Chapter SEC 3

DENIAL, SUSPENSION AND REVOCATION OF REGISTRATIONS

SEC 3.01 Commissions and expenses. (1) The aggregate amount of underwriters' and sellers' discounts, commissions and other compensation shall be reasonable, and except for issuers specified in subsection (2), is presumed reasonable if it does not exceed 10% of the aggregate selling price of the securities or if, when added to the other expenses paid or payable in connection with the offering and sale of the securities, the total of commissions and other expenses does not exceed 15% of the aggregate selling price of the securities.

(2) With respect to redeemable securities of investment companies registered under the investment company act of 1940, the maximum selling commission or discount is presumed reasonable if it does not exceed 9% of the selling price of the securities, including the percentage amount of any redemption fee payable upon redemption of the securities.

(3) With respect to investment company shares or face amount certificates sold pursuant to a contractual plan or program payable in installments, the selling commission may be deemed unreasonable if more than a pro rata portion of the total selling commission payable over the period of the contract is payable in connection with any installment payment, or if any charge or penalty is assessed for failure to make any installment payment.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70; r. and recr. Register, August, 1972, No. 200, eff. 9–1–72.

SEC 3.02 Offering price. The offering price of any security shall be fair and equitable to purchasers, taking into account all relevant factors. With respect to common stock, the offering price shall be reasonably related to the existing public market for the stock or to the net earnings of the issuer as stated in the prospectus.

(1) If a registration statement relating to common stock is filed in which the maximum or proposed offering price exceeds a multiple of 25 times the net earnings per share of the issuer for the last 12 months or its average net earnings per share for the last 3 years prior to the proposed offering date, or such other multiple of earnings as the commissioner may prescribe in particular cases, the information set forth below shall be filed in justification of the offering price.

(2) If there is an existing public market for the stock, information shall be filed justifying the adequacy of such public market, including (a) the number of shares traded during each of the preceding 6

months, the number of stockholders of the issuer at the beginning and end of such 6-month period, and the names and locations of broker-dealers regularly making a market in the stock and of the financial publications where market prices of the stock are regularly quoted if the stock is not listed on a national securities exchange, and (b) information accounting for any significant increase in the price/earnings multiple of the stock over such 6-month period.

(3) If there is no existing public market for the stock, information shall be filed justifying the proposed offering price in relation to the recent offering and current market prices of the stock of companies comparable to the issuer in terms of size, history of operation, industry and products, and other relevant factors. Such information may be contained in an underwriter's memorandum on the issuer prepared in connection with the proposed offering.

(4) If the issuer of the stock is in the promotional or developmental stage, the information prescribed in subsections (2) and (3) is not required, but the offering price shall be reasonably related to the price paid for the stock by promoters or controlling persons of the issuer in transactions effected prior to the public offering, except as permitted under Wis. Adm. Code section SEC 3.04.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70; am. (4), Register, August, 1972, No. 200, eff. 9–1–72.

SEC 3.03 Options and warrants. The amounts and kinds of options and warrants to purchase securities issued or sold, other than ratably to purchasers, in connection with a proposed offering of equity securities or securities convertible into equity securities, shall be reasonable. Options and warrants are presumed reasonable if they satisfy the following conditions:

(1) Restricted or qualified stock options to employes for incentive purposes, including employe stock purchase agreements extending for a period of more than one year, shall be reasonable in number and method of exercise.

(2) Options or warrants to underwriters are presumed reasonable if they satisfy all of the following conditions, but the commissioner may waive any of such conditions if the underwriting arrangements have been reviewed by the National Association of Securities Dealers, Inc., and have not been found to involve unfair and unreasonable underwriters' compensation:

(a) The options or warrants are issued to managing underwriters under a firm underwriting agreement, provided they are not transferable except among the partners or stockholders of the underwriter.

(b) The options or warrants do not exceed 5 years in duration and are exercisable no sooner than one year after issuance.

(c) The exercise price of the options or warrants is at least equal to the public offering price plus a step-up of said public offering price of either 7% each year such options or warrants are outstanding, so that the exercise price throughout the second year is 107%, throughout the third year 114%, throughout the fourth year 121%, and throughout the fifth year 128%; or in the alternative, 20% at any time after one year from the date of issuance; provided that an election as to either alternative must be made by the underwriters at the time that the options or warrants are issued.

(d) The options or warrants are issued by a company which is in the promotional or development stage, or which lacks a public market

for its stock, or other factors justify the issuance of options to obtain underwriting services; provided that the direct commissions to the underwriters are lower than the usual and customary commissions in the absence of such options or warrants.

(e) The prospectus used in connection with the offering fully discloses the terms and the reason for the issuance of such options or warrants, and, if such reason relates to future advisory services to be performed by the underwriter, a statement to that effect is placed in the prospectus.

(f) The value of the options or warrants shall be included in the computation of underwriting commissions and discounts. The market value of such options or warrants, if any, shall be used, and where no market value exists, a presumed fair value of not less than 20% of the public offering price of the stock to which the options or warrants relate shall be used, unless evidence indicates that a different value exists.

(3) Options or warrants issued to financing institutions, other than underwriters, in connection with financing arrangements made by the issuer are presumed reasonable if they satisfy all of the following conditions:

(a) The options or warrants are issued in connection with the issuance of the evidence of indebtedness of the loan.

(b) The options or warrants expire not later than 2 years after the final maturity date of the loan.

(c) The options or warrants are issued as a result of bona fide negotiations between the issuer and parties not affiliated with the issuer.

(d) The exercise price of such options or warrants is not less than the fair market value of the stock subject thereto on the date the loan is approved.

(e) The number of shares issuable upon exercise of the options or warrants multiplied by the exercise price thereof does not exceed the principal amount of the loan.

(4) The total amount of options and warrants issued or reserved for issuance at the date of the public offering shall be reasonable. The amount of options and warrants is presumed reasonable if the number of shares subject to such options and warrants, excluding options issued to financing institutions and options issued in connection with acquisitions, does not exceed either 10% of the shares to be outstanding upon completion of the offering or 10% of the shares outstanding during the period the registration statement is effective. The number of options and warrants reserved for issuance may be disregarded if the issuer files an undertaking or states in the prospectus that the amount of outstanding options and warrants shall not exceed the above amount during the period the registration statement is effective.

(5) All options and warrants except those issued to financing institutions shall be issued at not less than fair market value on the date of issuance, and the exercise price shall not be subject to change by the issuer except in accordance with anti-dilution provisions in effect on the date of issuance.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70; am. (1) and (2) (intro. par.), Register, August, 1972, No. 200, eff. 9–1–72.

SEC 3.04 Promotional or cheap stock. (1) An offering or sale of equity securities or securities convertible into equity securities may be deemed unfair and inequitable to purchasers and to involve unreasonable amounts of promoters' profits, or participations, if unreasonable amounts of promotional or cheap stock have been issued or sold prior to the offering.

(2) For the purpose of this rule, "promotional or cheap stock" includes any equity or convertible securities issued or sold at any time prior to the public offering date by any issuer in the promotional or developmental stage on that date, or within 2 years prior to the public offering date by any other issuer, to any persons who were at the time of such sale or issuance or are at the time of the public offering underwriters, promoters, finders, officers, directors, or controlling stockholders of the issuer, at a price lower than or at a conversion rate or for a consideration not reasonably related to the public offering price of such securities, in the absence of any public market for such equity securities or any substantial change in the earnings or financial position of the issuer.

(3) The issuance of promotional or cheap stock is presumed reasonable if any of the following conditions are satisfied:

(a) The issuer was organized less than 2 years prior to the public offering date and is in the promotional or developmental stage, the promotional or cheap stock was issued at or shortly after the date of organization, and the amount of promotional or cheap stock issued to persons subject to this rule, when added to the number of shares of stock subject to unexercised options and warrants issued to such persons, does not exceed 25% of the amount of stock to be outstanding on completion of the offering or outstanding during the period the registration statement is effective.

(b) The amount of promotional or cheap stock issued to persons subject to this rule, when added to the amount of unexercised options and warrants issued to such persons, does not exceed 10% of the amount of stock to be outstanding on completion of the offering or outstanding during the period the registration statement is effective.

(c) The proposed offering price of the equity securities does not exceed the multiple of earnings prescribed in section SEC 3.02 (1) for each of the last 2 years prior to the public offering date, after taking into account the promotional or cheap stock issued.

(4) The commissioner may require as a condition of registration of such securities that all or any part of the promotional or cheap stock of the issuer be deposited in escrow pursuant to section 551.27 (7), Wis. Stats., for such period and under such conditions as he may prescribe, and may then determine that the offering does not involve unreasonable promoters' profits or participations, if the aggregate amount of promotional or cheap stock, excluding any amount as to which the consideration paid was reasonably related to the public offering price, does not exceed 50% of the amount of stock to be outstanding on completion of the offering or outstanding during the period the registration statement is effective.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70; am. (2) and (4), Register, August, 1972, No. 200, eff. 9–1–72.

SEC 3.05 Promoters' investment. (1) The offering or sale of securities of an issuer in the promotional or developmental stage may be deemed unfair and inequitable to purchasers unless the fair value of

the equity investment of the officers, directors, and promoters of such issuer, determined as of the offering date, equals at least 10% of the total equity investment resulting from the sale of all the securities which are the subject of the proposed offering.

(2) For the purpose of this rule:

(a) The "fair value of the equity investment" of the officers, directors and promoters means the total of all amounts paid to the issuer in cash together with the reasonable value of all tangible assets paid to the issuer, as determined by independent appraisal or othewise, and as adjusted by any earned surplus of the issuer subsequent to the dates of such payments.

(b) "Total equity investment" means the total of the par or stated value of all securities of the issuer outstanding or offered or proposed to be offered, and the amounts of surplus of any kind, regardless of description and whether or not restricted.

(3) For the purpose of this chapter, an issuer in the "promotional or developmental stage" means an issuer which has no significant record of operations or earnings prior to the public offering date.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70; am. (2) (a) and (3), Register, August, 1972, No. 200, eff. 9–1–72.

SEC 3.06 Preferred stock and debentures. (1) The offering or sale of preferred stock of an issuer may be deemed unfair and inequitable to purchasers if the net earnings of the issuer for (a) its last year prior to the offering or (b) the average of its last 3 years prior to the offering, as stated in the prospectus, exclusive of nonrecurring items, or the substantiated future earnings capability of the issuer, is insufficient to cover the dividends on the securities to be offered or sold.

(2) The offering or sale of debt securities, including debentures, notes and bonds of an issuer, may be deemed unfair and inequitable to purchasers if the net earnings of the issuer before taxes for (a) its last year prior to the offering or (b) the average of its last 3 years prior to the offering, as stated in the prospectus, exclusive of nonrecurring items and adjusted for the issuance of the debt securities, or the substantiated future net earnings capability of the issuer, is insufficient to cover the interest on the securities proposed to be offered.

(3) If the issuer has made or proposes to make any material acquisitions subsequent to the last year specified in subsection (1) or (2) of this rule, the earnings or cash flow for such year shall be restated on a pro forma basis to include such acquisitions.

(4) The offering or sale of preferred stock or debentures by an issuer in the promotional or development stage is deemed unfair and inequitable to purchasers unless justified by the issuer or registrant under subsection (1) or (2).

(5) This rule does not apply to the offering or sale of (a) debt securities by a nonprofit issuer, (b) industrial development revenue bonds, (c) securities issued pursuant to a voluntary or involuntary corporate reorganization, or (d) securities of an issuer whose financial structure or the issuance of whose securities is regulated by federal or state governmental authority.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70; am. (2), Register, August, 1972, No. 200, eff. 9–1–72.

SEC 3.07 Unequal voting rights. The offering or sale of securities of any issuer may be deemed unfair and inequitable to purchasers if the class of securities being offered and sold to such purchasers has unequal voting rights as herein defined.

(1) If the issuer is a corporation having more than one class of equity securities authorized or outstanding, the offer or sale may be deemed unfair and inequitable to purchasers if the class of equity securities offered or sold to such purchasers (a) has no voting rights; or (b) has less than equal voting rights, in proportion to the number of shares of each class outstanding, adjusted for any prior reclassification of securities, on any matter, including election to the board of directors of the issuer; unless preferential treatment as to dividends and liquidation is provided with respect to the class of equity securities offered or sold or the inequality in voting rights is otherwise justified.

(2) If the issuer is a partnership, the offering or sale of its limited partnership interests may be deemed unfair and inequitable to purchasers unless the partnership agreement provides that (a) the limited partners, by a vote of a majority of the outstanding amount of limited partnership interests, shall have the right to remove the general partner, to amend the partnership agreement, to dissolve the partnership, and to continue its business with a substituted general partner; (b) the general partner shall cause a vote to be taken on any of the matters referred to herein upon the written request of 10% of the outstanding amount of limited partnership interests; (c) each limited partner shall have the right to a complete list of names, addresses, and interests of all limited partners, upon written request to the general partner, for any proper purpose; and (d) the partnership agreement shall not be amended in any material respect affecting the rights or interests of the limited partners except by the affirmative vote of not less than a majority of the outstanding amount of limited partnership interests; or unless the partnership agreement includes appropriate alternative provisions or the lack of limited partners' rights is otherwise justified.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70; r. and recr. Register, August, 1972, No. 200, eff. 9–1–72.

SEC 3.08 Capitalization. The offering or sale of one class of securities may be deemed unfair and inequitable to purchasers if the aggregate amount of the class of securities being offered is unreasonable in relation to the aggregate amount of other classes of outstanding securities of the issuer, consideration being given to the nature of the issuer's business and to other relevant factors. An offering of debt securities or preferred stock is presumed reasonable if the aggregate amount of stockholders' equity and junior securities exceeds 50% of the aggregate amount of the class of securities being offered, or if the offering is justified by the prevailing debt-equity ratios in the issuer's industry or by the issuer's history of interest or dividend coverage.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70.

SEC 3.09 Incomplete registration statements. Any registration statement which a registrant fails to complete or withdraw within one year from the date of filing shall be deemed materially incomplete under section 551.28 (1) (a), Wis. Stats., and the commissioner

may issue a stop order denying effectiveness to such registration statement.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70.

SEC 3.10 Federal securities laws. The commissioner may issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, any registration statement filed pursuant to section 551.26, Wis. Stats., when he finds that the sale of securities pursuant to such registration statement is or would be in violation of the securities act of 1933 or the investment company act of 1940.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70.

SEC 3.11 Investment companies. The offer or sale of redeemable securities of an open-end management investment company or unit investment trust, as defined in the investment company act of 1940, may be deemed unfair and inequitable to the purchasers thereof unless its prospectus, advisory contract, or organizational instruments include provisions satisfying the following requirements:

(1) The investments of the company shall be restricted in the following respects:

(a) No diversified investment company shall purchase the securities of any issuer, excluding government securities, if by reason thereof the value of its investment in all securities of that issuer will exceed 5% of the value of its total assets.

(b) No investment company shall purchase any securities of the classes herein defined, if by reason thereof the value of its aggregate investment in such classes of securities will exceed: 10% of its total assets in securities of issuers which the company is restricted from selling to the public without registration under the securities act of 1933; 5% of its total assets in securities of unseasoned issuers, including their predecessors, which have been in operation for less than three years, and equity securities of issuers which are not readily marketable; or 5% of its total assets in puts, calls, straddles, spreads, and any combination thereof.

(c) No investment company shall invest any part of its total assets in real estate or interests therein, excluding readily marketable securities; commodities or commodity futures contracts; or interests in oil, gas, or other mineral exploration or development programs.

(d) The fundamental investment policies of the company shall be stated in the prospectus in reasonable detail and shall not be materially changed in any respect unless authorized by the vote of a majority of the outstanding voting securities of the company.

(2) The policy stated or followed by any investment company of engaging in any material respect in any of the following or related speculative activities, whether individually or in combination, and the relatively greater risks or costs involved in such activities, shall be disclosed or clearly referred to in bold face type on the cover of the prospectus or on a prospectus supplement satisfactory in form to the commissioner:

(a) Borrowing money for investment in securities, excluding borrowing for temporary purposes;

(b) Purchasing securities for short-term trading;

(c) Purchasing restricted securities as herein defined;

(d) Purchasing put or call options or combinations thereof; or

(e) Short selling of securities, excluding short selling against the box.

(3) The aggregate annual expenses of every character paid or incurred by an invesetment company, including management and advisory fees but excluding interest, taxes, and brokerage commissions, and extraordinary expenses, whether such expenses are payable by the company or its shareholders, calculated at least quarterly on a basis consistently applied, shall not exceed 1½% of the first $30,000,000 of its net assets and 1% of any additional net assets. The investment adviser or manager shall reimburse the investment company not less than annually for the amount by which such aggregate annual expenses exceed the amounts herein provided, up to an amount not exceeding its management and advisory fees for the period for which reimbursement is made, prior to publication of the company's annual report, and shall promptly notify the commissioner if the aggregate expense limitation is exceeded by reason of any extraordinary expenses. The commissioner may require the investment adviser or manager to maintain financial resources reasonably sufficient to enable it to meet its reimbursement obligation hereunder.

(4) The net assets of an investment company, upon completion of the initial public offering of its securities or within a period of two years after the commencement thereof or such additional period as the commissioner may permit, shall not be less than $1,000,000.

(5) All payments by an investment company upon redemption of securties of which it is the issuer shall be made in cash, except that the payments in cash by a company which has filed an election pursuant to rule 18f-1 under the investment company act of 1940 may be limited to the amount specified thereunder. The company shall give prompt written notice to the commissioner prior to effecting any redemption in assets other than cash in this state, specifying the manner in which such redemption will be effected and the securities to be distributed upon redemption. The redemption fee payable by any shareholder shall not exceed 1% of the amount receivable upon redemption of his shares, except that if the shares of a company are sold without sales commission, the redemption fee shall not exceed 2% of such amount, subject to such conditions as the commissioner may prescribe.

(6) An investment company shall not effect any brokerage transactions in its portfolio securities with any broker–dealer affiliated directly or indirectly with its investment adviser or manager, unless such transactions, including the frequency thereof, the receipt of commissions payable in connection therewith, and the selection of the affiliated broker–dealer effecting such transactions, are not unfair or unreasonable to the shareholders of the company. The commissioner may require the company to file periodic reports concerning all such brokerage transactions.

(7) Each registered investment company shall notify the commissioner promptly when it is not in compliance with any of the above requirements, and its registration statements shall be subject to revocation or suspension.

History: Cr. Register, August, 1972, No. 200, eff. 9–1–72.

SEC 3.12 Other causes for denial, suspension or revocation. The enumeration of causes stated in Wis. Adm. Code sections SEC 3.01 through 3.11 is not exclusive, and the commissioner may issue a stop order denying effectiveness to, or suspending or revoking the effectiveness of, any registration statement for any cause stated in section 551.28 (1), Wis. Stats., whether similar to or different from the causes enumerated in these sections, when necessary or appropriate in the public interest or for the protection of purchasers.

History: Cr. Register, December, 1969, No. 168, eff. 1–1–70; renum. from SEC 3.11 to be SEC 3.12 and am., Register, August, 1972, No. 200, eff. 9–1–72.