

SECURITIES CHECKLISTS

These factors may indicate a violation of the CSL

Unqualified Sales (§25110)

- (1) offer or sale in California
- (2) of a security (stock, bond, mutual or hedge fund, promissory note, limited partnership, investment contract, etc.)
- (3) without a permit from the Corporations Commissioner
- (4) with financial benefit to the entity or person issuing the security

Material Misrepresentation (§25401)

- (1) offer or sale in California
- (2) of a security
- (3) by means of misstatements or omissions of material fact
- (4) with knowledge or criminal negligence regarding falsity

Unlicensed Broker-Dealer (§25210)

- (1) engaging in the business in California
- (2) of effecting, inducing or attempting to induce security transactions

Unlicensed Investment Adviser (§25230)

- (1) engaging in the business in California
- (2) for compensation
- (3) of advising others regarding value of securities or the advisability of buying or selling securities

NEED HELP?

The Department of Corporations:

- Provides information on individuals and companies licensed by the Corporations Commissioner
- Gives technical assistance on interpreting and applying the securities laws
- Issues desist-and-refrain orders and files civil actions

FOR MORE INFORMATION

CONTACT THE
DEPARTMENT OF CORPORATIONS
CONSUMER RESOURCE CENTER

1-866-ASK-CORP

(1-886-275-2677)

OR VISIT

www.corp.ca.gov

The Department of Corporations is California's investment and financing authority and is responsible for the regulation, enforcement, and licensing of securities, franchises, off-exchange commodities, investment and financial services, independent escrows, consumer and commercial finance lending, residential mortgage lending, and payday lenders. For general information about corporations, limited liability companies and limited partnerships, their filings, officers and agents for service of process, contact the Business Programs Division of the Secretary of State at 916-657-5448.



LAW ENFORCEMENT
GUIDE TO

**THE CORPORATE
SECURITIES LAW**

This pamphlet is a summary for general information and discussion only. It is not a full analysis of the matters presented. Please contact the Department of Corporations for further assistance.

Overview

This pamphlet sets forth a brief introduction to the criminal provisions of the Corporate Securities Law of 1968 (CSL), beginning at Corporations Code Section 25000. The CSL authorizes criminal prosecutions of persons who offer or sell securities without obtaining a qualification permit from the Corporations Commissioner and/or by means of material misrepresentations or omissions of fact, i.e., fraud. Criminal penalties may also be imposed upon persons who engage in business as broker-dealers or investment advisers without a license from the Corporations Commissioner. Sections 25540 and 25541 are the criminal charging sections of the Corporations Code.

Defining a “Security”

In addition to commonly recognized instruments such as stocks, bonds and limited partnerships, the CSL defines the term “security” to include “investment contracts.” An investment contract is:

- (1) an investment of money
- (2) in a common enterprise
- (3) with an expectation of profit
- (4) to be realized primarily through efforts of others.

A critical element of an investment contract is a passive investor:

In recent years, “investment contract” schemes have involved sales of tangible items, such as payphones, ATM machines or internet kiosks, combined with contracts for managing, servicing and placing the machines. The combination of the sale agreement plus the management contract constitutes an investment contract.

Other types of securities schemes marketed widely include offerings of promissory note investments, often to fund purported business start-ups, and vatical investments/life settlements which involve purported returns from investments in life insurance contracts. Recent spikes in oil prices have also triggered increases in fraudulent oil and gas-related investment offerings. Also common have been so-called “prime bank schemes,” in which investors are promised that their money will be pooled with other investors to qualify for high returns from offshore financial institutions that normally limit their services to the super-rich.

Qualification Requirement

Section 25110 provides:

“It is unlawful for any person to offer or sell in this state any security in an issuer transaction ... unless such sale has been qualified ... or unless such security or transaction is exempted or not subject to qualification....”

Exemptions from the Qualification Requirement

The CSL exempts certain security offerings from the qualification requirement. SEC-registered securities sold on major stock exchanges are not subject to qualification. The exemptions apply to non-public offerings to sophisticated or knowledgeable investors. When general forms of solicitation such as advertisements and telemarketing are used to offer and sell securities indiscriminately to unsophisticated persons of modest financial means, these exemptions are generally inapplicable.

Anti-Fraud Provision

Section 25401 imposes liability for factual misstatements or omissions used to induce an offer or sale of securities even if the transactions are otherwise exempt from the Section 25110 qualification requirement. Section 25401 states that:

“It is unlawful for any person to offer or sell a security in this state or buy or offer to buy a security in this state by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.”

Broker-Dealers and Investment Advisers

It is unlawful for persons to engage in business as broker-dealers or investment advisers unless they have obtained a license from the Corporations Commissioner or are otherwise exempted (Section 25210). Investment advisers must obtain a license from either the Corporations Commissioner or the SEC (Section 25230).

Section 25004 defines “broker-dealer” as “any person engaged in the business of effecting transactions in securities in this state....” Persons who are compensated for selling securities issued by third parties are probably broker-dealers.

Section 25009 defines “investment adviser” as:

“[A]ny person who, for compensation, engages in the

business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities, or who, for compensation and as a part of a regular business, publishes analyses or reports concerning securities.”

The definition has several exemptions, including publishers of bona fide financial publications of general, regular and paid circulation, and advisers registered with the SEC.

Criminal Sanctions

§25540. Violations of Corporate Securities Laws or rules or orders thereunder: punishment

“(a) Except as provided for in subdivision (b), any person who willfully violates any provision of this division, or who willfully violates any rule or order under this division, shall upon conviction be fined not more than one million dollars (\$ 1,000,000), or imprisoned in the state prison, or in a county jail for not more than one year, or be punished by both that fine and imprisonment; but no person may be imprisoned for the violation of any rule or order if he or she proves that he or she had no knowledge of the rule or order.

(b) Any person who willfully violates Section 25400, 25401, or 25402, or who willfully violates any rule or order under this division adopted pursuant to those provisions, shall upon conviction be fined not more than ten million dollars (\$ 10,000,000), or imprisoned in the state prison for two, three, or five years, or be punished by both that fine and imprisonment.”

§25541. Use of device, scheme or artifice to defraud: fraudulent practices: punishment

“(a) Any person who willfully employs, directly or indirectly, any device, scheme, or artifice to defraud in connection with the offer, purchase, or sale of any security or willfully engages, directly or indirectly, in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the offer, purchase, or sale of any security shall upon conviction be fined not more than ten million dollars (\$ 10,000,000), or imprisoned in the state prison for two, three, or five years, or be punished by both that fine and imprisonment.”