

Senate Bill No. 978

CHAPTER 669

An act to amend Section 10232.5 of, and to add Sections 10232.3 and 10232.45 to, the Business and Professions Code, and to amend Sections 25102 and 25113 of, and to add Section 25102.2 to, the Corporations Code, relating to securities transactions.

[Approved by Governor September 27, 2012. Filed with
Secretary of State September 27, 2012.]

LEGISLATIVE COUNSEL'S DIGEST

SB 978, Vargas. Securities transactions: exemption from qualification requirements.

(1) Existing law, the Corporate Securities Law of 1968, regulates the offer and sale of securities in this state by the Commissioner of Corporations. Existing law requires an issuer of securities to qualify with the commissioner the offer and sale of securities unless the transaction is subject to one of several specified exemptions from the qualification requirements. A willful violation of these provisions is a crime.

Existing law exempts from the qualification requirements the offer or sale of any security made to no more than 35 people, as specified, and allows the commissioner to require the issuer to file a notice of transactions. Existing law provides that the exemption remains available to an issuer that fails to file the notice or files the notice after the time specified by the commissioner. Existing law requires an issuer relying on that exemption to file a notice within 15 business days following discovery of the failure to timely file the notice, or after demand of the commissioner, whichever is earlier.

This bill would require the commissioner to require the issuer to file a notice of transactions in connection with that exemption.

Existing federal law defines the term "accredited investor," for purposes of regulating securities transactions, including determining whether an offer and sale of securities is required to be registered pursuant to the federal Securities Act of 1933.

This bill would require the commissioner to require an issuer that relies upon a specified exemption from the qualification requirements and that is principally engaged in the business of purchasing, selling, financing, or brokering real estate, for an offering to any person who is not an accredited investor in a transaction that is not registered pursuant to the Securities Act of 1933, to provide information regarding the nature of the proposed offering on a form prescribed by the commissioner, as specified. That information would include, but not be limited to, the offering disclosure documents provided to prospective investors, and the names of the officers and directors of a corporate issuer and, in the case of other types of issuers, the names of

other specified persons. The bill would also require the commissioner to prepare an annual report regarding the securities offerings and sales authorized by permit issued by the commissioner under specified provisions of existing law and to make the report publicly available by posting the report on the Internet Web site of the Department of Corporations.

(2) Existing law exempts from the qualification requirements, subject to complying with specified requirements, a transaction that involves the sale of a series of notes secured directly by an interest in real property or the sale of undivided interests in a note secured directly by real property equivalent to a series transaction, having no more than 10 investors. Existing law requires a real estate broker to indicate in the real estate broker's transaction file the provisions of law pertaining to qualification or exemption from qualification under which a transaction is being conducted. Existing law requires a real estate broker to file certain information with the commissioner relative to conducting these transactions that are exempt from qualification. Existing law requires a real estate broker to submit a copy of the information in the real estate broker's transaction file relative to qualification or exemption from qualification for a transaction to any investor from whom the real estate broker obtains funds in connection with the transaction.

This bill would require that a transaction that involves the sale of a note secured directly by an interest in real property or the sale of an undivided interest in a note secured directly by real property equivalent to a series transaction be conducted in compliance with those requirements.

(3) Existing law, the Real Estate Law, requires a real estate broker negotiating a loan, as specified, secured by a lien on real property or a business opportunity or the sale of a real property sales contract or promissory note secured directly or collaterally by a lien on real property, to provide a disclosure statement, containing specified information regarding the proposed transaction, to a prospective lender or a prospective purchaser, respectively. A willful violation of the Real Estate Law is a crime.

This bill would add to the information required to be included in the disclosure statement a statement that the broker has a responsibility to make reasonable efforts to determine that the loan or the purchase, respectively, is a suitable and appropriate investment for the lender or purchaser, respectively.

Because this bill would expand the scope of existing crimes, the bill would impose a state-mandated local program.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

The people of the State of California do enact as follows:

SECTION 1. Section 10232.3 is added to the Business and Professions Code, to read:

10232.3. (a) Any transaction that involves the sale of or offer to sell a note secured directly by an interest in one or more parcels of real property or the sale of an undivided interest in a note secured directly by one or more parcels of real property shall adhere to all of the following:

(1) Except as provided in paragraph (2), the aggregate principal amount of the note or interest sold, together with the unpaid principal amount of any encumbrances upon the real property senior thereto, shall not exceed the following percentages of the current market value of each parcel of the real property, as determined in writing by the broker or appraiser pursuant to Section 10232.6, plus the amount for which the payment of principal and interest in excess of the percentage of current market value is insured for the benefit of the holders of the note or interest by an insurer admitted to do business in this state by the Insurance Commissioner:

- (A) Single-family residence, owner occupied..... 80%
- (B) Single-family residence, not owner occupied..... 75%
- (C) Commercial and income-producing properties..... 65%
- (D) Single-family residentially zoned lot or parcel which has installed offsite improvements including drainage, curbs, gutters, sidewalks, paved roads, and utilities as mandated by the political subdivision having jurisdiction over the lot or parcel..... 65%
- (E) Land that has been zoned for (and if required, approved for subdivision as) commercial or residential development..... 50%
- (F) Other real property..... 35%

(2) The percentage amounts specified in paragraph (1) may be exceeded when and to the extent that the broker determines that the encumbrance of the property in excess of these percentages is reasonable and prudent considering all relevant factors pertaining to the real property. However, in no event shall the aggregate principal amount of the note or interest sold, together with the unpaid principal amount of any encumbrances upon the property senior thereto, exceed 80 percent of the current fair market value of improved real property or 50 percent of the current fair market value of unimproved real property, except in the case of a single-family zoned lot or parcel as defined in paragraph (1), which shall not exceed 65 percent of the current fair market value of that lot or parcel, plus the amount insured as specified in paragraph (1). A written statement shall be prepared by the broker that sets forth the material considerations and facts that the broker relies upon for his or her determination, which shall be retained as a part of the broker's record of the transaction. Either a copy of the statement or the information contained therein shall be included in the disclosures required pursuant to Section 10232.5.

(3) A copy of the appraisal or the broker's evaluation, for each parcel of real property securing the note or interest, shall be delivered to the purchaser. The broker shall advise the purchaser of his or her right to receive a copy. For purposes of this paragraph, "appraisal" means a written estimate of value based upon the assembling, analyzing, and reconciling of facts and value indicators for the real property in question. A broker shall not purport to make an appraisal unless the person so employed is qualified on the basis of special training, preparation, or experience.

(4) For construction or rehabilitation loans, where the amount withheld for construction or rehabilitation at the start of the project exceeds one hundred thousand dollars (\$100,000), the term "current market value" may be deemed to be the value of the completed project if all of the following safeguards are met:

(A) An independent neutral third-party escrow holder is used for all deposits and disbursements relating to the construction or rehabilitation of the secured property.

(B) The loan is fully funded, with the entire loan amount to be deposited in escrow prior to recording of the deed or deeds of trust.

(C) A comprehensive, detailed draw schedule is used to ensure proper and timely disbursements to allow for completion of the project.

(D) The disbursement draws from the escrow account are based on verification from an independent qualified person who certifies that the work completed to date meets the related codes and standards and that the draws were made in accordance with the construction contract and draw schedule. For purposes of this subparagraph, "independent qualified person" means a person who is not an employee, agent, or affiliate of the broker and who is a licensed architect, general contractor, structural engineer, or active local government building inspector acting in his or her official capacity.

(E) An appraisal is completed by a qualified and licensed appraiser in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP).

(F) The documentation includes a detailed description of the actions that may be taken in the event of a failure to complete the project, whether that failure is due to default, insufficiency of funds, or other causes.

(G) The entire amount of the loan does not exceed two million five hundred thousand dollars (\$2,500,000).

(5) For construction or rehabilitation loans, where the amount withheld for construction or rehabilitation at the start of the project is one hundred thousand dollars (\$100,000) or less, the term "current market value" may be deemed to be the value of the completed project if all of the following safeguards are met:

(A) The loan is fully funded, with the entire loan amount to be deposited in escrow prior to recording of the deed or deeds of trust.

(B) A comprehensive, detailed draw schedule is used to ensure proper and timely disbursements to allow for completion of the project.

(C) An appraisal is completed by a qualified and licensed appraiser in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP).

(D) The documentation includes a detailed description of the actions that may be taken in the event of a failure to complete the project, whether that failure is due to default, insufficiency of funds, or other causes.

(E) The entire amount of the loan does not exceed two million five hundred thousand dollars (\$2,500,000).

(6) If a note or an interest will be secured by more than one parcel of real property, for the purpose of determining the maximum amount of the note or interest, each security property shall be assigned a portion of the note or interest which shall not exceed the percentage of current market value determined by, and in accordance with, the provisions of paragraphs (1) and (2).

(b) The note or interest shall not be sold, unless the purchaser meets one or both of the qualifications of income or net worth set forth below and signs a statement, which shall be retained by the broker for four years, conforming to the following:

“Transaction Identifier: _____

Name of Purchaser: _____ Date: _____

Check either one of the following, if true:

- () My investment in the transaction does not exceed 10% of my net worth, exclusive of home, furnishings, and automobiles.
- () My investment in the transaction does not exceed 10% of my adjusted gross income for federal income tax purposes for my last tax year or, in the alternative, as estimated for the current year.

Signature”

SEC. 2. Section 10232.45 is added to the Business and Professions Code, to read:

10232.45. (a) Any broker subject to the provisions of Section 10232.3 or Article 6 (commencing with Section 10237) shall make reasonable efforts to ensure all of the following with respect to the offer or sale of notes or interest in notes to be secured by a lien on real property or a business opportunity:

(1) All persons to whom notes or interests are sold can be reasonably assumed to have the capacity to understand the fundamental aspects of the investment, by reason of their educational, business, or financial experience.

(2) All persons to whom notes or interests are sold can bear the economic risk of the investment.

(3) The investment in the notes or interests is suitable and appropriate for the purchaser, given the purchaser’s investment objectives, portfolio structure, and financial situation.

(b) A broker shall make this determination on the basis of information he or she obtains from the purchaser. Relevant information for this purpose

includes, at least, the age, investment objective, investment experience, income, net worth, financial situation, and other investments of the prospective purchaser, as well as any other pertinent factors the commissioner shall establish through regulation.

(c) A broker shall maintain records of the information used to determine that an investment is suitable and appropriate for each purchaser and shall retain these records for at least four years.

(d) A broker that complies with all of the following shall be deemed to have complied with subdivision (a):

(1) Obtains from each person to whom notes and deeds of trust or interests therein are offered or sold a completed investor questionnaire in a form approved by the commissioner.

(2) Uses the responses in that questionnaire as an aid in complying with subdivision (a).

(3) On an annual basis, obtains from each person to whom notes and deeds of trust or interests therein are offered or sold, or on whose behalf they are serviced, an updated investor questionnaire, which reflects any material changes that may have occurred with respect to any of the responses to questions in the questionnaire.

(e) Nothing in this section shall be construed to require a broker to utilize an investor questionnaire to ensure compliance with subdivision (a). Reliance of a broker on an investor questionnaire in a form approved by the commissioner shall not prohibit that broker from utilizing additional information to ensure compliance with subdivision (a).

SEC. 3. Section 10232.5 of the Business and Professions Code is amended to read:

10232.5. (a) If the real estate broker is performing acts described in subdivision (d) of Section 10131 in negotiating a loan to be secured by a lien on real property or on a business opportunity, the statement required to be given to the prospective lender shall include, but shall not necessarily be limited to, the following information:

(1) Address or other means of identification of the real property that is to be the security for the borrower's obligation.

(2) Estimated fair market value of the securing property as determined by an appraisal, a copy of which shall be provided to the lender. However, a lender may waive the requirement of an independent appraisal in writing, on a case-by-case basis, in which case, the real estate broker shall provide the broker's written estimated fair market value of the securing property, which shall include the objective data upon which the broker's estimate is based.

(3) Age, size, type of construction, and a description of improvements to the property if contained in the appraisal or as represented to the broker by the prospective borrower.

(4) Identity, occupation, employment, income, and credit data about the prospective borrower or borrowers as represented to the broker by the prospective borrower or borrowers.

(5) Terms of the promissory note to be given to the lender.

(6) Pertinent information concerning all encumbrances which constitute liens against the securing property and, to the extent of actual knowledge of the broker, pertinent information about other loans that the borrower expects or anticipates will result in a lien being recorded against the property securing the promissory note to be created in favor of the prospective lender.

As used in this paragraph, actual knowledge with respect to any anticipated or expected loan, means knowledge gained by the broker through arranging that other loan or receipt of written notification of that other loan. In this regard, the broker shall also provide to the prospective lender the option to apply to purchase a title insurance policy or an endorsement to an existing title insurance policy covering the securing property, and a copy of a written loan application, and a credit report.

(7) Provisions for servicing of the loan, if any, including disposition of the late charge and prepayment penalty fees paid by the borrower.

(8) Detailed information concerning any proposed arrangement under which the prospective lender along with persons not otherwise associated with him or her will be joint beneficiaries or obligees.

(9) If the solicitation is subject to the provisions of Section 10231.2, a detailed statement of the intended use and disposition of the funds being solicited including an explanation of the nature and extent of the benefits to be directly or indirectly derived by the broker.

(10) If the broker is subject to the provisions of Section 10232 or Article 6 (commencing with Section 10237), a statement that the broker has a responsibility to make reasonable efforts to determine that the loan is a suitable and appropriate investment for the lender, based on information provided by the lender regarding the lender's financial situation and investment objectives.

(b) If the real estate broker is performing acts described in subdivision (e) of Section 10131 or in Section 10131.1 in negotiating the sale of a real property sales contract or promissory note secured directly or collaterally by a lien on real property, the statement required to be given to the prospective purchaser by Section 10232.4 shall include, but shall not necessarily be limited to, the following information:

(1) Address or other means of identification of the real property that is the security for the trustor's or vendee's obligation.

(2) Estimated fair market value of the real property as determined by an appraisal, a copy of which shall be provided to the prospective purchaser. However, a purchaser may waive the requirement of an independent appraisal in writing, on a case-by-case basis, in which case, the real estate broker shall provide the broker's written estimated fair market value of the securing property, which shall include the objective data upon which the broker's estimate is based.

(3) Age, size, type of construction, and a description of improvements to the real property if known by the broker.

(4) Information available to the broker relative to the ability of the trustor or vendee to meet his or her contractual obligations under the note or contract

including the trustor's or vendee's payment history under the note or contract.

(5) Terms of the contract or note including the principal balance owing.

(6) Provisions for servicing of the note or contract, if any, including disposition of late charge, prepayment penalty or other fees or charges paid by the trustor or vendee.

(7) Detailed information concerning any proposed arrangement under which the prospective purchaser along with persons not otherwise associated with him or her will be joint beneficiaries or obligees. In this regard, the broker shall also provide to the prospective purchaser the option to apply to purchase a title insurance policy or an endorsement to an existing title insurance policy covering the real property and, if available from the seller of the note or contract or from the original lender, a copy of a written loan application, and a credit report.

(8) A statement as to whether the dealer is acting as a principal or as an agent in the transaction with the prospective purchaser.

(9) If the broker is subject to the provisions of Section 10232 or Article 6 (commencing with Section 10237), a statement that the broker has a responsibility to make reasonable efforts to determine that the purchase is a suitable and appropriate investment for the purchaser, based on information provided by the purchaser regarding the purchaser's financial situation and investment objectives.

SEC. 4. Section 25102 of the Corporations Code is amended to read:

25102. The following transactions are exempted from the provisions of Section 25110:

(a) Any offer (but not a sale) not involving any public offering and the execution and delivery of any agreement for the sale of securities pursuant to the offer if (1) the agreement contains substantially the following provision: "The sale of the securities that are the subject of this agreement has not been qualified with the Commissioner of Corporations of the State of California and the issuance of the securities or the payment or receipt of any part of the consideration therefor prior to the qualification is unlawful, unless the sale of securities is exempt from the qualification by Section 25100, 25102, or 25105 of the California Corporations Code. The rights of all parties to this agreement are expressly conditioned upon the qualification being obtained, unless the sale is so exempt"; and (2) no part of the purchase price is paid or received and none of the securities are issued until the sale of the securities is qualified under this law unless the sale of securities is exempt from the qualification by this section, Section 25100, or 25105.

(b) Any offer (but not a sale) of a security for which a registration statement has been filed under the Securities Act of 1933 but has not yet become effective, or for which an offering statement under Regulation A has been filed but has not yet been qualified, if no stop order or refusal order is in effect and no public proceeding or examination looking towards an order is pending under Section 8 of the act and no order under Section 25140 or subdivision (a) of Section 25143 is in effect under this law.

(c) Any offer (but not a sale) and the execution and delivery of any agreement for the sale of securities pursuant to the offer as may be permitted by the commissioner upon application. Any negotiating permit under this subdivision shall be conditioned to the effect that none of the securities may be issued and none of the consideration therefor may be received or accepted until the sale of the securities is qualified under this law.

(d) Any transaction or agreement between the issuer and an underwriter or among underwriters if the sale of the securities is qualified, or exempt from qualification, at the time of distribution thereof in this state, if any.

(e) Any offer or sale of any evidence of indebtedness, whether secured or unsecured, and any guarantee thereof, in a transaction not involving any public offering.

(f) Any offer or sale of any security in a transaction (other than an offer or sale to a pension or profit-sharing trust of the issuer) that meets each of the following criteria:

(1) Sales of the security are not made to more than 35 persons, including persons not in this state.

(2) All purchasers either have a preexisting personal or business relationship with the offeror or any of its partners, officers, directors or controlling persons, or managers (as appointed or elected by the members) if the offeror is a limited liability company, or by reason of their business or financial experience or the business or financial experience of their professional advisers who are unaffiliated with and who are not compensated by the issuer or any affiliate or selling agent of the issuer, directly or indirectly, could be reasonably assumed to have the capacity to protect their own interests in connection with the transaction.

(3) Each purchaser represents that the purchaser is purchasing for the purchaser's own account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in connection with any distribution of the security.

(4) The offer and sale of the security is not accomplished by the publication of any advertisement. The number of purchasers referred to above is exclusive of any described in subdivision (i), any officer, director, or affiliate of the issuer, or manager (as appointed or elected by the members) if the issuer is a limited liability company, and any other purchaser who the commissioner designates by rule. For purposes of this section, a husband and wife (together with any custodian or trustee acting for the account of their minor children) are counted as one person and a partnership, corporation, or other organization that was not specifically formed for the purpose of purchasing the security offered in reliance upon this exemption, is counted as one person. The commissioner shall by rule require the issuer to file a notice of transactions under this subdivision.

The failure to file the notice or the failure to file the notice within the time specified by the rule of the commissioner shall not affect the availability of the exemption. Any issuer that fails to file the notice as provided by rule of the commissioner shall, within 15 business days after discovery of the failure to file the notice or after demand by the commissioner, whichever

occurs first, file the notice and pay to the commissioner a fee equal to the fee payable had the transaction been qualified under Section 25110. Neither the filing of the notice nor the failure by the commissioner to comment thereon precludes the commissioner from taking any action that the commissioner deems necessary or appropriate under this division with respect to the offer and sale of the securities.

(g) Any offer or sale of conditional sale agreements, equipment trust certificates, or certificates of interest or participation therein or partial assignments thereof, covering the purchase of railroad rolling stock or equipment or the purchase of motor vehicles, aircraft, or parts thereof, in a transaction not involving any public offering.

(h) Any offer or sale of voting common stock by a corporation incorporated in any state if, immediately after the proposed sale and issuance, there will be only one class of stock of the corporation outstanding that is owned beneficially by no more than 35 persons, provided all of the following requirements have been met:

(1) The offer and sale of the stock is not accompanied by the publication of any advertisement, and no selling expenses have been given, paid, or incurred in connection therewith.

(2) The consideration to be received by the issuer for the stock to be issued consists of any of the following:

(A) Only assets (which may include cash) of an existing business enterprise transferred to the issuer upon its initial organization, of which all of the persons who are to receive the stock to be issued pursuant to this exemption were owners during, and the enterprise was operated for, a period of not less than one year immediately preceding the proposed issuance, and the ownership of the enterprise immediately prior to the proposed issuance was in the same proportions as the shares of stock are to be issued.

(B) Only cash or cancellation of indebtedness for money borrowed, or both, upon the initial organization of the issuer, provided all of the stock is issued for the same price per share.

(C) Only cash, provided the sale is approved in writing by each of the existing shareholders and the purchaser or purchasers are existing shareholders.

(D) In a case where after the proposed issuance there will be only one owner of the stock of the issuer, only any legal consideration.

(3) No promotional consideration has been given, paid, or incurred in connection with the issuance. Promotional consideration means any consideration paid directly or indirectly to a person who, acting alone or in conjunction with one or more other persons, takes the initiative in founding and organizing the business or enterprise of an issuer for services rendered in connection with the founding or organizing.

(4) A notice in a form prescribed by rule of the commissioner, signed by an active member of the State Bar of California, is filed with or mailed for filing to the commissioner not later than 10 business days after receipt of consideration for the securities by the issuer. That notice shall contain an opinion of the member of the State Bar of California that the exemption

provided by this subdivision is available for the offer and sale of the securities. The failure to file the notice as required by this subdivision and the rules of the commissioner shall not affect the availability of this exemption. An issuer who fails to file the notice within the time specified by this subdivision shall, within 15 business days after discovery of the failure to file the notice or after demand by the commissioner, whichever occurs first, file the notice and pay to the commissioner a fee equal to the fee payable had the transaction been qualified under Section 25110. The notice, except when filed on behalf of a California corporation, shall be accompanied by an irrevocable consent, in the form that the commissioner by rule prescribes, appointing the commissioner or his or her successor in office to be the issuer's attorney to receive service of any lawful process in any noncriminal suit, action, or proceeding against it or its successor that arises under this law or any rule or order hereunder after the consent has been filed, with the same force and validity as if served personally on the issuer. An issuer on whose behalf a consent has been filed in connection with a previous qualification or exemption from qualification under this law (or application for a permit under any prior law if the application or notice under this law states that the consent is still effective) need not file another. Service may be made by leaving a copy of the process in the office of the commissioner, but it is not effective unless (A) the plaintiff, who may be the commissioner in a suit, action, or proceeding instituted by him or her, forthwith sends notice of the service and a copy of the process by registered or certified mail to the defendant or respondent at its last address on file with the commissioner, and (B) the plaintiff's affidavit of compliance with this section is filed in the case on or before the return day of the process, if any, or within the further time as the court allows.

(5) Each purchaser represents that the purchaser is purchasing for the purchaser's own account, or a trust account if the purchaser is a trustee, and not with a view to or for sale in connection with any distribution of the stock.

For the purposes of this subdivision, all securities held by a husband and wife, whether or not jointly, shall be considered to be owned by one person, and all securities held by a corporation that has issued stock pursuant to this exemption shall be considered to be held by the shareholders to whom it has issued the stock.

All stock issued by a corporation pursuant to this subdivision as it existed prior to the effective date of the amendments to this section made during the 1996 portion of the 1995–96 Regular Session that required the issuer to have stamped or printed prominently on the face of the stock certificate a legend in a form prescribed by rule of the commissioner restricting transfer of the stock in a manner provided for by that rule shall not be subject to the transfer restriction legend requirement and, by operation of law, the corporation is authorized to remove that transfer restriction legend from the certificates of those shares of stock issued by the corporation pursuant to this subdivision as it existed prior to the effective date of the amendments to this section made during the 1996 portion of the 1995–96 Regular Session.

(i) Any offer or sale (1) to a bank, savings and loan association, trust company, insurance company, investment company registered under the Investment Company Act of 1940, pension or profit-sharing trust (other than a pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or individual retirement account), or other institutional investor or governmental agency or instrumentality that the commissioner may designate by rule, whether the purchaser is acting for itself or as trustee, or (2) to any corporation with outstanding securities registered under Section 12 of the Securities Exchange Act of 1934 or any wholly owned subsidiary of the corporation that after the offer and sale will own directly or indirectly 100 percent of the outstanding capital stock of the issuer, provided the purchaser represents that it is purchasing for its own account (or for the trust account) for investment and not with a view to or for sale in connection with any distribution of the security.

(j) Any offer or sale of any certificate of interest or participation in an oil or gas title or lease (including subsurface gas storage and payments out of production) if either of the following apply:

(1) All of the purchasers meet one of the following requirements:

(A) Are and have been during the preceding two years engaged primarily in the business of drilling for, producing, or refining oil or gas (or whose corporate predecessor, in the case of a corporation, has been so engaged).

(B) Are persons described in paragraph (1) of subdivision (i).

(C) Have been found by the commissioner upon written application to be substantially engaged in the business of drilling for, producing, or refining oil or gas so as not to require the protection provided by this law (which finding shall be effective until rescinded).

(2) The security is concurrently hypothecated to a bank in the ordinary course of business to secure a loan made by the bank, provided that each purchaser represents that it is purchasing for its own account for investment and not with a view to or for sale in connection with any distribution of the security.

(k) Any offer or sale of any security under, or pursuant to, a plan of reorganization under Chapter 11 of the federal bankruptcy law that has been confirmed or is subject to confirmation by the decree or order of a court of competent jurisdiction.

(l) Any offer or sale of an option, warrant, put, call, or straddle, and any guarantee of any of these securities, by a person who is not the issuer of the security subject to the right, if the transaction, had it involved an offer or sale of the security subject to the right by the person, would not have violated Section 25110 or 25130.

(m) Any offer or sale of a stock to a pension, profit-sharing, stock bonus, or employee stock ownership plan, provided that (1) the plan meets the requirements for qualification under Section 401 of the Internal Revenue Code, and (2) the employees are not required or permitted individually to make any contributions to the plan. The exemption provided by this subdivision shall not be affected by whether the stock is contributed to the plan, purchased from the issuer with contributions by the issuer or an affiliate

of the issuer, or purchased from the issuer with funds borrowed from the issuer, an affiliate of the issuer, or any other lender.

(n) Any offer or sale of any security in a transaction, other than an offer or sale of a security in a rollout transaction, that meets all of the following criteria:

(1) The issuer is (A) a California corporation or foreign corporation that, at the time of the filing of the notice required under this subdivision, is subject to Section 2115, or (B) any other form of business entity, including without limitation a partnership or trust organized under the laws of this state. The exemption provided by this subdivision is not available to a “blind pool” issuer, as that term is defined by the commissioner, or to an investment company subject to the Investment Company Act of 1940.

(2) Sales of securities are made only to qualified purchasers or other persons the issuer reasonably believes, after reasonable inquiry, to be qualified purchasers. A corporation, partnership, or other organization specifically formed for the purpose of acquiring the securities offered by the issuer in reliance upon this exemption may be a qualified purchaser if each of the equity owners of the corporation, partnership, or other organization is a qualified purchaser. Qualified purchasers include the following:

(A) A person designated in Section 260.102.13 of Title 10 of the California Code of Regulations.

(B) A person designated in subdivision (i) or any rule of the commissioner adopted thereunder.

(C) A pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or an individual retirement account, if the investment decisions made on behalf of the trust, plan, or account are made solely by persons who are qualified purchasers.

(D) An organization described in Section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, each with total assets in excess of five million dollars (\$5,000,000) according to its most recent audited financial statements.

(E) With respect to the offer and sale of one class of voting common stock of an issuer or of preferred stock of an issuer entitling the holder thereof to at least the same voting rights as the issuer’s one class of voting common stock, provided that the issuer has only one-class voting common stock outstanding upon consummation of the offer and sale, a natural person who, either individually or jointly with the person’s spouse, (i) has a minimum net worth of two hundred fifty thousand dollars (\$250,000) and had, during the immediately preceding tax year, gross income in excess of one hundred thousand dollars (\$100,000) and reasonably expects gross income in excess of one hundred thousand dollars (\$100,000) during the current tax year or (ii) has a minimum net worth of five hundred thousand dollars (\$500,000). “Net worth” shall be determined exclusive of home, home furnishings, and automobiles. Other assets included in the computation of net worth may be valued at fair market value.

Each natural person specified above, by reason of his or her business or financial experience, or the business or financial experience of his or her professional adviser, who is unaffiliated with and who is not compensated, directly or indirectly, by the issuer or any affiliate or selling agent of the issuer, can be reasonably assumed to have the capacity to protect his or her interests in connection with the transaction. The amount of the investment of each natural person shall not exceed 10 percent of the net worth, as determined by this subparagraph, of that natural person.

(F) Any other purchaser designated as qualified by rule of the commissioner.

(3) Each purchaser represents that the purchaser is purchasing for the purchaser's own account (or trust account, if the purchaser is a trustee) and not with a view to or for sale in connection with a distribution of the security.

(4) Each natural person purchaser, including a corporation, partnership, or other organization specifically formed by natural persons for the purpose of acquiring the securities offered by the issuer, receives, at least five business days before securities are sold to, or a commitment to purchase is accepted from, the purchaser, a written offering disclosure statement that shall meet the disclosure requirements of Regulation D (17 C.F.R. 230.501 et seq.), and any other information as may be prescribed by rule of the commissioner, provided that the issuer shall not be obligated pursuant to this paragraph to provide this disclosure statement to a natural person qualified under Section 260.102.13 of Title 10 of the California Code of Regulations. The offer or sale of securities pursuant to a disclosure statement required by this paragraph that is in violation of Section 25401, or that fails to meet the disclosure requirements of Regulation D (17 C.F.R. 230.501 et seq.), shall not render unavailable to the issuer the claim of an exemption from Section 25110 afforded by this subdivision. This paragraph does not impose, directly or indirectly, any additional disclosure obligation with respect to any other exemption from qualification available under any other provision of this section.

(5) (A) A general announcement of proposed offering may be published by written document only, provided that the general announcement of proposed offering sets forth the following required information:

- (i) The name of the issuer of the securities.
- (ii) The full title of the security to be issued.
- (iii) The anticipated suitability standards for prospective purchasers.
- (iv) A statement that (I) no money or other consideration is being solicited or will be accepted, (II) an indication of interest made by a prospective purchaser involves no obligation or commitment of any kind, and, if the issuer is required by paragraph (4) to deliver a disclosure statement to prospective purchasers, (III) no sales will be made or commitment to purchase accepted until five business days after delivery of a disclosure statement and subscription information to the prospective purchaser in accordance with the requirements of this subdivision.

(v) Any other information required by rule of the commissioner.

(vi) The following legend: “For more complete information about (Name of Issuer) and (Full Title of Security), send for additional information from (Name and Address) by sending this coupon or calling (Telephone Number).”

(B) The general announcement of proposed offering referred to in subparagraph (A) may also set forth the following information:

- (i) A brief description of the business of the issuer.
- (ii) The geographic location of the issuer and its business.
- (iii) The price of the security to be issued, or, if the price is not known, the method of its determination or the probable price range as specified by the issuer, and the aggregate offering price.

(C) The general announcement of proposed offering shall contain only the information that is set forth in this paragraph.

(D) Dissemination of the general announcement of proposed offering to persons who are not qualified purchasers, without more, shall not disqualify the issuer from claiming the exemption under this subdivision.

(6) No telephone solicitation shall be permitted until the issuer has determined that the prospective purchaser to be solicited is a qualified purchaser.

(7) The issuer files a notice of transaction under this subdivision both (A) concurrent with the publication of a general announcement of proposed offering or at the time of the initial offer of the securities, whichever occurs first, accompanied by a filing fee, and (B) within 10 business days following the close or abandonment of the offering, but in no case more than 210 days from the date of filing the first notice. The first notice of transaction under subparagraph (A) shall contain an undertaking, in a form acceptable to the commissioner, to deliver any disclosure statement required by paragraph (4) to be delivered to prospective purchasers, and any supplement thereto, to the commissioner within 10 days of the commissioner’s request for the information. The exemption from qualification afforded by this subdivision is unavailable if an issuer fails to file the first notice required under subparagraph (A) or to pay the filing fee. The commissioner has the authority to assess an administrative penalty of up to one thousand dollars (\$1,000) against an issuer that fails to deliver the disclosure statement required to be delivered to the commissioner upon the commissioner’s request within the time period set forth above. Neither the filing of the disclosure statement nor the failure by the commissioner to comment thereon precludes the commissioner from taking any action deemed necessary or appropriate under this division with respect to the offer and sale of the securities.

(o) An offer or sale of any security issued by a corporation or limited liability company pursuant to a purchase plan or agreement, or issued pursuant to an option plan or agreement, where the security at the time of issuance or grant is exempt from registration under the Securities Act of 1933, as amended, pursuant to Rule 701 adopted pursuant to that act (17 C.F.R. 230.701), the provisions of which are hereby incorporated by reference into this section, provided that (1) the terms of any purchase plan or agreement shall comply with Sections 260.140.42, 260.140.45, and 260.140.46 of Title 10 of the California Code of Regulations, (2) the terms

of any option plan or agreement shall comply with Sections 260.140.41, 260.140.45, and 260.140.46 of Title 10 of the California Code of Regulations, and (3) the issuer files a notice of transaction in accordance with rules adopted by the commissioner no later than 30 days after the initial issuance of any security under that plan, accompanied by a filing fee as prescribed by subdivision (y) of Section 25608. The failure to file the notice of transaction within the time specified in this subdivision shall not affect the availability of this exemption. An issuer that fails to file the notice shall, within 15 business days after discovery of the failure to file the notice or after demand by the commissioner, whichever occurs first, file the notice and pay the commissioner a fee equal to the maximum aggregate fee payable had the transaction been qualified under Section 25110.

Offers and sales exempt pursuant to this subdivision shall be deemed to be part of a single, discrete offering and are not subject to integration with any other offering or sale, whether qualified under Chapter 2 (commencing with Section 25110), or otherwise exempt, or not subject to qualification.

(p) An offer or sale of nonredeemable securities to accredited investors (Section 28031) by a person licensed under the Capital Access Company Law (Division 3 (commencing with Section 28000) of Title 4), provided that all purchasers either (1) have a preexisting personal or business relationship with the offeror or any of its partners, officers, directors, controlling persons, or managers (as appointed or elected by the members), or (2) by reason of their business or financial experience or the business or financial experience of their professional advisers who are unaffiliated with and who are not compensated by the issuer or any affiliate or selling agent of the issuer, directly or indirectly, could be reasonably assumed to have the capacity to protect their own interests in connection with the transaction. All nonredeemable securities shall be evidenced by certificates that shall have stamped or printed prominently on their face a legend in a form to be prescribed by rule or order of the commissioner restricting transfer of the securities in the manner as the rule or order provides. The exemption under this subdivision shall not be available for any offering that is exempt or asserted to be exempt pursuant to Section 3(a)(11) of the Securities Act of 1933 (15 U.S.C. Sec. 77c(a)(11)) or Rule 147 (17 C.F.R. 230.147) thereunder or otherwise is conducted by means of any form of general solicitation or general advertising.

(q) Any offer or sale of any viatical or life settlement contract or fractionalized or pooled interest therein in a transaction that meets all of the following criteria:

(1) Sales of securities described in this subdivision are made only to qualified purchasers or other persons the issuer reasonably believes, after reasonable inquiry, to be qualified purchasers. A corporation, partnership, or other organization specifically formed for the purpose of acquiring the securities offered by the issuer in reliance upon this exemption may be a qualified purchaser only if each of the equity owners of the corporation, partnership, or other organization is a qualified purchaser. Qualified purchasers include the following:

(A) A person designated in Section 260.102.13 of Title 10 of the California Code of Regulations.

(B) A person designated in subdivision (i) or any rule of the commissioner adopted thereunder.

(C) A pension or profit-sharing trust of the issuer, a self-employed individual retirement plan, or an individual retirement account, if the investment decisions made on behalf of the trust, plan, or account are made solely by persons who are qualified purchasers.

(D) An organization described in Section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, each with total assets in excess of five million dollars (\$5,000,000) according to its most recent audited financial statements.

(E) A natural person who, either individually or jointly with the person's spouse, (i) has a minimum net worth of one hundred fifty thousand dollars (\$150,000) and had, during the immediately preceding tax year, gross income in excess of one hundred thousand dollars (\$100,000) and reasonably expects gross income in excess of one hundred thousand dollars (\$100,000) during the current tax year or (ii) has a minimum net worth of two hundred fifty thousand dollars (\$250,000). "Net worth" shall be determined exclusive of home, home furnishings, and automobiles. Other assets included in the computation of net worth may be valued at fair market value.

Each natural person specified above, by reason of his or her business or financial experience, or the business or financial experience of his or her professional adviser, who is unaffiliated with and who is not compensated, directly or indirectly, by the issuer or any affiliate or selling agent of the issuer, can be reasonably assumed to have the capacity to protect his or her interests in connection with the transaction.

The amount of the investment of each natural person shall not exceed 10 percent of the net worth, as determined by this subdivision, of that natural person.

(F) Any other purchaser designated as qualified by rule of the commissioner.

(2) Each purchaser represents that the purchaser is purchasing for the purchaser's own account (or trust account, if the purchaser is a trustee) and not with a view to or for sale in connection with a distribution of the security.

(3) Each natural person purchaser, including a corporation, partnership, or other organization specifically formed by natural persons for the purpose of acquiring the securities offered by the issuer, receives, at least five business days before securities described in this subdivision are sold to, or a commitment to purchase is accepted from, the purchaser, the following information in writing:

(A) The name, principal business and mailing address, and telephone number of the issuer.

(B) The suitability standards for prospective purchasers as set forth in paragraph (1) of this subdivision.

(C) A description of the issuer's type of business organization and the state in which the issuer is organized or incorporated.

(D) A brief description of the business of the issuer.

(E) If the issuer retains ownership or becomes the beneficiary of the insurance policy, an audit report of an independent certified public accountant together with a balance sheet and related statements of income, retained earnings, and cashflows that reflect the issuer's financial position, the results of the issuer's operations, and the issuer's cashflows as of a date within 15 months before the date of the initial issuance of the securities described in this subdivision. The financial statements listed in this subparagraph shall be prepared in conformity with generally accepted accounting principles. If the date of the audit report is more than 120 days before the date of the initial issuance of the securities described in this subdivision, the issuer shall provide unaudited interim financial statements.

(F) The names of all directors, officers, partners, members, or trustees of the issuer.

(G) A description of any order, judgment, or decree that is final as to the issuing entity of any state, federal, or foreign country governmental agency or administrator, or of any state, federal, or foreign country court of competent jurisdiction (i) revoking, suspending, denying, or censuring for cause any license, permit, or other authority of the issuer or of any director, officer, partner, member, trustee, or person owning or controlling, directly or indirectly, 10 percent or more of the outstanding interest or equity securities of the issuer, to engage in the securities, commodities, franchise, insurance, real estate, or lending business or in the offer or sale of securities, commodities, franchises, insurance, real estate, or loans, (ii) permanently restraining, enjoining, barring, suspending, or censuring any such person from engaging in or continuing any conduct, practice, or employment in connection with the offer or sale of securities, commodities, franchises, insurance, real estate, or loans, (iii) convicting any such person of, or pleading nolo contendere by any such person to, any felony or misdemeanor involving a security, commodity, franchise, insurance, real estate, or loan, or any aspect of the securities, commodities, franchise, insurance, real estate, or lending business, or involving dishonesty, fraud, deceit, embezzlement, fraudulent conversion, or misappropriation of property, or (iv) holding any such person liable in a civil action involving breach of a fiduciary duty, fraud, deceit, embezzlement, fraudulent conversion, or misappropriation of property. This subparagraph does not apply to any order, judgment, or decree that has been vacated, overturned, or is more than 10 years old.

(H) Notice of the purchaser's right to rescind or cancel the investment and receive a refund pursuant to Section 25508.5.

(I) The name, address, and telephone number of the issuing insurance company, and the name, address, and telephone number of the state or foreign country regulator of the insurance company.

(J) The total face value of the insurance policy and the percentage of the insurance policy the purchaser will own.

(K) The insurance policy number, issue date, and type.

(L) If a group insurance policy, the name, address, and telephone number of the group, and, if applicable, the material terms and conditions of

converting the policy to an individual policy, including the amount of increased premiums.

(M) If a term insurance policy, the term and the name, address, and telephone number of the person who will be responsible for renewing the policy if necessary.

(N) That the insurance policy is beyond the state statute for contestability and the reason therefor.

(O) The insurance policy premiums and terms of premium payments.

(P) The amount of the purchaser's moneys that will be set aside to pay premiums.

(Q) The name, address, and telephone number of the person who will be the insurance policy owner and the person who will be responsible for paying premiums.

(R) The date on which the purchaser will be required to pay premiums and the amount of the premium, if known.

(S) A statement to the effect that any projected rate of return to the purchaser from the purchase of a viatical or life settlement contract or a fractionalized or pooled interest therein is based on an estimated life expectancy for the person insured under the life insurance policy; that the return on the purchase may vary substantially from the expected rate of return based upon the actual life expectancy of the insured that may be less than, equal to, or may greatly exceed the estimated life expectancy; and that the rate of return would be higher if the actual life expectancy were less than, and lower if the actual life expectancy were greater than the estimated life expectancy of the insured at the time the viatical or life settlement contract was closed.

(T) A statement that the purchaser should consult with his or her tax adviser regarding the tax consequences of the purchase of the viatical or life settlement contract or fractionalized or pooled interest therein and, if the purchaser is using retirement funds or accounts for that purchase, whether or not any adverse tax consequences might result from the use of those funds for the purchase of that investment.

(U) Any other information as may be prescribed by rule of the commissioner.

SEC. 5. Section 25102.2 is added to the Corporations Code, to read:

25102.2. The commissioner shall require any issuer that is engaged in the business of purchasing, selling, financing, or brokering real estate, and that relies upon an exemption authorized by subdivision (e), (f), (h), or (n) of Section 25102, or subdivision (p) of Section 25100, for an offering which involves the offer or sale of securities to any person who is not an accredited investor, as defined in Regulation D of the Securities and Exchange Commission (17 C.F.R. 230.501 et seq.), in a transaction that is not registered pursuant to the Securities Act of 1933, to provide additional information regarding the nature of the proposed offering on a form prescribed by the commissioner. This information shall include the names of the issuer's officers and directors in the case of a corporation, managers in the case of a manager-managed limited liability company, members in the case of a

member-managed limited liability company, general partner in the case of a limited partnership, or persons performing similar functions, in the case of other types of issuers, the offering disclosure documents provided to prospective purchasers, a list of all state and federal licenses required to further the purposes of the investment, and the names of all licensed persons that will undertake those activities.

SEC. 6. Section 25113 of the Corporations Code is amended to read:

25113. (a) All securities, whether or not eligible for qualification by coordination under Section 25111 or qualification by notification under Section 25112, may be qualified by permit under this section.

(b) (1) An application for a permit under this section shall contain any information and be accompanied by any documents as shall be required by rule of the commissioner, in addition to the information specified in Section 25160 and the consent to service of process required by Section 25165. For this purpose, the commissioner may classify issuers and types of securities.

(2) An applicant may file a small company application for permit under this section if it meets all of the following conditions:

(A) The applicant is: (i) a California corporation or a foreign corporation, which at the time of filing an application under this subdivision is subject to Section 2115, and neither corporation is a “blind pool” company, as that term is defined by the commissioner; (ii) not engaged in oil and gas exploration or production, or mining or other extractive industries; (iii) not an investment company subject to the Investment Company Act of 1940; and (iv) not subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934.

(B) The total offering of voting common stock and preferred stock by the applicant to be sold in a 12-month period, within or outside this state, is limited to one million dollars (\$1,000,000), less the aggregate offering price for all securities sold (within the 12 months before the start, and during the offering, of the voting common stock or preferred stock) under Rule 504 of the Securities and Exchange Commission, in reliance on any exemption under subdivision (b) of Section 3 of the Securities Act of 1933, or in violation of subdivision (a) of Section 5 of that act, and immediately after the proposed sale and issuance there will be only one class of voting common stock.

(C) The minimum offering price of the voting common stock and preferred stock (and the conversion price if the preferred stock is convertible into the voting common stock) to be sold is two dollars (\$2) per share and the applicant files an undertaking with the commissioner that there will be no stock splits, stock dividends, spinoffs, or mergers for a period of two years from the close of the offering. The undertaking notwithstanding, the commissioner may approve a spinoff or merger pursuant to an application for qualification filed by an applicant.

(D) The net proceeds from the offering are to be expended in the operations of the business.

(E) The offering is made pursuant to a Small Corporate Offering Registration disclosure document based on the Form U-7 as adopted by the

North American Securities Administrators Association and any additional requirements as the commissioner shall prescribe, that may include, but not be limited to, investor suitability and due diligence investigation requirements.

(F) The application and disclosure document is reviewed and signed by a majority of the members of the board of directors of the applicant.

(G) The application shall contain that information and be accompanied by those documents required by rule of the commissioner, in addition to the information specified in Section 25610 and the consent to service of process required by Section 25165.

(c) Qualification of securities under this section becomes effective upon the commissioner issuing a permit authorizing the issuance of those securities.

(d) The commissioner shall annually prepare a report, and make that report publicly available by posting the report on the department's Internet Web site, summarizing data collected from persons to which it issues permits pursuant to this section. The report shall include, but not be limited to, a summary of the general categories of investments for which permits are approved; the minimum, maximum, and average net worth required of those persons to whom permits are issued for each category of activity; the least stringent and most stringent suitability standards imposed on persons issued permits for each category of activity; the experience requirements imposed on persons issued permits for each category of activity; the total dollar amount of money sought to be raised per category of activity; the number and nature of enforcement actions taken against permitholders; and any other information the commissioner deems relevant to inform the Legislature about the activities of permitholders and the protections for those who invest with permitholders. The commissioner shall take steps to ensure that the publication of data collected from permitholders does not result in the release of proprietary information about individuals or businesses.

(e) The commissioner may examine those persons to whom permits are issued pursuant to this section to review compliance with the conditions of the permit and other applicable state law. The commissioner may disqualify an offering permitted pursuant to this section if he or she finds that the issuer has materially violated the provisions of its permit.

SEC. 7. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.