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BLUER SKIES IN MARYLAND:
An Introduction To The New Maryland Exemptions For Limited And Private Offerings of Securities

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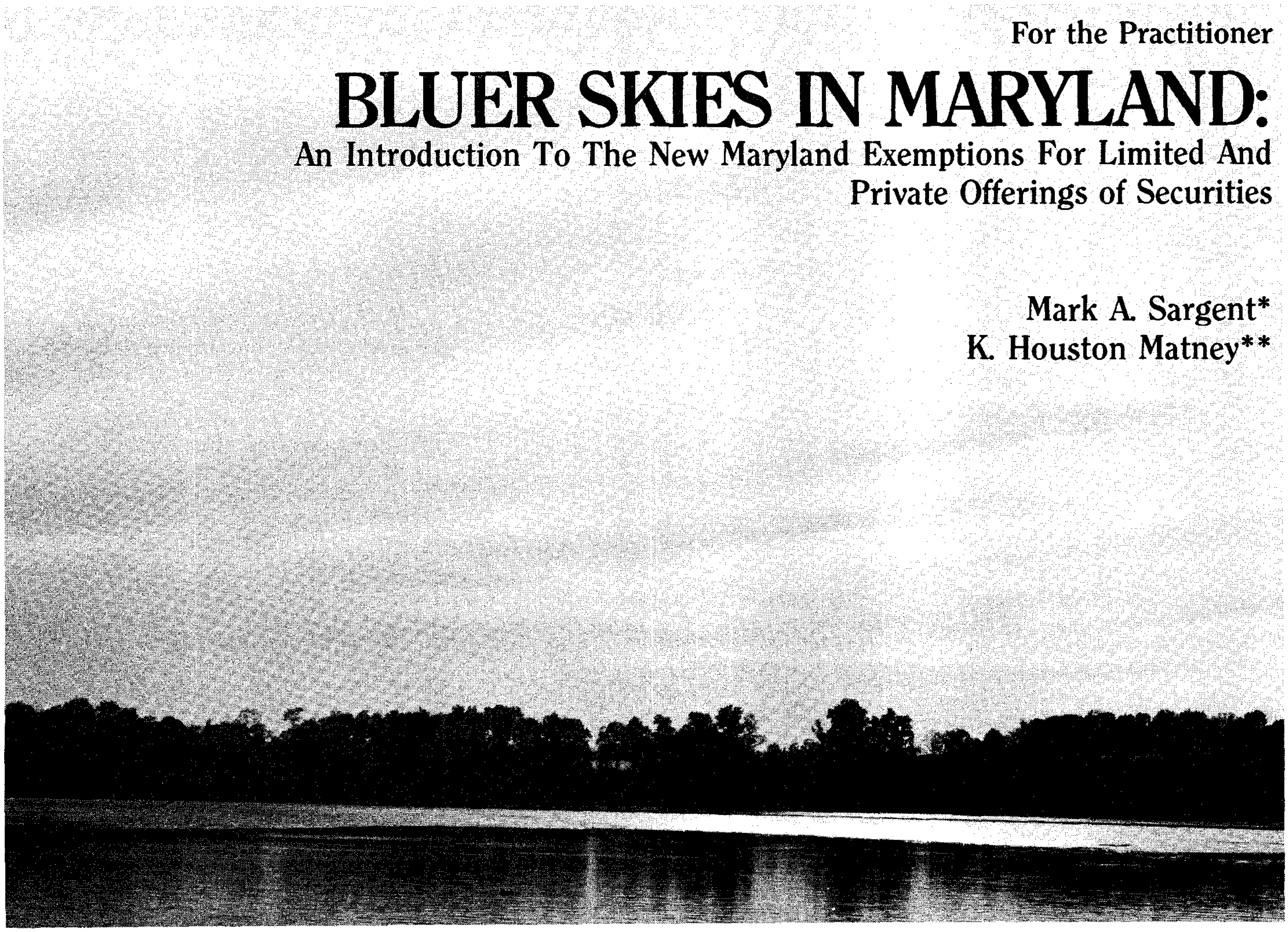

Introduction: The Unpleasant Surprise

The general business practitioner is often surprised to learn of the need to comply with the securities laws. The surprise is often an unpleasant one, since it usually arrives after a deal has fallen apart and the investors have filed suit on the basis of the registration or antifraud provisions of the federal and state securities laws. That surprise may even become a shock, if the practitioner learns that some agency has invoked the criminal provisions of those acts against his client or even against him.[1] The practitioner can avoid such surprises by remembering that some aspects of the state and federal schemes of securities regulation are applicable in varying degrees to *all* securities transactions, and that these schemes have supplanted the ancient maxim of *caveat emptor* with its opposite—*caveat venditor.*

Remembering that security regulation may apply is especially important when common sense suggests that the transaction has nothing to do with the securities laws. Common sense, for example, might suggest that the securities laws would not apply to a routine issuance of stock in a closely-held, "mom and pop" corporation. In this case, common sense would be wrong. The antifraud provisions of the securities laws apply to all securities transactions, including this one,[2] and mom and pop have the burden of proving an exemption for this transaction from the registration requirements.[3] That burden may not be difficult to carry, but it remains the responsibility of the persons selling the securities, even if those persons are mom and pop. Similarly, common sense might suggest that the sale of condominiums, yachts, chinchillas, and orange groves has nothing to do with the securities laws. Common sense might be wrong in these cases, too, since the sale of these commodities may be transformed into the sale of "investment contracts" by the manner in which they are sold.[4] Since "investment contracts" are securities,[5] the transaction would be subject to both the registration and antifraud provisions.

The practitioner should also remember that he has not exhausted his responsibilities by complying with the federal securities laws. Every state, including Maryland, has its own securities act, or "blue sky" law, and each state's act applies to every securities transaction within the state's borders. The practitioner must ensure compliance with the securities laws of every state in which the client offers or sells securities. This task is not simple: the state securities laws are not mirror images of either the federal securities laws or each other, and the state securities administrators are famous for their ingenious exercise of discretion.

Once the practitioner has alerted himself to the applicability of the securities laws, he needs to think about which aspects of those laws apply to the transaction in question. He can start with one simple premise: the antifraud provisions apply to all securities transactions, regardless of whether the securities are registered or exempt. In short, there are no exemptions from the antifraud provisions; the securities must be offered and sold without misrepresentation or omission of material fact.[6] The practitioner then has to think about whether the persons marketing the securities have complied with the broker-dealer and agent registration requirements, or whether they are somehow exempted from compliance with those requirements. Finally, the practioner has to determine whether the transaction can be exempted from the securities registration requirements. This is often the crucial determination, since the costs of registration can be great, and a security must be either registered or exempted before it can be offered to anyone. The offer or sale of an unregistered, unexempted security is a plain and simple violation of both federal and state law for which the offender will be held strictly liable.

This article will not try to summarize the vast range of issues surrounding securities law compliance. It will merely try to explain the one aspect of the Maryland securities laws that the general business practitioner is likely to encounter on a routine basis—the transactional exemptions for limited and private offerings of securities. This explanation should be timely, because two rules recently promulgated by the Maryland Division of Securities (the Division) have altered the ways in which these exemptions can be used and have done so against the backdrop of dramatic change in the federal exemptive provisions.[7] These new rules represent the culmination of a long-term, intensive effort by the Division to foster capital formation by Maryland business (especially small business), while continuing to meet its obligation to protect Maryland investors.

Federal Exemptions and Maryland Exemptions: The Problem of Coordination

Before turning to the new Maryland exemptive rules, let's recall a key premise: compliance with federal law must be coordinated with state law compliance. This coordination can take one of several forms. For example, a security registered at the federal level may also be registered in Maryland through "registration by coordination."[8] Similarly, some transactions exempted at the federal level may also be exempted from registration in Maryland. We will see how the new Maryland rules, in particular, enable such pairing of federal and state exemptions. On the other hand, a federally exempted transaction may end up registered in Maryland through the "registration by qualification" procedure.[9] A transaction exempted from federal registration because of its intra-state character,[10] for example, may have to be registered by qualification, unless an appropriate state exemption can be found. Conversely, some federally registered securities may be exempt in Maryland. Any security offered by issuers listed on the New York, American or Philadelphia Exchanges, for instance, will be automatically exempt in Maryland, even if it is registered at the federal level.[11]

Let's assume that an issuer desiring to offer and sell securities in Maryland has a federal exemption. Let's also assume that the exemption depends on the manner in which the security is being offered and sold. In other words, the issuer has a federal transactional exemption. That transactional exemption, furthermore, would probably be derived from § 3(b) of the Securities Act of 1933 (the 1933 Act), which exempts offerings limited in size, or § 4(2) of the 1933 Act, which exempts offerings private in character.[12]

The issuer offering securities in Maryland, and using one or both of these federal exemptions, has a major threshold decision. It can, of course, choose to register the securities in Maryland. This might be a wise decision. The costs of Maryland registration are not enormous, and state registration may facilitate resale. Furthermore, the Division ordinarily reviews the registration statement only for adequacy of disclosure, not for the substantive "fairness" or merits of the offering. Alternatively, the issuer may look to §§ 11-602(9) and (15) of the Maryland Securities Act.[13] Section 11-602(9), which sets out the Maryland limited offering exemption, was amended in 1981 to reflect the most important modern trends in exemption of limited offerings. Section 11-602(15) was enacted in 1981 to provide a statutory framework for coordination of federal and state exemptions. These 1981 statutory changes marked the first step in the Division's attempt to make Maryland's securities laws more responsive to the needs of Maryland business.

The new Maryland exemptive rules promulgated under §§ 11-602(9) and (15) mark the second step in this effort. The drafters of these rules were especially concerned with increasing the issuer's ability to coordinate these major federal and state exemptions. In other words, the drafters tried to define an exemptive scheme which would function systematically with the federal exemptive scheme. In so doing, the drafters gave effect to a policy expressed by the drafters of the Maryland Securities Act,[14] reflected in administrative practice and in Rule S-7[15] (the predecessor to these new exemptions) and made specific in § 11-602(15).

This policy of encouraging systematic coordination of federal and state securities regulation has more than one purpose. First, it reflects a conviction about the proper allocation of regulatory responsibilities in a federal system. Second, it reflects a desire to promote the efficient operation of the securities markets. The new Maryland rules respond to both of these concerns, but they also respond to another major concern—the need to encourage capital formation by small business. The following explanation will suggest several ways in which the new rules can assist small businesses in their capital raising efforts.

The Key To The System: Maryland Regulation 15 and "Exemption by Coordination"

As mentioned above, the 1933 Act provides two crucial exemptions from registration for limited and private offerings. Section 3(b) is a deferral to the rule-making power of the Securities and Exchange Commission (the SEC); it permits that agency to define by rule classes of transactions for which registration is not necessary because of the "small amount" of securities being offered or the "limited character" of the offering. Section 3(b)'s only limit on the SEC's discretion is a $5,000,000 cap on the aggregate offering price of the securities so exempted. The SEC has not hesitated to use its authority under this section, promulgating important exemptive provisions such as Regulation A,[16] which is still in effect, and Rules 240 and 242, both of which have been rescinded and replaced by Rules 504 and 505 of Regulation D.[17]

Section 4(2) exempts "transactions by an issuer not involving any public offering." In other words, § 4(2) exempts private offerings, or so-called "private placements." The exemption depends on the private character of the offering rather than its size, although the privacy requirement has traditionally tended to limit the number of participating investors, if not the aggregate offering price. The § 4(2) exemption also differs from the § 3(b) exemption in that it does not depend upon the SEC's rule-making power. That is, a "statutory" § 4(2) exemption exists apart from the rules which the SEC has adopted for the purpose of defining when an offering is public or private in character. The rules promulgated by the SEC under § 4(2) thus function only as "safe harbors." If the issuer complies with the specific conditions of the rule, it has a § 4(2) exemption; if it fails to do so, it may still "stumble" into a statutory exemption by relying on the case law and administrative utterances which have clustered around § 4(2) over the years.[18] The SEC's first § 4(2) rule was Rule 146, now rescinded and

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replaced by Rule 506 of Regulation D.

Regulation D represents a significant reform of the SEC's exemptive rules. While Regulation D is not necessarily simpler than its predecessor rules, and while it may not be of great help to very small businesses,[19] it is a great improvement over its predecessors. Since the provisions of Regulation D have been summarized recently elsewhere,[20] and since the focus of this article is the new Maryland rules, only a few key points about Regulation D need to be mentioned.

Regulation D consists of six separate but interrelated rules. Rules 504–506 state three distinct exemptions, two under § 3(b) (Rules 504 and 505), and one under § 4(2) (Rule 506). Rules 501–503 define terms and conditions applicable to all three exemptions. This in itself represents an improvement, because Rules 240, 242 and 146, which were adopted at different times and for different purposes, did not constitute a coherent, consistent system. The systematic qualities of Regulation D are not limited to the common set of definitions and conditions in Rules 501–503, but are also expressed in the relations among Rules 504–506.

To be precise: the three exemptions impose regulatory restraints in proportion to the amount of capital which can be raised. Rule 504, for example, permits the issuer to sell to an unlimited number of purchasers, during a twelve-month period, securities with an aggregate offering price of $500,000. These purchasers need not meet "suitability" standards with respect to their investment sophistication or economic risk-bearing ability. Furthermore, the exemption does not depend upon the securities being offered and sold through the use of a specific disclosure document, and the issuer is permitted to pay commissions to persons aiding the sales effort. The major conditions of the exemption are the relatively low dollar ceiling and a requirement that notice of sales be filed with the SEC.

Rule 505 raises the limit on the aggregate offering price to $5,000,000 in a twelve-month period, and proportionately increases the regulatory restraints. For example, Rule 505 securities may be sold to an unlimited number of accredited investors, but to only thirty-five non-accredited investors. Accredited investors are persons who meet certain objective standards of suitability. "Accredited Investor" is defined in Rule 501(a) to include certain institutional investors, certain persons related to the issuer, persons purchasing a stated large amount of securities, and persons meeting stated net worth or annual income criteria. Since accredited investors are deemed to be suitable, the issuer may sell to an unlimited number of them. Since the non-accredited investors, by definition, do not meet Rule 501(a)'s objective suitability criteria, and since Rule 505 does not require the issuer to make individual, subjective judgments about their suitability, the issuer may sell to only thirty-five of them.

If the issuer sells to one non-accredited investor, it must furnish a detailed disclosure document to every investor, both accredited and non-accredited, as a condition of the exemption. These conditions are supplemented by a prohibition on general solicitation and advertising, a notice filing requirement, and a denial of the exemption to issuers which have themselves or through associated persons been subject to specified judicial and administrative actions.

Rule 506 reflects the same kind of balancing. It places no cap on the aggregate offering price and no restriction on the types of issuers that can use the exemption. In addition, the issuer may sell to an unlimited number of accredited investors as well as to thirty-five non-accredited investors. The issuer must be satisfied, however, that each of those thirty-five non-accredited investors meet certain generally specified standards of investment sophistication. In addition, the sale to one non-accredited investor triggers an obligation to deliver a detailed disclosure document. If the aggregate offering price exceeds $5,000,000 the issuer must deliver a more detailed disclosure document than that required by Rule 505. These conditions peculiar to Rule 506 are joined by the restrictions on general solicitation and advertising and by the notice filing requirement.

One of the new Maryland rules was specifically designed to exploit these reforms in federal law. Division of Securities Regulation 15, subsection B(1)[21] provides an exemption for an offer or sale which "is part of an offering which is made in compliance with Rule 505 or 506 . . . as such rules may be amended from time to time." In short, a transaction which complies with Rules 505 or 506 will be eligible for exemption in Maryland, if it meets the three simple conditions to this exemption.

First, subsection B(2) requires the issuer to file with the Division a manually signed copy of the form filed with the SEC in connection with the Regulation D offering (SEC Form D). This copy must be filed within fifteen days after the first sale of securities under Regulation 15.

Second, subsection B(3) provides that the issuer may pay sales remuneration only to "a broker-dealer which the issuer reasonably believes is registered" in Maryland, or:

> [a] natural person who the issuer reasonably believes has not received a commission or similar remuneration for effecting any sale of securities on behalf of more than one other issuer within a 12-month period immediately preceding the first sale by that person in the offering made in reliance on this exemption.

In other words, commissions or other remuneration may be paid only to a person subject to licensing and regulation by the Division, or to a person who is not engaged in the business of selling securities, but merely acts, on an occasional basis, as an issuer's agent for the sale of securities. This latter limitation reflects the Division's long-standing position that a person who represents more than two issuers in any twelve-month period is "engaged in the business of effecting transactions in securities for the account of others," and as such is a "broker-dealer" under the Maryland Securities Act.[22] An issuer seeking the benefit of Regulation 15 should not be able to remunerate a person who is selling securities in violation of the Act as an unregistered broker-dealer.[23]

Third, subsection B(4) denies the exemption if the issuer, any of its directors, officers, general partners, beneficial owners of ten percent or more of any class of the issuer's equity securities, promoters currently connected with the issuer in any capacity, or non-registered recipients of remuneration for sales efforts has been subject to specified judicial or administrative actions within five years prior to the first sale of securities under this regulation. All of the specified actions concern discipline for acts of a fraudulent or deceitful nature. Note that these so-called "bad boy" disqualifications are additional to those already imposed on Rule 505 transactions by Rule 505(b)(2)(iii).

Regulation 15, therefore, permits a substantial degree of exemption by coordination. It represents a positive effort by the Division to use its authority under § 11-602(15) of the Maryland Securities Act to adopt rules coordinating state exemptions with federal exemptions under sections 3(b) and 4(2). Note, however, that Regulation 15 does *not* permit Rule 504 transactions to be exempted by coordination. This distinction reflects the SEC's intention of using Rule 504 as way of deferring to state securities regulation.[24] That is, the SEC defined in Rule 504 a class of small offerings in which the federal interest would be *de minimis,* provided that the state securities administrators would regulate those transactions. Accordingly, a Rule 504 transaction must either be registered by qualification in Maryland or be exempt from registration under another Maryland exemption, such as that provided by new Division of Securities Regulation 9.[25]

The Rest of the System: Maryland Regulation 9

Context

Regulation 15's exemption by coordination will be used for the great majority of limited offerings and private placements, especially those made by larger corporate issuers and by limited partnerships offering tax-sheltered investments, since those transactions will typically be exempted under Rule 505 and 506. We have just seen, however, that Regulation 15 cannot be used with a Rule 504 exemption. Similarly, a transaction exempted under the § 4(2) *statutory* exemption, but not under the Rule 506 safe harbor, cannot be exempted by coordination. This is a significant distinction: many offerings by small businesses may be genuinely private in character, but may not qualify for a Rule 506 exemption because of a failure to comply with one of the highly specific conditions of that Rule, such as the notice filing requirement. Furthermore, a transaction exempted under section 3(a)(11) of the 1933 Act because of its intra-state character would not be eligible for exemption by coordination.[26] This is also a significant distinction, because a small business may be very local in character and may wish to take advantage of this exemption.

Since all transactions exempted under Rule 504, § 4(2), or § 3(a)(11) should not be subject to registration, the drafters of the new Maryland rules attempted to devise an exemption which would provide business, especially small business, with a simple, practicable financing tool, while still furnishing Maryland investors a substantial degree of investor protection. Regulation 9 is the product of that effort.

Section 11-602(9), the statutory authority for Regulation 9, is similar to § 3(b) of the 1933 Act, in that the exemption depends entirely on the Commissioner's exercise of his rule or order-making authority. There is no automatic "statutory" § 11-602(9) exemption; the exemption may be obtained *only* through compliance with Regulation 9 or by order of the Commissioner.

Regulation 9 has a structure similar to that of Regulation D. Section A provides definitions; section B defines conditions applicable to all transactions to be exempted pursuant to Regulation 9; and sections C and D set out the exemptions themselves—the "Local Issuer" and "General Transactional" exemptions. Section E makes Regulation 9 inapplicable to federally registered transactions and to transactions federally exempted under Regulation A or Rules 505 and 506.

A functional analysis of how the regulation is intended to operate should begin with an examination of the General Transactional Exemption (the GTE), since that should be the most widely-used of the two Regulation 9 exemptions.

The General Transactional Exemption

The GTE exempts only specified securities issued by corporations, partnerships (both limited and general) and real estate investment trusts (REITs). Subsection D(1) limits the availability of the exemption to certain issuers and certain securities of those issuers in order to withhold the exemption from so-called "exotic" or unconventional securities in the form of investment contracts, since some of those securities have generated significant investor protection problems. The GTE is thus available as a matter of course to conventional equity and debt offerings by corporations, partnerships, and REITs. Subsection D(1) permits the Securities Commissioner, however, to extend the GTE by order "to other types of securities and other types of issuers in any case in which he determines that to do so would not be inconsistent with the public interest." Accordingly, the issuer of a security not specifically included in subsection D(1) may still be able to obtain the exemption upon application to the Commissioner.

The GTE does not directly restrict the number or character of the persons to whom securities can be *offered* and the only indirect restriction on the number of offerees results from subsection B(3)'s prohibition on general solicitation and advertising. The GTE does restrict, however, the number of *purchasers*. Subsection D(2) provides that "[t]he issuer shall reasonably believe that there are no more than thirty-five purchasers, in this State, of securities from the issuer in any offering pursuant to this section." The number "thirty-five" should not be read literally, however, because subsection B(6) excludes from the calculation of that figure certain related persons of the issuer, certain entities in which the issuer or its related persons have more than a 50 percent beneficial interest, and accredited investors.

The term "accredited investor" is defined in subsection A(1); the definition is a liberalized version of Rule 501(a) of Regulation D. Accordingly, "accredited investor" includes: certain institutional investors; directors, executive officers, and general partners of the issuer, together with related persons of such persons;[27] purchasers of at least $150,000 of the securities being offered, if the payment is made on certain specified terms and if the purchaser meets certain net worth criteria; and purchasers with a net worth of at least $1,000,000, or an annual income of $200,000 in each of the two most recent years.[28]

Subsection D(3) defines the issuer's disclosure obligations under the GTE. If the issuer sells only to accredited investors, no specific form of disclosure is mandated *as a condition of the exemption.* In other words, failure to provide a specific disclosure document will not result in loss of the GTE, although the antifraud laws will still require accurate disclosure of all material information. Similarly, the GTE requires no specific form of disclosure when the issuer sells only to persons who meet certain investment sophistication criteria, or only to a combination of accredited and sophisticated investors. Note that the concept of investment sophistication plays only a very limited role under Regulation 9. That is, the sophistication of the investors may be relevant to the form of disclosure, but the exemption itself does not depend upon offer and sale *only* to sophisticated investors. The old-fashioned "offeree suitability" concept has thus been abandoned. Conversely, an issuer cannot obtain an exemption simply by selling only to sophisticated investors. The other conditions must also be satisfied.

If the issuer sells to one non-accredited or unsophisticated investor, it must provide a disclosure document to every investor. If the issuer is a corporation, it may use Form MD-2. Form MD-2 is a simplified, fill-in-the-blank disclosure form. While every issuer should rely on experienced counsel in completing Form MD-2, the form is designed to help both the seller and the buyer understand the information being disclosed. It represents a major innovation and a departure from a tradition of securities regulation which mandates the production of repetitive, unreadable and unread disclosures. Only time will tell whether the innovation is successful, but it is intended to make the disclosure process more meaningful to both the investor and the entrepreneur.

Form MD-2 requires specific information about: the securities being offered; the use of the offering proceeds; the business of the issuer; the risk factors associated with the business; the organizational history of the issuer; the identity and remuneration of persons selling the securities; the identity and background of the managers and owners of the issuer; possible conflicts of interest; remuneration of management; recent distributions by the issuer; recent securities issuances; the terms of payment for the securities being offered; the expiration date of the offering; prior issuance of securities to insiders at a price lower than the offering price; and the terms of any escrow of the proceeds of the offering. In addition to the foregoing, Item 19 of Form MD-2 requires the issuer, as a condition to the exemption, to provide various forms of financial data. The amount and type of financial disclosure varies with the length of time the issuer has been in operation and with the availability of certified financial statements.

As just mentioned, only corporations may use Form MD-2. Limited partnerships and other issuers are, for now, required to fashion a disclosure document which will provide equivalent information in an appropriate form.[29] These documents need not track Form MD-2's "fill-in-the-blank" format. The Division plans to publish a form for use by limited partnerships after a period of experimentation with Form MD-2.

While the use of Form MD-2 or its equivalent is unnecessary when the issuer sells only to accredited or sophisticated investors, another form of disclosure to such investors is required whenever the issuer has previously issued "cheap stock" (stock sold at a price substantially lower than the offering price) to the insiders or does not intend to escrow the entire proceeds of the offering. In essence, the issuer is required to specifically disclose to all investors the existence of such cheap stock or the lack of escrow. Part II of Form MD-2 can be used for that purpose. Subsection D(2)(b)(i) defines when issuance of securities to insiders at a lower price triggers this disclosure requirement. These special disclosure requirements reflect the risks to investors which sometimes arise when the proceeds of the offering can be used before the offering is completed, and when the insiders have paid less for their equity position than the outside investors.

In addition to complying with subsection D(3)'s disclosure requirements, the issuer will have to make a simple notice filing with the Division of Securities on Form MD-1 if the aggregate *offering* price of the securities exceeds $100,000. This $100,000 limit thus applies to the amount of securities offered, not the amount actually sold. Subsection B(7) requires this filing to be made no more than fifteen days after the first sale of securities pursuant to the GTE.

The issuer must also exercise reasonable care to ensure that the purchasers of securities offered under the GTE are purchasing for investment and not with a view to distribution of the securities. Subsection B(5) lists several steps which the issuer can take to meet this duty of care, including placement of a restrictive legend on the certificate or other document evidencing the securities. A suggested form of legend is set out in that subsection; it states that the securities have been issued pursuant to a claim of exemption from the federal and state securities laws, and that they cannot be resold without registration or another exemption.

The issuer must also be wary of the "integration" requirement, *i.e.*, it must be sure that all of the sales which are part of the GTE offering meet all the conditions of the exemption (subsection B(2)). Finally, the issuer must reasonably believe that the persons remunerated for selling the securities meet the criteria of subsection B(4). These are the same criteria specified in Regulation 15 B(3).

Even if the issuer fulfills all of the foregoing conditions, however, it will be disqualified from the exemption if it or certain associated persons have been subject to certain specified judicial and administrative action. The "bad boy" provisions specified in subsection B(9) are identical to those set out in Regulation 15 B(4).

The Local Issuer Exemption

While the GTE should prove to be a flexible financing device, the drafters of Regulation 9 wanted to ensure that an even more flexible device would be available to very small businesses—to "mom and pop". This kind of flexibility is especially important because § 11-602(9), as noted above, does not offer a separate statutory exemption on which the issuer could rely apart from the rule.

The "Local Issuer Exemption" (the "LIE") thus allows some small, local corporations to issue a limited amount of securities to a limited number of investors with minimal regulatory interference. Under section C of Regulation 9, the LIE is available to corporations which: (1) are either incorporated or qualified to do business in Maryland; (2) have their principal place of business in Maryland; and (3) have fewer than fifty beneficial owners. Such "local issuers" may sell up to $100,000 of securities to no more than ten purchasers within a twelve-month period. Excluded from the calculation of the ten purchasers are the persons specified in subsection B(6). The local issuer can use the LIE, moreover, without filing any kind of notice with the Division, and no specific form of disclosure is required as a condition of the exemption. The antifraud laws, of course, will require accurate disclosure of all material information, but the exemption does not depend on that disclosure.

The only other conditions are those general ones imposed by section B: the general advertising and solicitation prohibitions, the remuneration restrictions, the "bad boy" disqualifications, and the resale restrictions. The integration requirement also applies to the LIE as well as the GTE.

The LIE offers a very simple exemption for small businesses trying to raise a limited amount of capital. The array of exemptions offered by the LIE, the GTE, and Regulation 15 should thus meet the financing needs of most Maryland issuers. The terms of these exemptions, however, are highly specific, and the possibility of unintentional non-compliance arises. Subsection B(1)(b) of Regulation 9, therefore, provides that an issuer that fails to meet all the conditions of either the LIE or the GTE may apply for an exempting order from the Securities Commissioner. The Commissioner may grant that order under subsection B(1)(b) if he finds that "the transaction demonstrates substantial compliance in good faith with the conditions of the regulation" and that "the order would not be inconsistent with the public interest."

Some Cautionary Notes

1. While this brief article may be of some help to the general business practitioner, it is no substitute for a careful examination of the rules themselves, since many crucial nuances must be omitted from an introductory survey.

2. Although an issuer using the GTE or the LIE will not always have to provide the investors with a Form MD-2 as a condition of the exemption, it should find use of the form helpful as a way of complying with the antifraud requirements. While use of the form does not in itself guarantee freedom from suit, its use may help the issuer avoid such litigation. The Division thus hopes that the availability of this clear and practical form will generate greater compliance with Maryland's securities laws.

3. The practitioner should accustom small business clients to planning securities law compliance *before* commencement of their capital-raising efforts. A belated attempt to comply runs a greater risk of failure, and failure may mean substantial liability as well as the death of the deal.

Footnotes

[1] *See, e.g.,* Securities Act of 1933, § 24, 15 U.S.C. § 77x (1981); MD. CORPS. & ASS'NS CODE ANN. § 11–705 (Supp. 1982).

[2] *See, e.g.,* Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1981); MD. CORPS. & ASS'NS CODE ANN. § 11–301 (1975).

[3] MD. CORPS. & ASS'NS CODE ANN. § 11–604 (1975).

[4] *See generally* Dillport, *Restoring Balance to the Definition of Security,* 10 SEC. REG. L.J. 99 (1982).

[5] Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1) (1981); MD. CORPS. & ASS'NS CODE ANN. § 11-101(o)(1)(xi) (1975).

[6] The practitioner should also remember that "fraud" under the securities laws encompasses a broader range of activities than does common law fraud.

[7] The authors were members of the joint Maryland State Bar Association-Division of Securities committee that drafted the rules discussed in this article.

8 Md. Corps. & Ass'ns Code Ann. § 11–503 (1975).

9 Md. Corps. & Ass'ns Code Ann. § 11–504 (1975).

10 By virtue of Securities Act of 1933, § 3(a)(11), 15 U.S.C. § 77c(a)(11) (1981).

11 Md. Corps. & Ass'ns Code Ann. § 11–601(8) (Supp. 1982).

12 15 U.S.C. §§ 77c(b) and 77d(2) (1981).

13 Md. Corps. & Ass'ns Code Ann. §§ 11–602(9), 11–602(15) (Supp. 1982). These key provisions are currently printed in the "pocket part" to this volume of the Code.

14 *See Report of the Committee to Study the Administration of the Blue Sky Law of Maryland* 5, 6 (October 11, 1961).

15 Md. Admin. Code (COMAR) § 02.02.03.07 (rescinded 1983). Note that the designation "Rule S-7" reflects the numbering system for state regulations which was in effect when the rule was promulgated. The authors use the designation here solely because of its familiarity to the Bar.

16 17 C.F.R. §§ 230.252–.263 (1982).

17 17 C.F.R. §§ 230.501–.506 (1982).

18 A "statutory" exemption under section 4(2) may not be easy to obtain. The pertinent law is scanty, and it does not suggest that section 4(2) allows the issuer to sell to large numbers of investors without registration. *See, e.g., SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953); *and Doran v. Petroleum Corp.*, 545 F.2d 893 (5th Cir. 1977).

19 *See generally* Kripke, *Has the SEC taken All the Dead Wood Out of its Disclosure System?*, 39 Bus. Law. 833 (1983).

20 *See, e.g.*, Sachs & Attman, *Raising Capital for Small Businesses by the Private Sale of Securities—The New Federal and Maryland Rules*, Md. B.J., June 1982, at 4.

21 Md. Admin. Code (COMAR) § 02.02.03.15 B(1) (1983).

22 *See* Md. Corps. & Ass'ns Code Ann. § 11–101(c)(1) (1975); *and* Md. Securities Release No. 18 (May 10, 1974), 1A Blue Sky L. Rep. [CCH] ¶ 30,560.

23 Note that state securities law interprets the terms "commission" and "remuneration" very broadly. *See, e.g., Prince v. Heritage Oil Co.*, 311 N.W. 2d 741 (Mich. Ct. App. 1981).

24 *See* SEC Rel. No. 33–6339 (Aug. 7, 1981).

25 Md. Admin. Code (COMAR) § 02.02.03.09 (1983).

26 A "safe harbor" for the section 3(a)(11) exemption is 17 C.F.R. § 230.147 (1982).

27 *Compare*, Rule 501(a)(4) (Related persons of the issuer's principals are not accredited investors).

28 *Compare*, Rule 501(a)(7) (The spouse's income may not be counted for purposes of calculating income).

29 The Division recommends that real estate limited partnerships use SEC Industry Guide 5 as a basis for the disclosure document. *See* 1 Fed. Sec. L. Rep. [CCH] ¶ 3829.