**Issuers as Dealers – California case People vs Cole**

**From:** Committee on State Regulation of Securities [mailto:BL-STATEREGS@MAIL.ABANET.ORG] **On Behalf Of** Parness, Alan  
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**To:** BL-STATEREGS@MAIL.ABANET.ORG  
**Subject:** People v. Cole - Officers and Directors of Issuers as "Broker-Dealers"

Attached find a copy of the decision in People v. Cole, 156 Cal. App. 4th 452, 67 Cal. Rptr. 3d 526 (Cal. Ct. App. 2007) (the opinion is also reprinted at 3A Blue Sky L. Rep. (CCH) par. 74,672), involving individuals criminally prosecuted for various violations of the antifraud provisions of the CA Blue Sky law, as well as for acting as unlicensed broker-dealers.  The CA Supreme Court denied a petition for review of this decision on 1/23/08 (2008 Cal. LEXIS 936).   While the facts of the Cole case are obviously tainted by the defendants' fraudulent activities, I believe that the court's holdings under parts (1) and (2) of the "Analysis" section of the opinion at pp. 15-17 create potentially problematic precedent for the criminal prosecution of, or civil or administrative actions against, officers, directors or other individuals representing issuers for acting as unregistered or unlicensed "broker-dealers," not only under CA's idiosyncratic statute, but under the many state Blue Sky laws still based on, or comparable to, the 1956 Uniform Securities Act (the "1956 USA"), even though those individuals may not be subject to the agent registration or licensing requirements of those laws.  [Note, however, that the Court of Appeal in Cole reversed the defendants' convictions for acting as unlicensed broker-dealers, solely with regard to their sale of securities of issuers of which they were officers or directors, on a procedural ground relating to the trial court's failure to instruct the jury that the defendants' good faith belief that they didn't need a broker-dealer license to sell such securities was a valid affirmative defense to this charge - see pp. 17-18 of the opinion.]

As many of you know, under 1956 USA Sec. 401(b), an individual representing an issuer in selling the issuer's securities will be excepted from the definition of the term "agent" by reason of selling certain exempt securities, or selling securities in exempt transactions or in transactions with existing employees, partners or directors of the issuer without compensation.  However, as held in the Cole case, by reason of such exception, such an individual thereby literally becomes disqualified from relying on the exception in 1956 USA Sec. 401(c)(1) for an "agent" from the definition of the term "broker-dealer."   Therefore, by reason of Cole, these individuals are forced to search for a different exception or exemption from registration as broker-dealers in their individual capacities (for example, they could claim reliance on the 1956 USA Sec. 401(c)(4) exception because they have no place of business in the state and only deal with institutional investors in the state, or don't direct more than 15 offers to other potential investors during any 12-month period).

Thankfully, this quandary is resolved by the 2002 Uniform Securities Act (the "2002 USA"), which shifts to an exemption approach for agents (see 2002 USA Sec. 402(b)), thereby preserving the "agent" exception from the broker-dealer definition in 2002 USA Sec. 102(4)(A) for individuals covered by one or more of such exemptions (i.e., they are still "agents" by definition, but don't have to be registered as such).

I don't think most Blue Sky lawyers typically think of individuals representing issuers as potentially being "broker-dealers" in their individual capacities (as contrasted with the federal approach under 1934 Act Sec. 3(a)(4) and SEC Rule 3a4-1 thereunder), but rather focus on whether they're subject to state registration or licensing as "agents."  Accordingly, I believe that Cole represents a new regulatory headache we will have to consider in the future.

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