Weekly Information Sheet 06

CORPORATIONS

Securities Regulation

1. State Regulation

• State Regulation Generally:

Corporate regulation under state law is as follows:

- **State Blue Sky Laws:**

  These laws apply only to intrastate transactions, and protect the public from the sale of fraudulent securities.

  The National Securities Markets Improvement Act of 1996 allocated responsibilities between federal and state authorities.

- **The Martin Act:**

  In 1921 the NYS Legislature enacted one of the nation's first blue sky laws, known as the Martin Act (Article 23-A of the NYS General Business Law).

  The law provides extraordinary powers to the State Attorney General to combat financial fraud.

• State Regulators

- **Office of the Attorney General**

  Under the Martin Act the Office of the NYS Attorney General has the legal authority to monitor and bring lawsuits for securities fraud and violations of the NYS General Business Law.

- ***Department of Financial Services***

  This new state entity, created in 2011, has jurisdiction to regulate all insurance companies and banks doing business in New York. They further have some limited power to regulate certain securities transactions where such regulation is not pre-empted under Federal law.

2. Anti Fraud Provisions

• Anti Fraud Provisions Generally

Both the Martin Act and the Federal Securities Laws provide for measures to combat fraud and misrepresentation with respect to the sale, purchase and transfer of securities.

These provisions permit enforcement by both federal and state authorities to combat fraud and misrepresentation and authorize the imposition of both civil and criminal sanctions upon the proof of such misconduct.

3. Federal Regulation

• Federal Regulation Generally

Corporate regulation under federal law began after the 1929 stock market crash.

There are four principal federal laws which provide the framework for federal regulation of the sale of securities in interstate commerce.

These include:

**** The Securities Act of 1933;***

**** The Securities Exchange Act of 1934;***

**** The Sarbanes-Oxley of 2002; and***

**** The Dodd-Frank Act of 2010***

- **Definition of Security:**

  The term “security” has defined as “stocks and bonds issued by a corporation”. Other definitions may also include other financial products interests that seek to provide unearned income.

- **Definition of Investment Contract:**

  An investment contract for purposes of the Securities Act, on the other hand, means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

• The Business Judgment Rule:

The business judgment rule is a case law-derived concept in corporations law whereby the "directors of a corporation . . . are clothed with [the] presumption, which the law accords to them, of being [motivated] in their conduct by a bona fide regard for the interests of the corporation whose affairs the stockholders have committed to their charge" (See Gimbel v. Signal Cos., 316 A.2d 599, 608 (Del. Ch. 1974)

The Business Judgment Rule has at its core, a responsibility of directors to weigh risk against reward. This is an art, not a science.

4. Insider Trading

• Insider Trading (Rule 10b)

- Trading of securities based upon “inside information” is unlawful and subjects those involved to both criminal sanctions and civil penalties of three times the profit made.

- Directors and corporate employees are liable for insider trading, as can be temporary insiders (consultant, attorney, CPA, etc).

- A person will only be liable if the insider providing the information breaches a fiduciary duty.

5. Industry Self Regulation

• Arbitration

- Many securities investment firms have adopted a code of arbitration, giving customers a contractual right to settle disputes through arbitration.

- Courts rarely overturn the decisions of an arbitrator in these cases, as due process and an opportunity to be heard for both sides is afforded.

- Arbitrators are selected jointly or pursuant to a contract