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Regulating Wisconsin-Based Businesses: The Wisconsin Uniform Securities Act

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Regulating Wisconsin-based Businesses:

THE WISCONSIN UNIFORM SECURITIES ACT

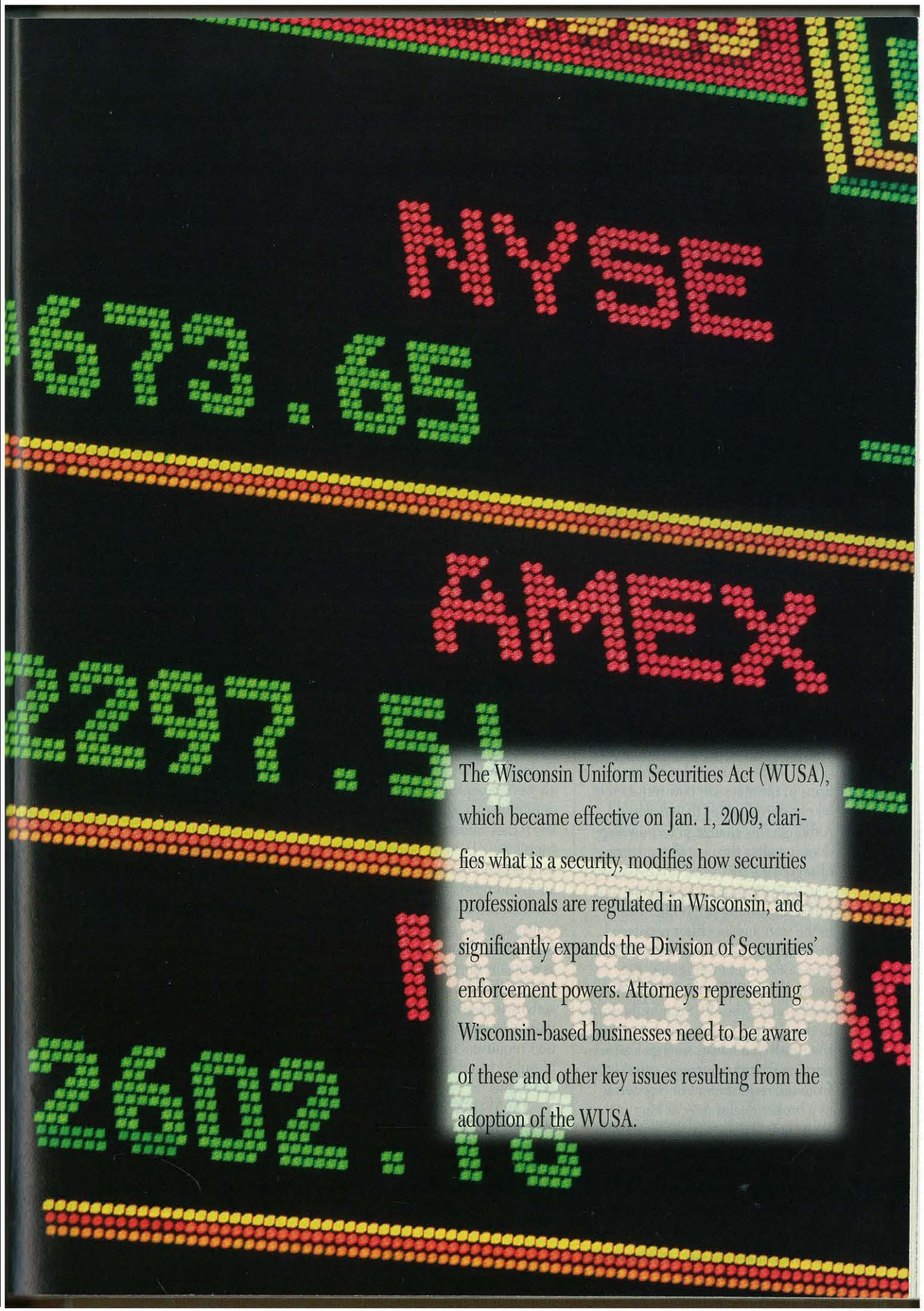
by Edward A. Fallone

In 2007, the Wisconsin Legislature passed the Wisconsin Uniform Securities Act (WUSA), which replaces the prior Wisconsin Uniform Securities Law.[1] The new law became effective Jan. 1, 2009. The WUSA, the result of a multi-year effort by the WUSA Study Group, generally tracks the Uniform Securities Act of 2002 (USA 2002). Prior Wisconsin law was based on the Uniform Securities Act of 1956 and had been amended several times, in keeping with changes in federal law.[2]

Wisconsin's securities-law statutes appear in Wis. Stat. chapter 551, which was renumbered and reorganized by the WUSA. Among other changes, the WUSA clarifies the definition of *security* and modifies the regulation of securities professionals who effectuate transactions that take place in Wisconsin. The WUSA also significantly expands the Division of Securities' enforcement powers. The WUSA continues to require that securities offerings made in Wisconsin be registered under state law unless the securities fall within the definition of *federal covered securities* or qualify for an exemption under Wisconsin law, but the WUSA seeks to clarify the boundary between state and federal regulation of securities offerings. Therefore, Wisconsin-based businesses should be aware of several key issues resulting from the adoption of the WUSA.

The Changes

The WUSA definitions section has led to several significant changes in Wisconsin law. One fundamental change is intended to clarify the definition of a security, in particular as it applies to unincorporated business entities. Under the WUSA, interests in limited liability companies (LLCs) and limited



The Wisconsin Uniform Securities Act (WUSA), which became effective on Jan. 1, 2009, clarifies what is a security, modifies how securities professionals are regulated in Wisconsin, and significantly expands the Division of Securities' enforcement powers. Attorneys representing Wisconsin-based businesses need to be aware of these and other key issues resulting from the adoption of the WUSA.

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liability partnerships (LLPs) are now deemed to be *investment contracts* (and therefore securities) unless one of two scenarios applies: 1) each interest holder is actively engaged in the management of the LLC or LLP; or 2) there are fewer than 15 interest holders and each one can bind the LLC or LLP.[3] This bright-line rule will add clarity to the scope of the WUSA's coverage. In addition, the WUSA continues the practice under prior state law of excluding most variable annuities from the definition of a security. Finally, the definitions of *filing*, *record*, and *sign* have been modified to explicitly provide for the electronic submission of documents to the Division of Securities.[4]

Another change in the WUSA relates to regulating securities professionals within Wisconsin. Broker-dealer firms in the state are now required to be *registered* rather than *licensed*.[5] Although this change in terminology does not alter the overall structure of regulating securities professionals – an individual or entity still may not transact business as a broker-dealer in the state unless either registered or exempt – the WUSA narrows the scope of certain exemptions. For example, the definition of *broker-dealer* under the WUSA now conforms to the Gramm-Leach-Bliley Act, with the result that banks, savings institutions, and trust companies are exempt from the requirement of registering as a broker-dealer only so long as they limit their activities to those permitted under that federal law.[6] The prior law's exemption for transactions engaged in by broker-dealers exclusively on behalf of sophisticated investors also has been redefined. Under the WUSA, entities performing broker-dealer services in Wisconsin are exempt from the registration requirement if their transactions in the state are limited to transactions with the issuer of the securities, other broker-dealers, "institutional investors" and accredited investors (not including individuals), and, in certain circumstances, bona fide preexisting customers.[7]

Individuals who act as agents in effectuating a securities transaction also are required to be registered unless they represent an exempt broker-dealer or they qualify for an exemption (that is, they represent a securities issuer that is exempt from state registration).[8] The current treatment of agents actually is less advantageous than their treatment under prior law. Previously, individuals were completely excluded from the definition of *agent* under Wisconsin law if they effectuated an exempt transaction, thereby placing those persons beyond the reach of the statute's antifraud provisions as well as the registration requirements. The WUSA, in contrast, relies on registration exemptions rather than definitional exclusions as a means of regulating agents' activities. Therefore, an agent whose only activity is to effectuate a transaction that is exempt from state registration requirements will nevertheless be subject to the WUSA's antifraud provisions.

The WUSA also makes significant changes in the enforcement provisions of securities law in Wisconsin. New statutory powers granted to the Division of Securities include the power to issue cease-and-desist orders, asset freezes, and rescission orders.[9] The statute of limitation for civil liability also has been modified. Claims based on a failure to register offerings or a broker-dealer's failure to register must be brought within one year, and all other claims must be brought within the earlier of two years after discovery or five years after the violation.[10]

What Stays the Same

With regard to state regulation of public offerings, the WUSA continues to require offerings of securities made in Wisconsin to be registered under state law unless they are either offerings of *federal covered securities* or they qualify for an exemption under Wisconsin law. Federal covered securities include securities listed on a national exchange and securities sold under certain exemptions contained in the Securities Act of 1933: Sections 4(1) and 4(3), if the issuer is a reporting company; Section 4(4); Rule 506; and sales to "qualified purchasers" (a term that remains undefined). However, federal covered securities *do not* include securities sold under other Securities Act exemptions, notably Section 3(a)(11), Rule 504, Rule 505, and Regulation A. Offerings made under this second group of federal exemptions remain subject to state-law registration requirements.

Registration with the Division of Securities, when required, is accomplished either via coordination with a federal filing or by qualification. In contrast, offerings of federal covered securities require only notice filings. The WUSA identifies specific securities and transactions that are exempt from the filing requirement and authorizes the Division to modify filing requirements and to deny or revoke exemptions. In certain instances, the WUSA deviates from the USA 2002 to preserve either existing state-law exemptions or established instances of Division

authority under Wisconsin law.

Under this division of authority between state and federal regulators, much depends on whether a particular offering is deemed to fall within the requirements of Rule 506 – and therefore to qualify as an offering of federal covered securities – or whether regulators believe that the offering fails to qualify. Many practitioners initially assumed that the Securities and Exchange Commission would be the only agency that could determine whether an offering complied with Rule 506, and that state regulators could not act unless the SEC first determined noncompliance. But state regulators across the country have successfully argued that they retain the authority to decide on their own initiative that offerings made within their respective states do not qualify under Rule 506.[11] Therefore, securities offered under Rule 506 in Wisconsin are nominally "federal covered securities" but that fact does not preclude the Division of Securities from arguing that a particular offering fails to qualify for Rule 506 and that, as a result, the issuer is liable for the failure to register the offering under state law.

The Consequences

Wisconsin companies should be aware of several issues as a result of the adoption of the WUSA. Unincorporated businesses should be aware of the new definition of investment contract, because it may affect their capital-raising activities. Financial institutions such as banks and savings and loans that perform broker-dealer services should verify that they and their agents remain exempt from state registration requirements under the new law. Any business entity raising capital through the sale of securities under the popular Rule 506 exemption should not assume that it is immune from a possible enforcement action by the Division of Securities for the failure to register the offering in Wisconsin.

Finally, victims of securities fraud and any purchasers of securities offered in violation of the WUSA's registration requirements may find it advantageous to file a civil suit under the WUSA as opposed to suing under the federal securities law. The WUSA offers plaintiffs lower pleading standards than federal law for claims of fraud, a cause of action for rescission that obviates the need to prove reliance or causation, and the option of naming aiders and abettors as defendants. These procedural and substantive advantages may not be available if the plaintiff chooses to bring a civil claim under federal law.

Endnotes

[1]Wisconsin Uniform Securities Law, Wis. Stat. ch. 551 (2007-08). All references to the Wisconsin Statutes are to the 2007-08 version, unless otherwise noted.

[2]The USA 2002 was drafted by the National Conference of Commissioners on Uniform State Laws. The USA 2002 revised and updated the model Uniform Securities Act of 1956, incorporated aspects of the little-adopted Revised Uniform Securities Act of 1985, and incorporated preemption principles instituted by the National Securities Markets Improvements Act of 1996. The main objectives of the USA 2002 were to increase uniformity among state securities laws; aid cooperation among relevant state, federal, and self-regulatory agencies; clarify the parameters of state and federal jurisdiction; and facilitate electronic submission of records, signatures, and filings. To date, 15 states have adopted the USA 2002.

[3]Wis. Stat. § 551.102(28)(e).

[4]Wis. Stat. § 551.102(8), (25), (30).

[5]Wis. Stat. § 551.401(1).

[6]Wis. Stat. § 551.102(4).

[7]Wis. Stat. § 551.401(2). The term *institutional investor* under the WUSA includes banks and other financial institutions, for-profit and nonprofit entities, qualified institutional buyers under Rule 144A, major U.S. institutional buyers under Rule 15a-6, and any other entities of an institutional character with total assets in excess of $10 million.

[8]Wis. Stat. § 551.402(2).

[9]Wis. Stat. §§ 551.603, .604.

[10]Wis. Stat. § 551.509(10).

[11]*See Brown v. Earthboard Sports USA Inc.*, 481 F.3d 901 (6th Cir. 2007); *In re Blue Flame Energy Corp.*, 871 N.E.2d 1227 (Ohio Ct. App. 2006); *Consolidated Mgmt. Group LLC v. Department Corp.*, 75 Cal. Rptr. 3d 795 (Ct. App. 2008); *Risdall v. Brown-Wilbert Inc.*, 753 N.W.2d 723 (Minn. 2008).