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The Elusive Limited Offering Exemption of the Utah Uniform Securities Act

Ralph R. Mabey* and Alan L. Smith**

State securities or "blue sky" laws generally encourage the initial capitalization and subsequent expansion of local businesses by exempting the limited offering of their securities from the often expensive and burdensome requirements of registration.¹ Utah's Securities Commission and commentators have supported such an exemption.² Indeed, this support has resulted in the recognition by rule and by conduct of an exemption for limited offerings of securities in Utah.³ However, the source and definition of such an exemption in the Utah Uniform Securities Act (Utah Act)⁴ remain unclear thirteen years after the Act's passage. The following exploration of the Utah Act and the Securities Commission Director's rule on the subject suggests an incongruity and lack of clarity calling for legislative and regulatory curatives.

I. UTAH'S REJECTION OF THE UNIFORM ACT'S LIMITED OFFERING EXEMPTION

Although enacting almost the entire Uniform Securities Act

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1. See, e.g., rule A67-03-7(1)(c), 3 BLUE SKY L. REP. (CCH) ¶ 47,607 (1976) (quoted at note 45 *infra*). But see 1 L. LOSS, SECURITIES REGULATION 370-73 (2d ed. 1961).

This article generally refers to the exemption from registration of securities sold to a small number of investors as a "limited offering" exemption since this is the appropriate terminology of the Uniform Act upon which the Utah Act is based. The roughly corresponding term in federal securities law parlance is "private placement" exemption.

2. See rule A67-03-7, *infra* note 45; Bennett, *Should Utah Adopt the New Uniform Securities Act?*, 5 UTAH L. REV. 471, 476-77 (1957). See also Hill, *Pitfalls in the Texas Securities Act*, 10 SW. L.J. 265, 279 (1956); Note, *The South Dakota Blue Sky Law and the Need for a Private Offering Exemption*, 12 S.D.L. REV. 341, 343-46 (1967); Note, *The Uniform Securities Act*, 12 STAN. L. REV. 105, 147-48 (1959).

Professor Bennett argues that something like an isolated transaction exemption is necessary but supports this argument by citing the Draftsmen's Commentary from the Uniform Securities Act which deals with limited offering exemptions. Bennett, *Should Utah Adopt the New Uniform Securities Act?*, 5 UTAH L. REV. 471, 476-77 (1957).

3. Rule A67-03-7, *infra* note 45. It is the authors' experience that the conduct of principals in corporate organizations in Utah most often assume a Utah exemption for initial, limited securities offerings.

4. UTAH CODE ANN. §§ 61-1-1 to -30 (1968) (Act was enacted in 1963).

(Uniform Act),⁵ the Utah legislature declined to pass section 402(b)(9), the limited offering exemption. In states where enacted, this provision exempts from registration requirements offers for the sale of securities directed to not more than ten persons in the state (not including institutional buyers and broker-dealers) within a twelve-month period, provided that no commission is paid for soliciting prospective buyers and that the seller reasonably believes the buyers are purchasing for investment. The state's securities administrator is given authority to withdraw the exemption or to impose additional conditions, and also to increase or decrease the number of offerees permitted.⁶

Passage of this section may have failed in Utah in part because of the lobby of local broker-dealers who feared a loss of sales commissions resulting from the section's requirement that commissions not be paid for the exempted sale of securities.⁷ Other objections to the Uniform limited offering provision may have been more telling. Professor Wallace R. Bennett, while supporting the section's basic thrust, found its limitation based on offerees instead of purchasers difficult to administer in the absence of an objective means of determining the number of solicitations.⁸

5. Uniform Act provisions are referred to herein as Uniform provisions or Uniform sections.

6. UNIFORM SECURITIES ACT § 402(b)(9) (1956 version) provides an exemption for any transaction pursuant to an offer directed by the offeror to not more than ten persons (other than those designated in paragraph (8)) in this state during any period of twelve consecutive months, whether or not the offeror or any of the offerees is then present in this state, if (A) the seller reasonably believes that all the buyers in this state (other than those designated in paragraph (8)) are purchasing for investment, and (B) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective buyer in this state (other than those designated in paragraph (8)); but the [Administrator] may by rule or order as to any security or transaction or any type of security or transaction, withdraw or further condition this exemption, or increase or decrease the number of offerees permitted, or waive the conditions in Clauses (A) and (B) with or without the substitution of a limitation on remuneration

7. Legislative history is silent concerning the grounds for failure of passage of this section. The suggestion of the text is based upon the author's informal conversations with Professor Bennett and others who were present during the legislative proceedings.

In the absence of the Uniform limited offering exemption, issuers have relied upon Utah's preorganization subscription exemption, UTAH CODE ANN. § 61-1-14(2)(i) (1953), which similarly prohibits sales commissions, *see* text accompanying note 17 *infra*, and upon rule A67-03-7, *infra* note 45, which does not prohibit the payment of such commissions.

8. Bennett, *supra* note 2, at 477. The draftsmen of the Uniform act defended the section's limitation on offerees as follows:

In adopting a test in terms of *ten offerees*, § 402(b)(9) is stricter than the few statutes which limit the number of *buyers*. But there are a number of things to be considered in this connection: First, about half of the states which now have a comparable exemption either limit the number of offerees or condition

Professor Bennett also criticized the requirement that the purchase be made "for investment."⁹ Again, the problem foreseen was that the section did not provide an objective standard for determining when a purchase is made "for investment" and not for resale. These prescient objections have since been reflected in federal and state securities regulations.¹⁰ Professor Bennett also found the proposed section to be part of a "confusing dichotomy" with the next following Uniform section, 402(b)(10).¹¹ That section simply relieves issuers from the necessity of registering preorganization certificates and subscriptions, which are themselves securities,¹² even if offered to more than ten persons, thus permitting an otherwise impermissible unregistered public solicitation in order to launch a new corporation. This exemption, however, is conditioned upon the severe requirements that the offering result in no more than ten preorganization subscribers, that no payment be made by any subscriber for his subscription, that no sales commission be paid, and that the subscription not be filled by the issuance of shares until those shares are either registered or exempted by another provision of

the exemption upon the absence of any public solicitation. Second, the test here is not so inflexible as that in Florida and Massachusetts, where a company which already has a specified number of security holders or a certain amount of capital, or both, cannot use the exemption even to make an offer or sale to a single person. Third, the exemption here is not limited to domestic entities, or to corporations. Fourth, about half of the statutes today have no comparable exemption at all. Fifth, the maximum of ten offerees does not include the institutional buyers and broker-dealers designated in § 402(b)(8), and there is no limit on the total number of offerees as long as it does not exceed ten "in this state"; this, among other things, provides all the flexibility needed to permit "private placements" insofar as the buyers may be wealthy individuals or other persons who do not come within § 402(b)(8). Sixth, the "but" clause authorizes the Administrator to increase (or decrease) the number of offerees permitted, either by application and order in a particular case or by rule for all cases or for certain types of securities or transactions. That is to say, the figure ten is only a *prima facie* figure, as stated in the official comment. Moreover, a state which prefers to start with a larger or smaller number of offerees can substitute some other figure for "ten" in the section and take the rest of it as it stands.

L. LOSS & E. COWETT, *BLUE SKY LAW* 373 (1958) (emphasis in original).

9. Bennett, *supra* note 2, at 477.

10. See, e.g., SEC rule 146, 17 C.F.R. § 230.146 (1976). For examples of conforming state securities laws, see HAWAII REV. STAT. § 485-6(15) (1975) and ARK. STAT. § 67-1248(b)(14) (1975).

11. Bennett, *supra* note 2, at 477. Section 402(b)(10) provides an exemption for any offer or sale of a preorganization certificate or subscription if (A) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective subscriber, (B) the number of subscribers does not exceed ten, and (C) no payment is made by any subscriber

UNIFORM SECURITIES ACT § 402(b)(10) (1956 version).

12. UTAH CODE ANN. § 61-1-13(12) (1953); UNIFORM SECURITIES ACT § 401(1) (1956 version).

the Uniform Act, such as the preceding limited offering exemption.¹³ The perceived "confusing dichotomy" between these sections may have been founded in the apparent ambivalence of the draftsmen who were, in effect, willing to allow a preincorporation public solicitation of stock subscriptions under the preorganization subscription exemption, but were unwilling to allow a postincorporation public solicitation under the limited offering exemption.¹⁴

Professor Bennett's objections to the confusing nuances in the Uniform Act's limited offering exemption may well have contributed to its elimination from the Utah Act and the marginally compensatory expansion of the preorganization subscription exemption.¹⁵ At best, the sum of the two legislative actions left Utah, perhaps unintentionally, with a highly restrictive limited offering exemption in the name of a preorganization subscription exemption.

II. UTAH'S WORKHORSE PREORGANIZATION SUBSCRIPTION EXEMPTION

Apparently in the place of the Uniform Act's limited offering exemption, the Utah Act contains an expanded exemption for preorganization subscriptions.¹⁶ That section exempts

13. UNIFORM SECURITIES ACT § 402(b)(9) (1956 version).

14. The Uniform Act draftsmen explained this "ambivalence" by noting that:

Section 402(b)(10) should not be confused with § 402(b)(9). As stated in the official comment, they are related but serve different purposes. Section 402(b)(10) by itself simply *postpones* registration. If preorganization subscriptions were offered under circumstances making the § 402(b)(9) exemption available, and if sufficient subscriptions were obtained as a result, § 402(b)(10) would be unnecessary. But, if the *subscriptions* were offered to the public generally under the § 402(b)(10) exemption, neither section would exempt the subsequent issuance of the *stock*. If registration were excused altogether under § 402(b)(10), with no limit on the number of offerees, the statute would put a premium on making the public offering *before incorporation*—when, if anything, the public needs protection more than *after* incorporation. That is why the definition of "security" in this Act, as in most of the existing statutes, specifically includes any "preorganization certificate or subscription."

. . . So limited, § 402(b)(10) is essentially a technical exemption which fulfills a necessary function but lacks the potential for public harm, since registration is required before the stock is issued or paid for.

L. LOSS & E. COWETT, *supra* note 8, at 375 (emphasis in original).

15. Opinion of the Utah Attorney General to the Securities Commission Director, 3 BLUE SKY L. REP. (CCH) ¶ 71,205, at 67,740 (1975) [hereinafter cited as Utah Attorney General's Opinion]; Bennett, *Securities Regulation in Utah: A Recap of History and the New Uniform Act*, 8 UTAH L. REV. 216, 230 (1963).

16. See Utah Attorney General's Opinion, *supra* note 15, at 67,740. The opinion

[a]ny offer or sale of a preorganization certificate or subscription if (i) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective subscriber, (ii) the number of subscribers acquiring any legal or beneficial interest therein does not exceed ten.¹⁷

This provision differs from the Uniform provision only by the deletion of the prohibition of payment by any subscriber and by the increased specification of the term "subscribers" to include any "legal or beneficial interest" in the subscription.¹⁸ In light of the narrow intent of the Uniform provision as a technical exemption for preorganization subscriptions but not for any stock that might be issued pursuant to such subscriptions,¹⁹ it is surprising that Utah's modified version has enjoyed legitimization as a "true" limited offering exemption for stock issued under a preorganization subscription.²⁰ This result may be as much the stepchild of perceived necessity in the face of a legislative failure to adopt a limited offering exemption as it is the result of principled statutory interpretation.

On its face, the Utah provision exempts only the sale of securities that are preorganization certificates or subscriptions. The Uniform Act's commentary makes it clear that the underlying shares issued pursuant to such certificates and subscriptions are not exempted from registration unless elsewhere provided.²¹ But

further speculates that deletion of the term "non-issuer" from the Uniform Act's isolated transaction exemption, UNIFORM SECURITIES ACT § 402(b)(1) (1956 version), in Utah's version of that exemption, UTAH CODE ANN. § 61-1-14(2)(a) (1953), may also have been intended to compensate for the loss of the limited offering exemption.

17. UTAH CODE ANN. § 61-1-14(2)(i) (1953).

18. UNIFORM SECURITIES ACT § 402(b)(10) (1956 version).

19. Note 14 and accompanying text *supra*.

20. The Utah Attorney General has stated that:

In adopting its version of the Uniform Act, Utah did not choose to include § 402(b)(9) (the so-called "private offering exemption"). Although Utah did adopt (Sec. 61-1-14(2)(i)) a version of § 402(b)(10) of the Uniform Act (the so-called "preorganization subscription exemption"), the Utah version deleted the third condition of the Uniform version . . . which required that no payment be made by any subscriber for the exemption to be available. The effect of this deletion was to make the Utah version of the "preorganization subscription exemption" a "true" exemption from registration whereas under the Uniform Act . . . that exemption merely postponed registration but did not excuse it altogether. It thus appears that in failing to enact the "private offering exemption" of the Uniform Act while at the same time making the so-called "preorganization subscription exemption" a "true" exemption from registration, the Utah Legislature intended that Section 61-1-14(i) at least in part serve the purpose that the private offering exemption of the Uniform Act . . . was intended to serve.

Utah Attorney General's Opinion, *supra* note 15, at 67,740 (footnote omitted).

21. Note 14 *supra*.

Utah's regulatory practices and interpretations clearly exempt the issuance of the underlying securities as well.²² It is arguable that the two modifications in Utah's preorganization subscription exemption do not warrant this dramatic change in the effect of the provision, but it is not improbable that Utah courts will accept present local interpretations.²³ Nevertheless, such an extension of this provision suggests gentle incongruities.

The Utah Securities Commission has, in another context, taken the position that postincorporation sales of shares must generally be accompanied by certain disclosures,²⁴ yet a promoter may avoid all disclosure by selling the shares to ten or fewer investors if he ties the sales to preincorporation subscriptions. The contradiction is accentuated if the shares subscribed for are purchased in installments over a long period of time (as may be provided for in the subscription).²⁵ Furthermore, if ten persons enter into preorganization subscriptions but ultimately fail to purchase the subscribed shares, the incongruous result would appear to be the exhaustion of the stock issuance exemption even though no shares had been issued.²⁶ In addition, it is not clear whether the Securities Commission can prevent one preorganization subscriber from asking the corporation to issue his subscription shares in the names of, for instance, fifty persons, since the issuance of subscription shares is interpreted to be exempt without more and since, absent some further tie, it may be difficult

22. See Utah Attorney General's Opinion, *supra* note 15, at 67,740. This opinion is adhered to by the Utah Securities Commission insofar as it concerns the exemption of stock subscribed for prior to incorporation.

23. In the case of *Anzai v. Kawai*, 50 Haw. 406, 441 P.2d 345 (1968), the Hawaii Supreme Court construed a preincorporation subscription exemption statute which, like the Utah statute, had deleted condition (C) of Uniform Securities Act § 402(b)(10). The court first noted that the Hawaii Securities Commission had always extended the preincorporation subscription exemption to stock issued pursuant to preincorporation subscriptions and then stated that "[w]e see nothing therein which warrants the construction that the exemption is limited to sales of preincorporation subscriptions for capital stock and does not extend to issuance of stock certificates pursuant to such subscriptions." *Id.* at 411, 441 P.2d at 349.

24. Rule A67-03-7(2)(a), *infra* note 45.

25. It may be argued that a preorganization subscriber is better informed than a postincorporation stock purchaser and, therefore, needs no disclosure, but there is little evidence or convincing logic to support this notion.

26. Failure to purchase the subscribed shares is a real possibility if subscriptions are made revocable as Utah law permits. UTAH CODE ANN. § 16-10-16 (1953) provides that "[a] subscription for shares of a corporation to be organized shall be irrevocable for a period of six months, unless otherwise provided by the terms of the subscription agreement or unless all of the subscribers consent to the revocation of such subscription." See also *Utah Hotel Co. v. Madsen*, 43 Utah 285, 134 P. 577 (1913); H. HENN, *HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* § 115 (2d ed. 1970).

to demonstrate that the fifty persons possessed a beneficial interest in the preorganization subscription itself in violation of the exemption.

The foregoing exercises may, at least for the present, be viewed as more academic than actual. The exemption's principal shortcomings are more serious. First, once incorporation has been accomplished, further availability of the exemption is foreclosed. The promoter who overeagerly incorporates before seeking out and selling to some or all of his backers is unfortunate. The corporation that exhausts its organizational capital and seeks to issue additional shares to ten persons is precluded from again using the preorganization subscription exemption. Second, the number of exempted legal or beneficial subscriber-purchasers is frozen at ten.²⁷ The deleted limited offering exemption of the Uniform Act has neither of these shortcomings, since it is available on a continuing basis, even after incorporation, and the number of permissible offerees can be increased by administrative order or regulation.²⁸

Furthermore, the cogent criticism that the Uniform limited offering exemption has imported from federal law the panoply of interpretations surrounding the difficult concept of "purchasing for investment"²⁹ may be applied to the Utah exemption: the Utah Securities Commission also requires preorganization subscribers to take their shares for "investment."³⁰ While it is true that the Utah preorganization subscription exemption does not limit the number of offerees as does the Uniform limited offering exemption,³¹ taken in its entirety it nonetheless constitutes a much narrower exemption³²—perhaps in legislative recognition of

27. Such a restriction has been viewed as extremely confining. See 6 L. LOSS, SECURITIES REGULATION 2634-41 (Supp. 1969); J. MOFSKY, BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS 81 (1971); Shapiro & Sachs, *Blue Sky Law and Practice: An Overview*, 4 U. BALT. L. REV. 1, 17-18 (1974); Note, *Maryland Blue Sky Reform: One State's Experiment with the Private Offering Exemption*, 32 MD. L. REV. 273, 278 (1972).

28. UNIFORM SECURITIES ACT § 402(b)(9) (1956 version) is available to an issuer even after incorporation as long as the "twelve consecutive month" time limitation is complied with. Likewise the number of permissible offerees can be increased by administrative order or regulation. The Uniform Act's limitation upon offerees, rather than purchasers, however, remains a difficult and restrictive provision.

29. Bennett, *supra* note 2, at 477.

30. Interview with William Sargeant, Director of the Utah Securities Commission in Salt Lake City, Dec. 31, 1975.

31. The Utah preorganization subscription exemption does not, however, contain a flexibility clause similar to that found in Uniform Securities Act § 402(b)(9) which specifies that "the [Administrator] may by rule or order, as to any security or transaction . . . increase or decrease the number of offerees permitted"

32. Compare UTAH CODE ANN. § 61-1-14(2)(i) (1953) with UNIFORM SECURITIES ACT § 402(b)(9) (1956 version).

the broker-dealer lobby respecting threatened commissions, perhaps as a matter of public policy, or perhaps as a legislative inadvertence.

In any case, experience raises the suspicion that local and limited postincorporation offerings not uncommonly are effected absent formal compliance with registration requirements or exemptions, either in ignorance or in the belief that, if not exempted, they should be. The local bar and the Utah Securities Commission, perhaps sensitive to this belief, have sought to expand available exemptions by interpretation, rule, and legislation.³³ These expansive interpretation and rulemaking efforts have most recently been focused on the isolated transaction exemption of the Utah Act.³⁴

III. UTAH'S ISOLATED TRANSACTION EXEMPTION

A polite skirmish brews about Utah's isolated transaction exemption between those who would find in it narrow exemptive authority for one or two transactions³⁵ and those who would find in it broad exemptive authority for limited offerings unauthorized by any other provision of the Utah Act.³⁶ The provision exempts "[a]ny isolated transaction, whether effected through a broker-dealer or not."³⁷ It is adapted from the Uniform provision, which, however, is limited to "non-issuer" transactions.³⁸ Within the framework of the Uniform Act, this exemption appears intended for the occasional transaction only, while the Uniform Act's lim-

33. See Rule A67-03-7 *infra* note 45; Utah Attorney General's Opinion, *supra* note 15; S.B. 302, Utah Legislature, Gen. Sess. (1975). This legislation, among other things, would have established an additional exemption similar to the private placement SEC rule 146, 17 C.F.R. § 230.146 (1976). Further legislation was introduced in the 1977 general session of the Utah legislature as S.B. 316.

34. UTAH CODE ANN. § 61-1-14(2)(a) (1953).

35. Utah Attorney General's Opinion, *supra* note 15.

36. Rule A67-03-7, *infra* note 45.

37. UTAH CODE ANN. § 61-1-14(2)(a) (1953).

38. UNIFORM SECURITIES ACT § 402(b)(1) (1956 version). The Attorney General's Opinion, *supra* note 15, at 67,740 n.2, suggests two reasons for the deletion of the "non-issuer" restriction. First, the drafters may have attempted to liberalize the section and thereby compensate for the failure to enact the Uniform Act's limited offering exemption, § 402(b)(9). Second, they may have realized that under pre-1963 law the isolated transaction exemption in Utah "had been held to be available to issuers," and that this holding should be given continued effect. In support of this proposition, the opinion cites *Johnson v. Crail*, 11 Utah 2d 392, 360 P.2d 485 (1961), claiming that *Johnson* overruled *sub silentio* *Harper v. Tri-State Motors, Inc.*, 90 Utah 212, 58 P.2d 18 (1936), *modified*, 90 Utah 226, 63 P.2d 1056 (1937). The *Johnson* decision, in fact, did not squarely face the question of whether an issuer can take advantage of the isolated transaction exemption. *Cf. Ersted v. Hobart Howry Co.*, 68 S.D. 111, 299 N.W. 66 (1941).

ited offering exemption is designed for heavier work.³⁹

The term "isolated transaction" is not defined in most state securities statutes, and even the Draftsmen's Commentary to the Uniform Act's isolated transaction provision admits that "indefiniteness here is traditional and probably inevitable."⁴⁰ Nevertheless, the case law and legal commentary that have construed isolated transaction statutes have, with few exceptions, limited the number of permissible sales under such statutes to a very few.⁴¹ The argument for a restrictive interpretation is

39. L. Loss & E. COWETT, *supra* note 8, at 316-20.

40. *Id.* at 318.

41. See, e.g., *Arkansas Real Estate Co. v. Fullerton*, 232 Ark. 713, 339 S.W. 2d 947 (1960); *Hippensteel v. Karol*, 304 N.E.2d 796 (Ind. App. 1973); *Allen v. Schauf*, 202 Kan. 348, 449 P.2d 1010 (1969); *Elting v. Pickett*, 190 Kan. 54, 372 P.2d 261 (1962); *State v. Harper*, 137 Kan. 695, 22 P.2d 454 (1933); *Commonwealth v. Allen*, 441 S.W.2d 424 (Ky. 1969); *Kneeland v. Emerton*, 280 Mass. 371, 183 N.E. 155 (1932); *Anderson v. Mikel Drilling Co.*, 257 Minn. 487, 102 N.W.2d 293 (1960); *Gales v. Weldon*, 282 S.W.2d 522 (Mo. 1955); *Nelson v. State*, 355 P.2d 413 (Okla. Crim. App. 1960); *Tarsia v. Nick's Laundry & Linen Supply Co.*, 239 Ore. 562, 399 P.2d 28 (1965); *Ersted v. Hobart Howry Co.*, 68 S.D. 111, 299 N.W. 66 (1941); *Johnson v. Crail*, 11 Utah 2d 392, 360 P.2d 485 (1961); Note, *Regulation of Non-issuer Transactions Under Federal and State Securities Registration Laws*, 78 HARV. L. REV. 1635, 1646-47 (1965).

On the other hand, an intriguing, although largely untested, argument may be made for the proposition that an isolated transaction exemption is the same as (and, therefore, as broad as) a *private* placement exemption. Some courts have used traditional private placement criteria to define isolated transactions. *E.g.*, *Turner v. Inventors Eng'r, Inc.*, 3 BLUE SKY L. REP. (CCH) ¶ 71,179 (Minn. 1974) (experience and sophistication of the investor); *Rucker v. La-Co, Inc.*, 496 F.2d 850 (8th Cir. 1974) ("insider" status of the investor); *Butler v. American Asphalt & Contracting Co.*, 3 BLUE SKY L. REP. (CCH) ¶ 71,244 (Ariz. App. 1975) (using *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953) standards to measure the availability of Arizona's isolated transaction exemption with respect to one sophisticated purchaser). *Cf.* *Vohs v. Dickson*, 495 F.2d 607 (5th Cir. 1974) and *Arnold v. Mixon*, 127 Ga. App. 549, 194 S.E.2d 307 (1972) (employing a sale-transaction distinction in order to facilitate a broader reading of the isolated transaction exemption). Other sources have defined a private placement as an "isolated sale," H.R. REP. NO. 85, 73d Cong., 1st Sess. 15-16 (1933) (commenting on the private placement exemption of the Securities Act of 1933), or as an "isolated transaction," 4 L. Loss, *supra* note 1, at 2637 (Supp. 1969) (Tennessee law); Opinion of the Attorney General of Tennessee to the Dep't of Insurance, 3 BLUE SKY L. REP. (CCH) ¶ 71,150 (1974) (quoting the Tennessee Securities Code). Utah's rule A67-03-7 appears similarly to define an isolated transaction in the private placement vocabulary of rule 146 (*e.g.*, sophistication, experience, disclosure, small number). Indeed, in rule A67-03-7, the Utah Securities Commission takes the intriguing (and at least superficially anomalous) position that an isolated transaction means up to 35 if the rule is complied with, but otherwise means only one or two. Rule A67-03-7(4)(a), *infra* note 45. There may be some justification for this equivalence of private placement and isolated transaction since, arguably, the same policy underlies both exemptions, *i.e.*, that sales to just a few are not harmful enough to warrant registration when the few are sophisticated investors who can watch out for themselves.

However, similar vocabulary and policy notwithstanding, the court decisions take the preponderant view, as demonstrated by this footnote's citations, that an isolated transaction is limited to an occasional sale (to one or two) while a private placement may include

strengthened by the fact that Utah's legislature defeated the proposed Uniform limited offering exemption⁴² and recently defeated proposed amendments to the Utah Act containing a liberalized limited offering exemption.⁴³ These defeats suggest, tentatively to be sure, disapproval of a limited offering exemption or its equivalent.

Nevertheless, the Utah Securities Commission has, under the umbrella of Utah's isolated transaction exemption and the Commission's interpretive power,⁴⁴ promulgated rule A67-03-7 as a substantial limited offering exemption.⁴⁵ The rule, in outline,

sales to a group of 20 or 30 or more persons. Perhaps this preponderant and narrow view of the isolated transaction exemption reflects an additional, although related, policy, *i.e.*, to engage the cumbersome and expensive regulatory machinery for one or two isolated and occasional stock sales is counterproductive, inefficient, and impractical. One sale is free; 10, 20, or 30 sales deserve some regulation; more sales require more regulation.

42. Compare UTAH CODE ANN. § 61-1-14(2) with UNIFORM SECURITIES ACT § 402(b)(10) (1956 version).

43. Note 33 *supra*.

44. UTAH CODE ANN. § 61-1-24(1) (1953) provides that:

The commission may from time to time make, amend, and rescind such rules, forms, and orders as are necessary to carry out the provisions of this act, including rules and forms governing registration statements, applications, and reports, and defining any terms, whether or not used in this act, in so far as the definitions are not inconsistent with the provisions of this act.

Where appropriate, interpretations should "make uniform the law of those states which enact [the Uniform Securities Act] . . . [and] co-ordinate the interpretation and administration of [the Utah Act] with related federal regulation" UTAH CODE ANN. § 61-1-27 (1953).

45. Rule A67-03-7 provides:

A condition of uncertainty has prevailed and does prevail respecting the scope of an "isolated transaction." Under Section 61-1-14(2)(a) which exempts from the registration provisions of the Utah Uniform Securities Act, "any isolated transaction, whether effected through a broker-dealer or not." That uncertainty has proven to be an unnecessary impediment to the raising of investment capital and to the growth of local industry.

The problem has come into focus recently because of the adoption by the United States Securities Exchange Commission (SEC) of Rule 146 under the Securities Act of 1933, which defines the Federal Private Offering exemption and provides objective standards for determining the availability of the exemption.

Section 61-1-27 of the Utah Uniform Securities Act mandates that the Act shall be so construed as to effectuate its general purpose to make uniform the law of the states which enact the Uniform Securities Act and to coordinate the interpretation of this act with the related federal regulation. The Utah State "Isolated Transaction" exemption is closely related to the Federal Private Placement exemption in that they both are calculated to allow sales of securities to a limited number of persons without registration.

In order to comply with that mandate, and to minimize uncertainty by providing objective standards for determining the availability of the exemption,

defines an isolated transaction to include sales to thirty-five per-

the Securities Commission of Utah, under its statutory authority, Utah Code Ann. § 61-1-24 (1953), has promulgated Rule A67-03-7, which interprets section 61-1-14(2)(a)—the “isolated transaction” exemption to enable offerors of securities to file an Application for Exemption Order (which will be deemed granted if not disallowed within five business days) for the offer or sale of securities which is not made by general solicitation or general advertising, and in the 12 months preceding the date of the last sale of such securities involves an aggregate maximum of 35 Utah residents who acquire a beneficial interest regardless of the amount of consideration, provided they are furnished a full disclosure statement in accordance with Federal Rule 146. The offeror is required to satisfy the offeree and purchaser suitability standards of Federal Rule 146.

No person who offers or sells securities under this exemption shall be considered a “broker-dealer” or agent within the scope of section 61-1-3 of the Act. Issuers are required to use restrictive legends on certificates issued in reliance on this exemption and to issue appropriate stop transfer instructions. Transactions with nonresidents shall not affect the availability of the exemption, and sales to such nonresidents shall not be computed in limitations of consideration and number of beneficial owners.

Determinations regarding integration within an offering shall depend upon whether the offerings are part of a single plan of financing, made about the time for the same general purpose involving the same class of security and same type of consideration. Certain relatives, trusts or estates, and corporations or organizations of a beneficial owner are not deemed separate beneficial owners. Also excluded from the computation is any owner of a purchase money mortgage or interest of a similar nature. A corporation or other organization shall be counted as one beneficial owner, provided it was not organized for the purpose of acquiring securities.

An exemption order shall be effective for a period of twelve months. However, an interim material change in the terms of offering, or with respect to the offeror, must be timely reflected through appropriate amendment to the exemption order.

Any transaction made in unwarranted reliance of an exemption from registration does not affect the availability of an exemption for other transactions, except it is computed in limitations of consideration and number of beneficial owners.

The rule is, by its terms, non-exclusive.

This rule is subject to change or modification any time the Director of the Utah Securities Commission may feel it will enable him to more effectively administer the Utah Uniform Securities Act and the exemptions provided therein. Proper notice will be given to all interested persons. This introductory note shall be incorporated into and made a part of the rule as set forth below. A67-03-7: Isolated Transaction Exemption as amended

1. Premises.

a. It is deemed in the public interest to interpret the Utah Uniform Securities Act consistent with the requirements of other states and applicable federal laws and regulations in accordance with Section 61-1-27.

b. It is deemed in the public interest to encourage the aggregation of capital to promote full employment and economic growth.

c. It is in the public interest that the investment of investors not be diluted by the unduly burdensome high costs of registering small transactions, it being recognized that such high costs are expenses which are ultimately borne by the investors.

sons resident in Utah within twelve months, irrespective of the

d. Persons acquiring securities in essentially negotiated transactions in restricted circumstances do not require the protections of the Act

to the extent deemed appropriate in unlimited offerings to the general public.

e. It is in the public interest that the Commission promulgate rules pursuant to the authority set forth in Section 61-1-24 of the Act to define relevant terms.

2. Exemption Order.

a. Offerors may file with the Commission an Application for securities to be offered and sold in reliance upon the exemption from registration set forth in Section 61-1-14(2)(a) for "Any isolated transaction, whether effected through a broker-dealer or not. . . ." if the proposed offer and sale of such securities is made in compliance with all of the conditions of A67-03-7:2 of this regulation and if neither the issuer nor any persons acting on its behalf offers, offers to sell, offers for sale or sells the securities by means of any form of general solicitation or general advertising;

If, within 12 months immediately preceding the date of last sale of securities offered hereunder, 35 or fewer persons who are residents of this state acquire a beneficial interest in the securities in an offering from offeror or for the offeror's account and if each investor is furnished, at or prior to the time at which the purchase of the securities is consummated, a disclosure statement containing all of the information set forth in the application and the information furnished to investors in accordance with the requirements of Rule 146(e) promulgated pursuant to the Securities Act of 1933, and such investors meet the suitability standards of Rule 146(d).

b. Offers and sales of securities in an offering to persons not residents of this state shall not affect the availability of an exemption order pursuant to this section and such sales to non-residents shall not be included in computing the consideration received for or the number of persons acquiring a beneficial interest in securities in an offering.

c. An application for an exemption order on the form provided therefor shall be deemed to be granted if the Commission does not by order disallow the exemption within the next five business days on the ground that the application is incomplete in a material respect or fails to contain the information required by subparagraph a. hereof. Such exemption order shall be effective for a period of one year following its grant, provided however, that such application or any disclosure statement prepared in connection therewith shall be revised and updated to reflect any material change in the offering or in the business and financial condition of the offeror while such securities are being offered.

A67-03-7:3

3. Miscellaneous

a. The determination as to whether offers, offers to sell, offers for sale or sales of securities are integrated within a specific offering depends on the following facts and circumstances:

- (1) Whether the offerings are part of a single plan of financing;
- (2) Whether the offerings involve issuance of the same class of security;
- (3) Whether the offerings are made at or about the same time;
- (4) Whether the same type of consideration is to be received; and

amount of sales proceeds, if each purchaser meets the qualifica-

(5) Whether the offerings are made for the same general purpose.

b. For the purposes of A67-03-7:2 hereof, the following shall be deemed the same and not a separate beneficial owner:

(1) Any relative or spouse of a beneficial owner and any relative of such spouse who has the same home as such beneficial owner;

(2) Any trust or estate in which a beneficial owner or any of the persons related to him, as specified in section 3.b(1) hereof, collectively, have 100 percent of the beneficial interest (excluding contingent interests);

(3) Any corporation or other organization of which a beneficial owner or any of the persons related to him as in section 3.b(1) hereof, collectively are the beneficial owners of all of the equity securities (excluding directors' qualifying shares) or equity interests;

(4) There shall be counted as one beneficial owner any corporation or other organization, except that if such entity was organized for the specific purpose of acquiring the securities in such entity each beneficial owner of equity interests or equity securities in such entity shall count as a separate beneficial owner;

(5) There shall be excluded from the computation any owner of only a purchase money mortgage and any bank, savings institution, trust company, insurance company, investment company registered under the Investment Company Act of 1940, small business investment company or minority enterprise small business investment company licensed by the U.S. Small Business Administration, or pension or profit sharing trust which purchases or holds only non-convertible notes or similar evidences of indebtedness of the issuer.

c. A transaction made in reliance on an exemption from registration or in violation of the registration requirements does not affect the availability of an exemption for other transactions, except that the calculations of limitations on the amount of consideration and the numbers of beneficial owners shall include the sales of all securities within the relevant period in unregistered non-exempt transactions.

d. This regulation and the exemption order issued pursuant hereto are not the exclusive basis for determining whether the exemption provided under Section 61-1-14(2)(a) is available. Accordingly, although persons claiming the exemption have the burden of proving its availability, persons may continue to rely on such exemption by complying with the relevant administrative and judicial interpretations in effect at the time of the transaction. The protection afforded by these regulations, however, is available only to those who satisfy all its conditions.

e. The offer or sale of securities registered pursuant to A67-03-7:2 hereof shall not render any person a "broker-dealer" or "agent" within the scope of Section 61-1-3 of the Act.

f. The availability of an exemption for transactions consummated in reliance upon an exemption order obtained pursuant to A67-03-7:2 hereof does not constitute an exemption from the anti-fraud provisions of the Act.

g. Offers shall use a legend in substantially the following form:

The securities represented hereby have been issued pursuant to an exemption from the registration requirements of the Utah Uniform Securities Act. No subsequent resale or other disposition of such

tions of rule 146(d)⁴⁶ and receives the disclosure information specified in rule 146(e), as promulgated by the SEC pursuant to the "private placement" exemption of the Securities Act of 1933.⁴⁷

The Utah Securities Commission indeed has authority to define by rule the term "isolated transaction" insofar as its definition is consistent with the policies and other provisions of the Utah Act and insofar as its definition, where appropriate, effectuates maximum uniformity with analogous blue sky provisions of other jurisdictions.⁴⁸ But such authority seems severely taxed by rule A67-03-7. The rule runs counter to the majority understanding of isolated transactions⁴⁹, and, while it recites a close relationship and need for uniformity between Utah's isolated transaction exemption and other states' limited offering exemptions, such a close relationship is belied by the existence in most other states of a limited offering exemption analogous to that omitted from the Utah Act and an isolated transaction exemption, of narrow interpretation, also analogous to Utah's. Indeed, in view of the Utah legislature's reluctance in the matter of limited offering exemptions, the rule cannot persuasively be said to further legislative intent. The suggestion that the rule furthers salutary uniformity between state and federal regulations because it incorporates rule 146 is not compelling, since most applications of the Utah rule occur under the federal intrastate exemption (not the rule 146 "private placement" exemption), in which

securities may be made within the state of Utah in the absence of an effective registration statement respecting these securities or an exemption therefrom.

Such legend shall appear on the share certificate or other document evidencing the security issued in transactions effectuated in reliance on the exemption order issued pursuant to A67-03-7:2. hereof.

The offeror shall issue stop transfer instructions to its transfer agents or if the issuer transfers its own securities, to make a similar notation on the transfer records, referring to the restrictions on transfer and sale of the securities. Any subsequent transactions, however denominated, can only be effectuated in accordance with applicable laws.

4. Other Isolated Sales.

a. Under all other facts and circumstances pertaining to the isolated sale of securities it shall be the position of the Utah Securities Commission that, "any isolated transaction, whether effected through a broker-dealer or not," means that a seller of securities shall be entitled to make two sales within a twelve month period of time under the exemption as provided in Utah Uniform Securities Act, Section 61-1-14(2)(a).

46. 17 C.F.R. § 230.146(d) (1976).

47. Section 4(2) of the Securities Act of 1933, 15 U.S.C. §§ 77(d)(2) (1970).

48. See note 44 *supra*.

49. See note 41 *supra*.

state regulation is justifiably adapted to state needs and coordinated with other state, not federal, regulations.

IV. THE POLICIES VS. THE PROVISIONS OF RULE A67-03-7

Questions of validity aside, the issue of rule A67-03-7's adaptation to the needs of Utah's investment community becomes paramount. The rule's introductory provisions recognize a need to loosen restrictions on capital formation by eliminating the necessity of registering securities when sold to a modest number of residents.⁵⁰ However, this policy appears defeated by the rule's own provisions.

The rule's exemption is unavailable unless each investor meets the requirements of SEC rule 146(d).⁵¹ Under these requirements, the issuer must reasonably believe that each "offeree" is either financially sophisticated enough to evaluate the investment opportunity or is capable of bearing the investment risk. In addition, each "purchaser" must also be either sophisticated enough financially to evaluate the investment opportunity or have retained an adviser sophisticated enough to counsel him and, at the same time, be able to bear the economic risk of the investment.⁵² Even if these requirements are met, the rule's exemption is still unavailable until rule 146(e) has been fulfilled by

50. Rule A67-03-7(1)(b)-(c), *supra* note 45.

51. 17 C.F.R. § 230.146(d) (1976). Rule 146(d) imposes restrictions relative to both offerees and purchasers while rule A67-03-7 speaks ambiguously of "investors" who meet the requirements of rule 146(d). Utah's rule may once again have imported offeree restrictions that were, in another context, effectively criticized by Professor Bennett. Bennett, *supra* note 2, at 477; text accompanying note 8 *supra*.

Whether offers as well as sales should be counted in determining the availability of the isolated transaction exemption itself remains an open question. In *Tarsia v. Nick's Laundry & Linen Supply Co.*, 239 Ore. 562, 399 P.2d 28 (1965), the court held that "at least two sales of securities to two different individuals within a reasonable period of time" would not give rise to a presumption that the isolated transaction exemption was inapplicable. However, the facts in *Tarsia* reveal that the defendant corporation had made at least one offer to sell its unregistered securities to an individual in addition to the two sales referred to above. In a dissenting opinion, Judge O'Connell argued that:

As I read the record in this case there were more than two sales. . . . Under [Oregon law] a sale includes every "attempt to dispose of a security or interest in a security for a consideration." The record discloses one attempted sale and two completed sales. Thus, there were three sales.

For an undisclosed reason, the majority opinion in *Tarsia* did not consider the defendant's attempted offer to sell as part of the isolated transaction. *But see* *Livens v. William D. Witter, Inc.*, 374 F. Supp. 1104, 1112 (D. Mass. 1974). Although other courts have not explicitly addressed themselves to this issue, the Kansas Securities Commission has adopted a rule which defines "transaction" to include both sales and solicitations. *See* *Allen v. Schauf*, 202 Kan. 348, 449 P.2d 1010 (1969).

52. 17 C.F.R. § 230.146(d) (1976).

either providing the investor with access to all material investment information or with a disclosure statement containing essentially this same information.⁵³

The foregoing federal exemption requirements have been described as both more strict and more treacherous than those required for registration of securities under federal law.⁵⁴ They are certainly more severe than Utah's registration provisions, which have no suitability requirements and a more simplified disclosure requirement.⁵⁵ On balance, then, rule A67-03-7 fails in its purpose of facilitating capital formation through easing the restrictions on small and local securities offerings.⁵⁶ Secondary purposes of rule A67-03-7, to provide for consistency between Utah's requirements and those "of other states and applicable federal laws and regulations,"⁵⁷ also appear unattained.

So far as has been determined, the rule is similar to statutes and rules of only a handful of other states.⁵⁸ While superficially similar to rule 146, rule A67-03-7 differs in material aspects. The Utah rule appears to cover issuers and nonissuers alike, while the SEC rule covers issuers only.⁵⁹ Thus the rule may well conflict

53. It is important to note in this regard that most Utah corporations will probably be nonreporting corporations within the meaning of the Securities Exchange Act of 1934 and, therefore, will have to comply with the much more onerous disclosure requirements imposed on nonreporting corporations by rule 146(e)(1)(ii)(b).

Because rule A67-03-7 requires a "disclosure statement" containing rule 146(e) information, it may be forcefully argued that the alternative of providing only access to the information is foreclosed to those attempting to comply with the Utah rule.

54. See Alberg & Lybecker, *New SEC Rules 146 and 147: The Nonpublic and Intra-State Offering Exemptions from Registration for the Sale of Securities*, 47 COLUM. L. REV. 622 (1974); Kessler, *Private Placement Rules 146 and 240—Safe Harbor?*, 44 FORDHAM L. REV. 37 (1975); Patton, *Private Offerings: A Proposal for Administrative Action in Arizona*, 15 ARIZ. L. REV. 1 (1973); Note, *State Exemptions from Securities Regulation Coextensive with S.E.C. Rule 146*, 61 CORNELL L. REV. 157 (1975); Note, *SEC Rules 144 and 146: Private Placement for the Few*, 59 VA. L. REV. 886 (1973).

55. UTAH CODE ANN. §§ 61-1-8 to 10 (1953). It is true, however, that, in addition to disclosure requirements, securities registration in Utah is subject to the Securities Commission's determination of the fairness of the offering pursuant to UTAH CODE ANN. §§ 61-1-6 & -12 (1953).

56. Should one successfully negotiate the rule's tortuous path of suitability and disclosure, one would still face unsettled questions such as whether or not compliance with the Utah rule exempts 35 sales in addition to the exemption for ten preorganization subscribers. On the other hand, while technical compliance with the rule is difficult and any shortfall is likely to result in the issuer's liability, clearance by the Utah Securities Commission under the rule is expeditious and an exemption order will usually issue within five days of application. Such an exemption order may constitute a defense to issuer's liability. See UTAH CODE ANN. § 61-1-24(5) (1953).

57. Rule A67-03-7(1)(a), *supra* note 45.

58. See Note, *State Exemptions from Securities Regulations Coexistent with S.E.C. Rule 146*, 61 CORNELL L. REV. 157 (1975).

59. UTAH CODE ANN. § 61-1-14(2)(a) (1953) (the isolated transaction exemption) upon

with other SEC rules (*e.g.*, rule 144) governing nonissuer transactions and thereby raise grave uncertainties as to compliance. As noted earlier, the Utah rule appears limited to investors instead of offerees and appears to require a disclosure statement instead of allowing the alternative of investor access to pertinent materials.⁶⁰ In addition, the Utah rules on transfer restrictions differ substantially from those of rule 146.⁶¹ The Utah rule provides that offerors must print on the share certificates, or other documents evidencing the securities issued pursuant to a rule A67-03-7 transaction, a legend warning purchasers that the securities represented by such certificates or other documents have been issued pursuant to an exemption from the registration requirements of the Utah Uniform Securities Act and that no subsequent resale or other disposition of such securities may be made within Utah in the absence of an effective registration statement or an exemption from registration. The rule further mandates that offerors issue stop-transfer instructions to their transfer agents with respect to securities issued pursuant to rule A67-03-7 and concludes by stating somewhat ambiguously that "[a]ny subsequent transactions, however denominated, can only be effectuated in accordance with applicable laws."⁶² Rule 146(h), by way of contrast, makes additional demands on issuers to insure against the redistribution of restricted securities. These include, among other requirements, "making reasonable inquiry to determine if the purchaser is acquiring the securities for his own account or on behalf of other persons . . . obtaining from the purchaser a signed written agreement that the securities will not be sold without registration under the Act or exemption therefrom."⁶³ More-

which rule A67-03-7 is expressly based, deletes the "non-issuer" limitation imposed by the Uniform Act's § 402(b)(1) as observed in notes 37 & 38 *supra*.

60. Notes 51 and 53 *supra*.

61. Compare 17 C.F.R. § 230.146(h) (1976) with rule A67-03-7(3)(g), *supra* note 45. One commentator has noted in this regard that:

Under the Rule [146], the issuer must take steps to prevent inappropriate redistribution of the securities to the public at large, and file a report with SEC after any quarter in which sales have been made pursuant to the Rule. The particular measures called for by the Rule are, to be sure, not unreasonable. Yet it would seem more appropriate to impose these requirements on issuers through a separate regulation rather than as a condition for exemption under Rule 146. There is little point in making the issuer subject to rescission of the entire offering, at the suit of one of the *original* purchasers, simply for a technical violation of such requirements.

Note, *Revising the Private Placement Exemption*, 82 YALE L.J. 1512, 1522-23 (1973) (emphasis in original) (footnotes omitted).

62. Note 45 *supra*.

63. 17 C.F.R. § 230.146(h) (1976).

over, rule 146 makes its restrictions on the transferability of private placement securities a condition for relying on that rule, while rule A67-03-7 ostensibly does not condition the availability of the isolated transaction exemption in Utah on compliance with anything other than paragraph (2)(a) of that rule.

Finally, the Utah rule puzzlingly avoids any similarity to SEC rule 240, which allows much simplified and relaxed exemption procedures for private placements totalling less than \$100,000.⁶⁴ Rule 240 would appear worthy of emulation if the Utah rule's purpose is conformity with federal private placement regulations, and more worthy of emulation than rule 146 if the Utah rule's purpose is to facilitate capital formation as described in its introductory provisions. It must be concluded that the Utah rule does not efficiently further its stated purposes.

As the foregoing review of statutory underpinnings and regulatory policies demonstrates, rule A67-03-7 and the isolated transaction exemption upon which it uneasily rests are not a wholly efficacious limited offering exemption.

V. CONCLUSION

Utah's limited securities offering exemption is certainly elusive and possibly illusory. Should the Utah legislature and Utah Securities Commission seek to establish a definitive limited offering exemption, recourse should not be had to rule 146 or Utah rule A67-03-7, both of which are inapposite. Instead, deliberate analysis of the needs of local issuers and investors for streamlined, largely quantitative rather than qualitative small offering exemptions, should be undertaken.⁶⁵ And if such an analysis dictates, an explicit legislative framework for limited offerings should be adopted and reliance on misused state regulations should be abandoned.

64. 17 C.F.R. § 230.240 (1976). The Utah rule, as originally promulgated, provided an exemption along the lines of rule 240 for private placements totalling less than \$100,000, but this exemption was later deleted by amendment.

65. See, e.g., the private placement exemption of the proposed Federal Securities Code which relies principally upon quantitative standards as to buyers, ALI Federal Securities Code § 227(b)(1)(A), Comment 2(b), at 16 (Tent. Draft No. 1, 1972); Mofsky, *supra* note 27; Patton, *supra* note 54, at 12-17.