Ass., 1st Reg. Sess. § 22 (1961).