THE REAL ESTATE SECURITIES JOURNAL®

VOLUME 6; NUMBER 2 1985

The Real Estate Syndicator as a Securities Broker-Dealer

By Marc H. Morgenstern

REAL ESTATE SECURITIES AND SYNDICATION INSTITUTE®

The Real Estate Syndicator As a Securities Broker-Dealer

By Marc H. Morgenstern

Section 15[1] of the Securities Exchange Act of 1934, as amended (the "Exchange Act") provides that no person can make use of the mails or interstate commerce to purchase or sell any security unless such person is registered as a broker-dealer in accordance with section 15(b)[2] of the Exchange Act. Limited partnership interests sold in real estate syndications are "investment contracts"[3] and, therefore, constitute securities within the meaning of the Securities Act of 1933, as amended[4] (the "Securities Act") and the Exchange Act.[5] Most state blue sky laws similarly define an investment contract as a security.[6] A general partner selling limited partnership interests in the partnership of which he is a general partner must accordingly register as a broker-dealer absent an applicable exemption. Federal law, and most state law,[7] indicates that even when sale of the security is exempt from registration, the person selling the security must nonetheless be a registered broker-dealer.

General partners of limited partnership syndications who sell their own securities have attempted to avoid federal registration as a broker-dealer by relying on either the "intrastate" or "issuer" exemptions. Section 15 of the Exchange Act expressly exempts intrastate brokers from registration so that a general partner can sell their own securities provided that the sales are exclusively intrastate and, in most instances, that the general partner registers with the state as a broker-dealer. The federal issuer exemption is a definitional exemption provided in section 3(a)(4)[8] of the Exchange Act, which may be applicable on a limited basis to those general partners who restrict their selling activities solely to their own partnerships. This article explores the parameters of each exemption and concludes that for both legal and business considerations a general partner actively engaged in the business of selling securities would be ill-advised to long rely upon either statutory federal exemption,[9] and accordingly, should register as a broker-dealer.[10]

Intrastate Exemption

Section 15(a)[11] provides that brokers "whose business is exclusively intrastate and who do not use the national exchanges . . ." do not have to register with the Securities and Exchange Commission (the "SEC"). In the words of the SEC,

Marc H. Morgenstern is a principal in the Cleveland, Ohio law firm of Kahn, Kleinman, Yanowitz & Arnson Co., L.P.A. Mr. Morgenstern received his B.A. in 1972 from Yale University and his J.D. from Boston University in 1975.

"the intrastate exception from broker-dealer registration is highly restricted and... depend[s] upon full compliance with the conditions of its applicability."[12] The SEC has summarized the requirements as follows:

> Provided there is no use of any facility of a national securities exchange, the determination whether a broker-dealer is engaged in an exclusively intrastate business and is thus exempt from the broker-dealer registration requirement depends principally on the location and residence of all the broker-dealer's customers, including the issuer of any securities being distributed. It must be stressed that the term "exclusively" is strictly and literally construed. In order for the exemption to be available, all the broker-dealer's customers must be residents of and located in, or (in the case of an issuer where the broker-dealer is participating in a distribution) resident and doing business within, the state of the broker's own residence, where the offering and the sales of the securities are to take place.[13]

The availability of the exemption hinges on: (1) the residence of the broker's customers; and (2) the residence of the issuer.

The standards for determining whether the customers of a broker are residents of a state are analogous to the standards developed for the intrastate exemption of section 3(a)(11) of the Securities Act[14] from registration of certain securities, and the safe-harbor provisions of Rule 147[15] promulgated thereunder. Individuals are residents of the state where they have their principal residence.[16] Entities (including corporations, partnerships, and trusts) are residents of the state where the principal office of the entity is located,[17] provided that the entity was not formed for the specific purpose of acquiring the security.[18] Thus, a general partner of an issuer who wishes to avail himself of the intrastate exemption can satisfy the initial prerequisite for that exemption by confining offers of limited partnership interests solely to residents of the state in which the broker-dealer is organized and conduct its own business.

Compliance with the second aspect of the test is somewhat more difficult. Under federal securities law, the issuer itself is deemed to be a customer of the broker-dealer. Rule 147 indicates that the issuer is deemed to be doing business in a state if the issuer: (1) derives at least 80% of its gross revenues from within that state; (2) had at least 80% of its aspects in the state at the end of its most recent semiannual fiscal period; and (3) intends to, and in fact does, use at least 80% of the net proceeds from sales of the securities in connection with operations within the state.[19] Thus, where an issuer proposes an acquisition of a specified property located in the state where the broker does business, and a limited partnership is formed pursuant to the laws of such state, an intrastate broker-dealer could sell limited partnership interests therein in compliance with the intrastate exemption.[20]

Attention must be paid, however, to the ongoing activities of the general partner of the issuer to determine whether an intrastate broker can sell the securities of the issuer. SEC no-action letters have indicated that where a general partner has confined its activities with respect to a particular issue to a single state and offered

and sold its own securities only in such state, the availability of the intrastate broker-dealer exemption was nonetheless subject to other transactions involving the general partner.[21] The SEC responded to an inquiry from Boetel & Co. which had previously formed several real estate limited partnerships under the laws of Nebraska and distributed the limited partnership interests in them exclusively to residents of Nebraska. Boetel contemplated forming future limited partnerships which would be "interstate in nature" either because the real estate projects would be outside Nebraska, the investors would not be from Nebraska, or both. At the same time, Boetel intended to continue to organize offerings limited to the State of Nebraska. The SEC concluded that the intrastate broker-dealer exemption would no longer be available to Boetel with respect to the exclusively intrastate offerings because the general partner's overall business would no longer be "exclusively intrastate."[22]

The strict scrutiny to which the intrastate exemption is subject is emphasized in other SEC interpretations.[23] In a no-action letter issued to National Educator's Group, Inc.[24] the SEC declared that the intrastate exemption is not available to any officer, director, or employee of an issuer when such person has previously engaged in a securities business in a state other than the state in which the issuer proposes to offer its securities. Thus, even a syndicator who had complied with the intrastate broker-dealer exemption in the state of Florida for many years, who subsequently desired to move his activity to California and who would be willing to confine his future activities to the state of California, would be unable to qualify for the intrastate broker-dealer exemption in California.

As the foregoing discussion indicates, an active general partner will face several difficulties in maintaining his status as an intrastate broker-dealer. First, he will only be able to deal in the acquisition of real property within a single state. Second, his offerees and customers will be restricted to that state. Syndicators in certain large states, such as Texas or California, may be able to avail themselves of the intrastate broker-dealer exemption over an extended period of time. Acquisition and development work can be limited to the state, and because of the large and relatively affluent population base, capital can be raised without the necessity of crossing state borders. Syndicators operating in smaller states, such as Massachusetts or Rhode Island, will find adherence to the exemption more restrictive. In the normal flow of commerce, numerous potential investors in Boston projects are residents of New Hampshire, Rhode Island, or other states in near geographic proximity. General partners who comply with the exemption by continuing to operate within a single state may well deprive themselves of access to natural sources of capital as well as properties located in other states which would otherwise be appropriate for their programs.

The final factor militating against extended reliance on the exemption is that the exemption is difficult to obtain, and maintain, as a matter of law. The broker-dealer must police its offerees and customers, sales force, officers, directors, and employees, as well as the issuer and the issuer's business. Constant diligence is required by the broker-dealer who wishes to rely on the intrastate exemption.

While compliance is possible, the limitations imposed on the intrastate broker-dealer are highly restrictive. The broker-dealer choosing to rely on the exemption must voluntarily forego access to desirable capital and product. With the relative ease of obtaining and maintaining federal broker-dealer registration under the Direct Participation Program ("DPP") broker-dealer license,[25] it is hard to imagine why a broker (whether a captive to a General Partner or not) would choose to rely on the intrastate exemption. This conclusion is reinforced by the fact that in most instances the intrastate broker-dealer will register with the state where he operates and therefore will have to comply with numerous regulations despite his federal exemption.

Issuer Exemption

The second statutory exemption available to a general partner who wants to sell limited partnership interests in his own partnerships but does not want to register with the SEC as a broker-dealer is the "issuer" exemption. Section 3(a)(4)[26] of the Exchange Act defines the term "broker" as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." The term "dealer" is similarly defined in section 3(a)(5)[27] as "any person engaged in the business of buying and selling securities for his account, through a broker or otherwise but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business." Historically, when an issuer of securities has distributed its own securities through its regular officers, employees and directors, the SEC and the courts have interpreted the definition so that the issuer would neither have to register as a broker or a dealer.

The more difficult question has persisted, however, as to when persons acting on behalf of the issuer in the distribution constitute "brokers," who would themselves be subject to registration. Such employees are clearly effecting transactions in securities for the account of another (*i.e.*, the issuer). Both by SEC interpretation, and through the issuance of a new, non-exclusive, safe harbor Rule 3a4,[28] the SEC has attempted to delineate those circumstances when persons assisting the issuer do not constitute "brokers" within the meaning of the Exchange Act. The inquiry has primarily focused on three major criteria: (1) whether the person is "engaged in the business" of selling securities; (2) whether a person is receiving compensation solely in exchange for selling securities; and (3) whether the issuer is selling all of its securities by itself or in conjunction with a registered broker-dealer.

Engaged in the Business

The first issue is whether a person is a broker because he is "engaged in the business" of effecting transactions in securities. The phrase suggests either that a

person sells securities on a regular basis, or sells sufficient quantities of securities, so that he is involved in a continuous business. The courts and the SEC, however, have consistently maintained that there is no requirement that the activity of selling securities constitutes a person's principal business or source of income in order for him to be engaged in the business of selling securities. Furthermore, there is no requirement that the compensation derived from the sale of securities represents a substantial portion of the person's income before he is deemed to be a broker. Thus, where a contractor/developer repeatedly sold interests in various real estate projects as a regular part of his business, the SEC staff concluded that he was a "dealer."[29] In addition, repeated activities of persons effecting transactions for a series of "issuers" or "even a single issuer"[30] may suggest that the persons engaged in the distribution process "are doing so as part of a regular business and are therefore brokers within the meaning of section 3(a)(4)."[31]

In *UFITEC, S.A.* v. *Carter,*[32] plaintiff, a Swiss banking corporation, contended that it was not a broker or dealer because its security transactions were "a relatively small part of its investment banking and placement activity."[33] The court disagreed with this contention and held that there is no requirement that a person's primary activity be that of a seller of securities in order to be a broker.[34] Whether an issuer sells its own securities in a single transaction, or in a series of transactions, the intention of the statute is to regulate the activity of those who engage in the business of purchasing and selling securities. Whether those activities constitute one percent of their time, or one hundred percent of their time, such conduct falls within the purview of the Exchange Act and the practices it seeks to regulate.

Compensation to Employees

The second principal issue which the SEC has addressed has been the right of an issuer to compensate its employees in connection with selling securities. The staff has repeatedly opined that the issuer exemption is not available where employees were either retained solely or primarily for the purpose of selling securities, or received compensation based specifically on their performance in selling securities.[35] The SEC has emphasized that the persons engaged in selling securities must have substantially full-time activities with the issuer, other than the sale of securities, which continue beyond the termination of the distribution period of the securities,[36] in order for such individuals to be properly classified as employees.

Exclusivity of Issuer Exemption

The third major issue has been the availability of the issuer exemption where the issuer is also employing the services of a registered broker. The SEC staff has determined that the issuer exemption is not exclusive, and therefore an issuer can sell its own securities while simultaneously employing a registered broker to distribute the same securities without rendering the exemption unavailable.[37] While the employees of both the issuer and the broker can sell the same securities,

the issuer's employees cannot supervise the broker's employees or the broker's activities.[38] The additional aspect of supervision would suggest that the issuer's employees are engaging in the business of selling securities.

New Rule 3a4-1

To clarify the issuer exemption, the SEC recently adopted Rule 3a4-1 (the "Rule") which was first proposed in 1977,[39] revised in 1984,[40] and finally adopted in July, 1985. The text of the Rule is set forth in Appendix A. The Rule delineates those circumstances under which an associated person of an issuer will not be deemed to be a broker solely by reason of his participation in the sale of the issuer's securities. The Rule provides that only certain persons can avail themselves of the exemption and such persons can only rely on the exemption in specified circumstances.

Who Can Use the Rule?

The issuer exemption is available to officers, directors, partners and/or employees of an issuer,[41] and is limited to natural persons.[42] The exemption is similarly available to a corporate general partner of a limited partnership, as well as a company or a partnership that controls, "is controlled by, or is under common control with, the issuer."[43] One of the major benefits of the Rule, which differs from the 1977 release, is the inclusion of this control concept. The Rule makes clear that the issuer exemption applies both to the issuing limited partnership as well as employees of a corporate general partner of such partnership.

An individual who satisfies the foregoing conditions must nonetheless fulfill three additional prerequisites. The individual: (1) must not be subject to a statutory disqualification within the meaning of section 3(a)(39) of the Exchange Act at the time of his participation; (2) cannot be compensated, directly or indirectly, in connection with his participation by payment of commissions or other compensation based on such transactions; and (3) cannot, at the time of the sale of the securities, be an "associated person of a broker or dealer."[44] This latter rule eliminates numerous persons who are full-time registered representatives for a brokerage house but who occasionally serve as general partners in a syndication. Because their primary employment involves selling securities, it would be inappropriate to permit them to rely on the issuer exemption, the theoretical lynchpin of which is that the person relying on the exemption is not engaged in the business of selling securities.

Assuming satisfaction of all of these conditions, then the Rule provides for three safe harbors, compliance with which will ensure that neither the issuer nor those persons effecting a distribution of securities on its behalf need register as a broker.

Safe Harbor Provisions

The first safe harbor, provided by section 3a4-1a(i), is a transactional exemption normally inapplicable to a seller of real estate securities. The provision exempts from broker registration those persons effecting offers to broker-dealers, investment companies, and savings and loans. It likewise eliminates broker registration requirements for persons involved in certain transactions (securities issued from a bankruptcy proceeding, or an exchange by an issuer of its own securities with existing shareholders), Rule 145 or merger transactions, or sales to an issuer's own employee profit sharing plan.

The second and third safe harbor provisions, by contrast, are applicable in virtually every real estate syndication where the issuer is selling for its own benefit. These provisions echo the guidelines long established by the SEC in its no-action letters.

Section 3a4-1(a)(ii) provides that a person who: (1) performs "substantial duties otherwise than in connection with transactions in securities," (2) who has not been a broker-dealer, investment adviser, an associated person of a broker-dealer, or an investment adviser within the last 12 months, and (3) who has not made any sales for an issuer within the last 12 months [except in reliance on paragraph (a)(4)(i) or (a)(4)(iii)] will not be deemed to be a broker.

Each of the three conditions is important. First, the Rule codifies the long-standing SEC position that an issuer cannot hire a person to act as a salesman for the duration of an offering and consider such a person a full-time employee of the issuer for whom the exemption is available. Second, by making the exemption unavailable to associated persons who previously worked for a broker or dealer within the one-year period preceding the offering, the Rule makes clear that an issuer cannot indirectly hire a broker-dealer and still utilize the issuer exemption. This change eliminates the temptation of a general partner to hire an employee of a broker-dealer, state that they intend to retain such person full-time, and then terminate them shortly after the offering. Presumably, the one-year period allows a cooling-off period so that retention of a former broker-dealer is not a disguised method of hiring a broker-dealer.

The last condition in section 3a4-1(a)(ii) makes the issuer exemption available only once in any 12-month period. For any reasonably active issuer of real estate limited partnership interests, this limitation should provide the death knell for reliance on the issuer exemption. Only those issuers who engage in sales on a relatively infrequent or sporadic basis will be able to continue to avail themselves of the issuer exemption.

The final safe harbor provision, enunciated in section 3a4-1(a)(iii), relates to those persons who perform primarily ministerial or clerical work. Those employees of an issuer who prepare written communications (subject to approval by a partner, officer, or director of the issuer), respond to inquiries from prospective purchasers (rather than initiate conversations), or perform other essentially ministerial or clerical work will not be deemed to be persons requiring registration

as a broker under federal securities law. Thus, secretaries, office workers, and other non-sales related employees of an issuer can perform primarily mechanical tasks in connection with an issuer's distribution without fear that they are engaging in the business of selling securities.

Conclusion

The intrastate exemption from broker-dealer registration retains its vitality for those syndicators who are prepared to limit their acquisition, development and selling activities to a single state. If that limitation on their business does not unduly restrict them, then such issuers can continue to register solely with the state and avoid registration with the SEC.

The adoption of the Rule, however, clearly circumscribes the continued availability of the issuer exemption. While the Rule was pending, many syndicators took the position that the issuer exemption was available no matter how frequently the issuer, the general partners, or their affiliates engaged in the sale of real estate securities. The overall impact of the Rule, particularly section 3a4-1a(ii), however, eliminates that interpretation. General partners selling limited partnership interests in two separate partnerships in a 12-month period cannot rely upon the safe harbor issuer exemption. Accordingly, active and prudent general partners will either have to avail themselves exclusively of the intrastate broker-dealer exemption, register as a broker-dealer pursuant to the Exchange Act, or retain a registered broker-dealer to sell their securities. Because of the expense and inconvenience of retaining outside broker-dealers, many active general partners would be well advised to form captive DPP broker-dealers to sell their own securities.

It would appear that the growth of real estate syndication as an increasingly national business, coupled with the promulgation of the Rule, has substantially diminished whatever vitality the federal broker-dealer exemptions ever possessed.

REFERENCES

1. Section 15(a)(1) provides:
   It shall be unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer which is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempt security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered in accordance with subsection (b) of this Section. 15 U.S.C. §78(o)(a)(1).
2. 15 U.S.C. §78(o)(b).

3. Section 2(1) of the Securities Act defines a security as "any . . . investment contract. . . ." 15 U.S.C. § 77(b)(1)(1976).
4. 15 U.S.C. §77(a) *et seq.* (1976).
5. 15 U.S.C. §78(a) *et seq.* (1976).
6. The Uniform Securities Act defines a security as "any . . . investment contract; . . ."UNIFORM SECURITIES ACT § 401(A).
7. Some states have established a broker-dealer exemption for persons selling a security in a private placement transaction exempt from registration pursuant to section 4(2) of the Securities Act. As an example, *see* Florida Securities Act, FLA. STAT. ANN. §517.12(3) which provides that the registration requirements with respect to registration of dealers, associated persons and investment advisers does not apply in a transaction exempted by sections 517.061(1)-(12), (14), and (15), which includes the Florida private placement exemption as well as sales under section 4(1) of the Securities Act, isolated sales, and sales to banks, among other exemptions.
8. Section 3(a)(4) of the Exchange Act provides that "[t]he term 'broker' means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." 15 U.S.C. § 78 (c)(a)(4).
9. This article does not address the issue of whether the general partner, or a captive affiliate of the general partner, must register under state law. A broker relying upon the intrastate broker-dealer exemption at the federal level must ordinarily register as a broker-dealer with the state within which he operates, absent an applicable state exemption. There is, in certain states, a definitional exemption under state law comparable to the federal issuer exemption. The Uniform Securities Act states that the term "broker-dealer" does not include "an issuer." UNIFORM SECURITIES ACT, § 401(c). In addition, some states eliminate registration requirements for sellers of securities in a private placement transaction. *Supra,* note 7.
10. Failure to register with the SEC as a broker-dealer pursuant to the requirements of the Exchange Act exposes the unregistered broker-dealer to substantial liability.

    > . . . a person found to be an unregistered securities broker faces serious possible liabilities, including injunctions, criminal sanctions, damage suits and contract rescissions, through actions instituted by the SEC, the United States Department of Justice, or by private parties to the transactions. Ellsworth, *Liability Under the 1934 Act for an Unregistered Broker-Dealer,* 1 R.E.SEC.J. 59, 60 (Fall, 1980).

11. Section 15(a) provides that:

    > It shall be unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer . . . (other than such a broker or dealer whose business is *exclusively* intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of

interstate commerce to effect . . . the purchase or sale of, any security . . . unless such broker or dealer is registered in accordance with subsection (b) of this Section. (emphasis added) 15 U.S.C. §78(o)(a).

12. SEC legislation, 1963, hearings before Subcommittee of Senate Committee on Banking and Commerce on S. 1642, 88th Cong., First Sess. (1963) 388; S. Rep. No. 379, 88th Cong., First Sess. (1963) 47.
13. SEC No-Action Letter, Allied Real Estate Securities, Inc. (January 15, 1977).
14. Section 3(a)(11) of the Securities Act provides that the registration provisions of the Securities Act do not apply to a class of securities when the security "is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident, and doing business within, or if a corporation, incorporated by and doing business within, such State or Territory," 15 U.S.C. §77(c)(a)(11) (1976).
15. 17 C.F.R. §230.147 (1981).
16. 17 C.F.R. §230.147(d)(2) (1981).
    (d)(2) An individual shall be deemed to be a resident of a state or territory if such individual has, at the time of the offer and sale to him, his principal residence in the state or territory.
17. 17 C.F.R. §230.147(d)(1) (1981).
    (d)(1) A corporation, partnership, trust or other form of business organization shall be deemed to be a resident of a state or territory if, at the time of the offer and sale to it, it has its principal office within such state or territory.

    It should be noted that the state of residence is defined differently for purposes of offerees and purchasers than for the issuer. The issuer is a resident of the state where it has its principal office, and it is incorporated or organized if it is an entity organized under state or territorial law. 17 C.F.R. §230.147(c)(1) (1981).
18. 17 C.F.R. §230.147(d)(3) (1981).
    . . . (3) A corporation, partnership, trust or other form of business organization which is organized for the specific purpose of acquiring part of an issue offered pursuant to this rule shall be deemed not to be a resident of a state or territory unless all of the beneficial owners of such organization are residents of such state or territory.
19. 17 C.F.R. §230.147(c) (1981).
    (c) *Nature of the Issuer.* The issuer of the securities shall at the time of any offers and the sales be a person resident and doing business within the state or territory in which all of the offers, offers to sell, offers for sale and sales are made.

    (1) The issuer shall be deemed to be a resident of the state or territory in which:

    (i) It is incorporated or organized, if a corporation, limited partnership,

trust or other form of business organization that is organized under state or territorial law;
(ii) Its principal office is located, if a general partnership or other form of business organization that is not organized under any state or territorial law;
(iii) His principal residence is located if an individual.
(2) The issuer shall be deemed to be doing business within a state or territory if:
(i) The issuer derived at least 80 percent of its gross revenues and those of its subsidiaries on a consolidated basis.
(A) For its most recent fiscal year, if the first offer of any part of the issue is made during the first six months of the issuer's current fiscal year; or
(B) For the first six months of its current fiscal year or during the twelve month fiscal period ending with such six month period, if the first offer of any part of the issue is made during the last six months of the issuer's current fiscal year from the operation of a business or of real property located in or from the rendering of services within such state or territory; provided, however, that this provision does not apply to any issuer which has not had gross revenues in excess of $5,000 from the sale of products or services or other conduct of its business for its most recent twelve month fiscal period;
(ii) The issuer had at the end of its most recent semi-annual fiscal period prior to the first offer of any part of the issue, at least 80 percent of its assets and those of its subsidiaries on a consolidated basis located within such state or territory;
(iii) The issuer intends to use and uses at least 80 percent of the net proceeds to the issuer from sales made pursuant to this rule in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; and
(iv) The principal office of the issuer is located within such state or territory.

20. It would even be theoretically possible to conduct an intrastate blind-pool offering provided that all acquisitions of real property would be limited to a single state.
21. SEC No-Action Letter, Boetel & Co. (August 30, 1971).
22. *Id.*
23. For a sampling of other no-action letters dealing with the issue of the intrastate broker-dealer exemption, *see,* SEC No-Action Letter, Corporate Investment Company (July 18, 1984) (where the issuer filed an S-1 Registration Statement, but voluntarily restricted sales to Pennsylvania, the intrastate broker-dealer exemption was available); SEC No-Action Letter, North Albuquerque Associates (August 18, 1978) (where limited partnership units were offered only to New Mexico residents, by full-time employees of the issuer who were

also New Mexico residents, and a "cooling off" period separated such sales from activities conducted outside of such state, the SEC did not recommend enforcement activity); SEC No-Action Letter, Winchester Securities Corporation (April 1, 1971) (without further information, the SEC was not able to conclude that a broker-dealer which was a continuation of an interstate business, could operate prospectively as an intrastate broker-dealer.)

24. SEC No-Action Letter, National Educator's Group, Inc. (November 17, 1977).
25. For articles discussing the mechanics of obtaining and maintaining registration as a DPP broker-dealer, *see* Cole and Mayo, *Supervisory Procedures for the Direct Participation Program Broker,* 4 R.E.SEC.J. 38 (Winter, 1983); Augustine, Fass, Robinson, and Bachman, *Licensing a Broker-Dealer Firm for Real Estate Syndication Purposes,* 4 SEC. REG. L.J. 89 (1976).
26. 15 U.S.C. §78(c)(a)(4).
27. 15 U.S.C. §78(c)(a)(5).
28. Securities Act Release No. 34-22172, 17 C.F.R. 240.3a4-1 (1985).
29. SEC No-Action Letter, Hofheimer, Gartlir, Gottlieb & Gross (Nov. 12, 1982); *c.f.,* SEC No-Action Letter, Castleman & Co. (July 15, 1983).
30. Securities Act Release No. 34-13195, 17 C.F.R. 240.3a4-1 (1977).
31. *Id.*
32. UFITEC, S.A. v. Carter, CCH Fed. Sec. L. Rep. [1977-1978 Transfer Binder] ¶96,252 (S.C. Cal. 1977).
33. *Ibid.* p. 29,682.
34. In applying the margin requirements of the Exchange Act to the transaction, the court noted that the essential purposes intended by the margin requirements would be effectively defeated "if large business in this Country were permitted to use a small percentage of their total activity to lend in excess of the margin requirement." *Id.*
35. For an example of the numerous staff interpretations granting no-action requests predicated on the issuer's representation that the employees effecting the distribution of securities would not receive compensation, *see* SEC No-Action Letter, China Trade Corporation (July 24, 1978); SEC No-Action Letter, Jammer Cycle Products, Inc. (July 26, 1973); SEC No-Action Letter, Choice Communities, Inc. (December 29, 1972); SEC No-Action Letter, The Woodmar Corporation (February 3, 1972).
36. *See, e.g.,* SEC No-Action Letter, Midland-Guardian CO. (November 27, 1978); SEC No-Action Letter, ITT Financial Corporation (July 15, 1978); SEC No-Action Letter, DeMatteis Development Corporation (September 2, 1971).
37. SEC No-Action Letter, Midland-Guardian Co. (December 27, 1978).
38. SEC No-Action Letter, Jammer Cycle Products, Inc. (July 26, 1973).
39. Securities Act Release No. 34-13195 (1977).
40. Securities Act Release No. 34-20943 (1984).
41. Reg. §240.3a4-1(c)(1)(i).

42. *Id.*
43. Reg. §240.3a4-1(c)(1)(ii) and (iii).
44. The Rule provides that:

> ... The term "associated person of a broker or dealer" means any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial and any person who is required under the laws of any state to register as a broker or dealer in that state solely because such person is an issuer of securities shall not be included in the meaning of such term for purposes of this Rule 3a4-1. Reg. §240.3a4-1(c)(2).

APPENDIX A

Associated Persons of an Issuer Deemed Not to be Brokers

Reg. §240.3a4-1 (a) An associated person of an issuer of securities shall not be deemed to be a broker solely by reason of his participation in the sale of the securities of such issuer if the associated person:

(1) Is not subject to a statutory disqualification, as that term is defined in Section 3(a)(39) of the Act, at the time of his participation; and

(2) Is not compensated in connection with his participation by the payment of commissions or other remuneration based either directly or indirectly on transactions in securities; and

(3) Is not at the time of his participation an associated person of a broker or dealer; and

(4) Meets the conditions of any one of paragraphs (a)(4)(i), (ii), or (iii) of this section.

(i) The associated person restricts his participation to transactions involving offers and sales of securities:

(A) To a registered broker or dealer; a registered investment company (or registered separate account); an insurance company; a bank; a savings and loan association; a trust company or similar institution supervised by a state or federal banking authority; or a trust for which a bank, a savings and loan association, or trust company, or a registered investment adviser either is the trustee or is authorized in writing to make investment decisions; or

(B) That are exempted by reason of Section 3(a)(7), 3(a)(9) or 3(a)(10) of the Securities Act of 1933 from the registration provisions of that Act; or

(C) That are made pursuant to a plan or agreement submitted for the vote or consent of the security holders who will receive securities of the issuer in connection

with a reclassification of securities of the issuer, a merger or consolidation or a similar plan of acquisition, involving an exchange of securities, or a transfer of assets of any other person to the issuer in exchange for securities of the issuer; or

(D) That are made pursuant to a bonus, profit-sharing pension, retirement, thrift, savings, incentive, stock purchase, stock ownership, stock appreciation, stock option, dividend reinvestment or similar plan for employees of an issuer or a subsidiary of the issuer.

(ii) The associated person meets all of the following conditions:

(A) The associated person primarily performs, or is intended primarily to perform at the end of the offering, substantial duties for or on behalf of the issuer otherwise than in connection with transactions in securities; and

(B) The associated person was not a broker or dealer, or an associated person of a broker or dealer, within the preceding 12 months; and

(C) The associated person does not participate in selling of securities for any issuer more than once every 12 months other than in reliance on paragraphs (a)(4)(i) or (a)(4)(iii)of this section, except that for securities issued pursuant to Rule 415 under the Securities Act of 1933, the 12 months shall begin with the last sale of any security included within one Rule 415 registration.

(iii) The associated person restricts his participation to any one or more of the following activities:

(A) Preparing any written communication or delivering such communication through the mails or other means that does not involve oral solicitation by the associated person of a potential purchaser; *provided, however,* that the content of such communication is approved by a partner, officer or director of the issuer;

(B) Responding to inquiries of a potential purchaser in a communication initiated by the potential purchaser; *provided, however,* that the content of such responses are limited to information contained in a registration statement filed under the Securities Act of 1933 or other offering document; or

(C) Performing ministerial and clerical work involved in effecting any transaction.

(b) No presumption shall arise that an associated person of an issuer has violated Section 15(a) of the Act solely by reason of his participation in the sale of securities of the issuer if he does not meet the conditions specified in paragraph (a) of this section.

(c) *Definitions.* When used in this section:

(1) The term "associated person of an issuer" means any natural person who is a partner, officer, director, or employee of:

(i) The issuer;

(ii) A corporate general partner of a limited partnership that is the issuer;

(iii) A company or partnership that controls, is controlled by, or is under common control with, the issuer; or

(iv) An investment adviser registered under the Investment Advisers Act of 1940 to an investment company registered under the Investment Company Act of 1940 which is the issuer.

(2) The term "associated person of a broker of dealer" means any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial and any person who is required under the laws of any state to register as a broker or dealer in that state solely because such person is an issuer of securities or associated person of an issuer of securities shall not be included in the meaning of such term for purposes of this section.