Department of Corporations

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The Department of Corporations (DOC) is part of the cabinet-level Business, Transportation and Housing Agency, and is empowered under section 25600 of the California Code of Corporations. The Commissioner of Corporations, appointed by the Governor, oversees and administers the duties and responsibilities of the Department. The rules promulgated by the Department are set forth in Division 3, Title 10 of the California Code of Regulations.

The Department administers several major statutes, including the Corporate Securities Law of 1968, Corporations Code section 25000 *et seq.*, which requires the qualification of all securities sold in California. "Securities" are defined quite broadly, and may include business opportunities in addition to more traditional stocks and bonds. Many securities may be "qualified" through compliance with the Federal Securities Acts of 1933, 1934, and 1940. If the securities are not under federal qualification, the Commissioner may issue a permit for their sale in California.

Through DOC's Securities Regulation Division, the Commissioner licenses securities agents, broker-dealers, and investment advisers, and may issue "desist and refrain" orders to halt unlicensed activity or the improper sale of securities. Deception, fraud, or violation of any DOC regulation is cause for license revocation or suspension of up to one year. Also, any willful violation of the securities law is a felony, and DOC refers these criminal violations to local district attorneys for prosecution.

The Commissioner also enforces a group of more specific statutes involving similar kinds of powers: the California Finance Lenders Law (Financial Code section 22000 *et seq.*); the California Residential Mortgage Lending Act (Financial Code section 50000 *et seq.*); the Franchise Investment Law (Corporations Code section 31000 *et seq.*); the Security Owners Protection Law (Corporations Code section 27000 *et seq.*); the California Commodity Law of 1990 (Corporations Code section 29500 *et seq.*); the Escrow Law (Financial Code section 17000 *et seq.*); the Check Sellers, Bill Payers and Proraters Law (Financial Code section 12000 *et seq.*); the Securities Depository Law (Financial Code section 30000 *et seq.*); and–effective July 1, 1999–the Capital Access Company Law (Corporations Code section 28000 *et seq.*) (see below).

The Corporations Commissioner also administers the Knox-Keene Health Care Service Plan Act of 1975, Health and Safety Code section 1340 *et seq.*, which is intended to promote the delivery of health and medical care to Californians who enroll in or subscribe to services provided by a health care service plan or specialized health care service plan. Coverage of these DOC activities is found above, under "Health Care Regulatory Agencies."

MAJOR PROJECTS

DOC Rulemaking Under the Capital Access Company Law

SB 2189 (Vasconcellos) (Chapter 668, Statutes of 1998) enacted the Capital Access Company Law (CACL) at Corporations Code section 28000 *et seq.* The new law, which will be administered by the Corporations Commissioner effective July 1, 1999, establishes the framework for a new licensing and regulatory scheme for capital access companies organized to provide financing assistance to small business firms in California. *[16:1 CRLR 146]*

The Capital Access Company Law establishes the framework for a new licensing and regulatory scheme for capital access companies organized to provide financing assistance to small business firms in California.

Prior to the enactment of SB 2189, the primary statutory vehicle for small California businesses to raise funds was through business and industrial development corporations (BIDCOs) and the State Assistance Fund for Business and Industrial Development Corporations. However, these mechanisms typically provide financing through the making of loans rather than by purchasing securities of small businesses because of the requirements of the federal Investment Company Act of 1940 (the Act). The Act subjects investment companies (companies that invest in the securities of businesses on behalf of investors) to oversight and regulation by the Securities and Exchange Commission pursuant to the federal Investment Company Act of 1940 (the Act). At the federal level, these companies are required to register and comply with various requirements regarding periodic reporting, disclosure of information, examination, and audit that are designed to protect the investing public. In 1996, however, the federal National Securities Markets Improvement Act (NSMIA) amended the Act to exempt from its requirements any company not engaged in the business of issuing redeemable securities, if that company's operations are regulated by the state where it is formed pursuant to a statute regulating firms that provide financial or managerial assistance to companies doing business in the state and if certain additional conditions are met. SB 2189 is intended to implement NSMIA and enable certain investment companies to rely on its exemption from the registration requirement under the Act.

Under the CACL, an applicant for licensure as a capital access company must: (1) have a tangible net worth of at least $250,000 and funds of at least $5 million to invest; (2) have additional financial resources to pay expenses for at least three years; (3) have directors, officers, and controlling persons who are of good character and sound financial standing and are collectively competent; (4) have reasonable promise of successful operation; and (5) agree to comply with all the provisions of the statute. A capital access company's securities may be sold only to accredited investors, and a capital access company may not issue redeemable securities. The offer or sale of non-redeemable securities by a licensed capital access company is exempt from the qualification requirement of the Corporate Securities Law of 1968 (CSL). A capital access company licensed under the CACL is also exempt from the broker-dealer licensure requirements of the CSL. The CACL establishes application and other fees; sets forth requirements relating to a capital access company's organization and name, directors, officers, business transactions, records, reports, examinations, acquisition of control, merger and purchase or sale of business, and voluntary surrender of license; enacts conflict of interest provisions; prescribes enforcement procedures; and establishes civil and criminal penalties for its violation.

On February 5, DOC published notice of its intention to adopt regulations to implement SB 2189. The Department proposes to add a new subchapter to Chapter 3, Title 10 of the CCR, commencing with section 280.100. The new regulations would contain the application form for licensure as a capital access company which must be filed with the Commissioner. Along with the application form, applicants would be required to submit several exhibits, including a statement of financial solvency, a copy of the applicant's fidelity bond, a statement of identity and questionnaire, fingerprint card, a notice identifying the "control persons" of the company, a detailed business plan including numerous specified items, an authorization which will enable the Commissioner to have access to the applicant's financial information that is under the control of third parties (such as banks), a copy of the applicant's certificate of filing and proof of publication, a copy of the applicant's organizational documents and any amendments thereto, a statement disclosing the name of the applicant's parent corporation if the applicant is a subsidiary, a copy of the applicant's conflict of interest policies and procedures, a copy of any contracts into which the applicant has entered with any investment adviser, a consent to service of process form, and a list of attestations made by the applicant.

Section 280.300 would prohibit a capital access company licensee from advertising that any of its officers, employees, or agents are bonded, supervised, regulated, audited, or examined by an agency of the State of California, and would require licensees—when referring to its licensure under SB 2189 in any type of advertising—to state "licensed by the Department of Corporations under the Capital Access Company Law." Section 280.301 would prohibit a licensee from "blind" advertising—that which gives only a telephone number, post office or newspaper box number, or a name other than that of the licensee.

The proposed regulations would also specify the filing fees for applications for licensure, and require that each licensed capital access company provide and maintain a fidelity bond which covers each officer, director, partner, member, trustee, or employee who has access to or responsibility for the funds or securities of the company. The bond may be either a primary commercial blanket bond or a blanket position bond written by an insurer licensed by the California Insurance Commissioner. The regulations would set forth a list of activities that the Commissioner considers unsafe and unsound acts; establish guidelines for financial statements and reports that are required to be submitted pursuant to SB 2189; set deadlines for the filing of specified reports with the Commissioner; and require licensees to maintain, keep, and preserve specified records, books, accounts, and other documents.

The Commissioner did not hold a public hearing on these regulations, but accepted written comments through April 9. At this writing, DOC is preparing the rulemaking record on the proposed regulations for submission to the Office of Administrative Law (OAL) in hopes that OAL will approve them before the July 1 effective date of the CACL.

DOC Rulemaking Under the California Finance Lenders Law

On March 12, the Commissioner published notice of his intent to amend section 1556, Title 10 of the CCR, which specifies requirements for guaranteed loan offers under the Finance Lenders Law and, among other things, requires finance companies to submit complete guaranteed loan offer packages (and any related advertising copy) to the Commissioner for examination. The Commissioner proposes to add new subsection (f) to section 1556, which would authorize the Commissioner, by order, to exempt any finance company from being required to submit guaranteed loan offer packages for examination if the Commissioner finds the company has been "in substantial compliance with the [Finance Lenders Law] or any regulation or order regarding advertising for a period of not less than 12 months immediately prior to the effective date of the order. Any order issued pursuant to this subsection shall continue in effect until it expires by its terms or until the order is revoked by the Commissioner."

The Commissioner did not hold a public hearing on the proposed changes, but accepted written comments until April 26. At this writing, DOC staff is preparing the rulemaking record on the proposed changes for submission to OAL.

DOC Affirms Authority Over Internet Securities Offerings

On February 25, DOC announced its adoption of a hearing officer's proposed decision and issuance of a desist and refrain order to FairShare, Inc., and its principal officer and shareholder. The order directs FairShare to stop offering to California residents investments in an Internet-based investment club, which sought to give small investors an opportunity to make venture capital investments in emerging companies. According to DOC, FairShare used the Internet to sell memberships to small investors and offered to investigate and provide information and recommendations on emerging companies in which they might wish to invest, and to negotiate favorable terms for its members. It also offered referral fees for bringing in new members. Investors received such promises as "Now You Can Play Like The Big Guys."

DOC found that the FairShare program did more than provide a forum for small investors to find out about investment opportunities in emerging companies. In fact, the investors/members relied upon the expertise of FairShare to provide its members with screening, due diligence review, and negotiations with promising new businesses with good investment potential. The hearing officer found—and Acting Commissioner Kenefick agreed—that the scheme is a securities transaction requiring review and qualification by DOC under the Corporate Securities Law of 1968.

A DOC news release announcing the desist and refrain order quoted Acting Commissioner Kenefick as follows: "The Internet has opened up the marketplace to small investors as never before, but many of the protections provided by traditional markets and prior review by regulators are not present in Internet transactions. Many of the research, due diligence, risk disclosure, and suitability considerations that apply in the relationship between investors and registered broker-dealers in securities offerings are being eroded as more and more investors choose to go it alone on the Internet, with a corresponding increase in risk."

DOC's February 25 decision affirms two earlier orders in the area of Internet securities transactions issued by the Corporations Commissioner. On November 5, 1996, in Release No. 100-C, the Commissioner stated that the broad definitions of the terms "offer" and "offer to sell" under the CSL include an attempt or offer to dispose of, or the solicitation of an offer to buy, a security or an interest in a security for value, that is made on the Internet or a similar proprietary or common carrier electronic system. Consequently, an "offer" made "in this state" requires prior qualification under Corporations Code sections 25510, 25120, or 25130 (unless an exemption from qualification exists). Moreover, such "offers" made over the Internet are "advertisements" under Corporations Code section 25002 required to be filed with the Commissioner of Corporations, insofar as they concern a security sold or offered for sale in California (unless otherwise exempted).

DOC's February 25 decision affirms two earlier orders in the area of Internet securities transactions issued by the Corporations Commissioner.

With respect to offers made on the Internet, the Commissioner declared that offers of securities made by, or on behalf of, issuers on or through the Internet are exempt from the qualification requirement only if all of the following conditions are met: (1) the Internet offer originates from outside California and indicates, directly or indirectly, that the securities are not being offered or sold to residents of California; (2) the Internet offer originates from outside California and is not directed to any person in California by, or on behalf of, the issuer of the securities; and (3) no sales of the issuer's securities will be made in California as a result of the Internet offer under (1) and (2) above until such time as the sale of the securities being offered has been qualified under the CSL.

On August 19, 1997, in Release No. 107-C, the Commissioner warned Internet securities sellers and investment advisers that their use of the Internet to advertise and otherwise disseminate information on products and services to prospective customers and clients in California is deemed to be the "transaction of business" in California and requires licensure and certification in this state. Specifically, the Commissioner stated that broker-dealers, investment advisers, broker-dealer agents, and investment adviser representatives or associated persons (collectively, "sellers/advisers") who use the Internet to distribute information on available products and services directed generally to anyone having access to the Internet will not be deemed to be "transacting business" in California for purposes of licensure only if the seller/adviser posts a clear written legend which states all of the following: (1) sellers/advisers may only transact business in a particular state after licensure or the satisfaction of qualification requirements of that state, or if they are excluded or exempted from the state's seller/adviser requirements; (2) follow-up, individualized responses to consumers in a particular state by sellers/advisers that involve either the effecting or attempting to effect transactions in securities or the rendering of personalized investment advice for compensation will not be made without first complying with the state's seller/adviser requirements, or pursuant to an applicable exemption or exclusion; and (3) for information concerning the licensure status or disciplinary history of a seller/adviser, a consumer should contact his or her state securities law administrator. Further, the communications of Internet sellers/advisers must contain a mechanism, including technical "firewalls" or other implemented policies and procedures, designed to ensure that prior to any direct communication with prospective customers or clients in California, the seller/adviser is first licensed or qualified in California or qualifies for an exemption or exclusion from the licensure requirement. Finally, the Internet communication must not involve either effecting or attempting to effect transactions in securities, or the rendering of personalized investment advice for compensation, as the case may be, in California over the Internet, but must be limited to the dissemination of general information on products and services.

In related action, on April 26 DOC announced the creation of a new page on its website devoted to its efforts to combat investment fraud on the Internet. Consumers may access the page by clicking on the "Investor Education" button at the Department's home page. In a press release announcing the new page, DOC noted that it has been working to educate consumers about Internet investment fraud since 1994. In March 1998, DOC's Enforcement Division set up an Internet Surveillance Unit consisting of two attorneys, one investigator, and one examiner to engage in surveillance activities to identify illegal and fraudulent securities and other investment offerings on the Internet and to bring enforcement actions. Since that time, DOC has issued 39 desist and refrain orders to a total of 158 subjects, has filed one civil injunctive action and obtained a preliminary injunction against 26 defendants, and has referred two cases for criminal prosecution involving illegal or fraudulent Internet offerings.

LEGISLATION

AB 517 (Maldonado). Existing law requires DOC to license escrow agents, and requires all escrow agents to be members of the Escrow Agents' Fidelity Corporation (EAFC), a private entity which indemnifies its members against the loss of trust obligations when the loss results from fraud, misappropriation, or embezzlement by an escrow officer, director, or employee. The corporation maintains three funds: an operations fund, a membership fund, and a fidelity fund. As amended April 12, this bill would modify the calculation of the assessment for the membership and fidelity funds.

Current law requires a $5 million aggregate balance between the membership and fidelity funds. The membership fund is supported by a $3,000 membership deposit assessed each member; thus, the larger the membership, the higher the membership fund balance. The fidelity fund, which is used to make claim payments and pay fidelity bond premiums, is supported by assessments according to a formula which requires that if the aggregate fund balance between the fidelity fund and the membership fund should fall below $5 million (even if only by one cent), the members must be assessed $1 million, rather than the amount necessary to bring the aggregate balance back up to $5 million. The proponents of this bill argue that this statute is not justified and is leading to over-assessment of the industry. To address this problem, the bill proposes a fidelity fund balance of $2.5 million. The calculation would focus more on the balance in the fidelity fund, rather than the combined balances of the fidelity fund and membership fund. The proponents emphasize that the new formula is less dependent on member population as a factor for achieving adequate fund balances and sufficiently protects the industry.

This bill would also revise various procedures and requirements for appeals to the Commissioner of Corporations when a member or successor in interest is aggrieved by any action or decision of the EAFC. *[S. FI&IT]*

AB 410 (Lempert and Papan). As noted above, the Escrow Law requires every person licensed pursuant to that law to participate as a member of EAFC. As amended March 24, this bill would limit that membership requirement to those persons engaged in the business of receiving escrows in certain types of traditional escrow transactions. The bill would require the Corporations Commissioner to establish indemnity bond standards for licensees receiving escrows for other types of transactions (such as Internet escrow transactions), and require that—if an escrow agent chooses to engage in both traditional and non-traditional escrow activities—such an escrow agent maintain separate books and records of accounts for each type of escrow business and maintain separate trust accounts.

This bill is sponsored by the EAFC, and its purpose is to clarify that EAFC coverage and assessment apply to traditional escrow activities, while separate bonding requirements will apply to non-traditional, personal property escrows, such as Internet escrows. According to the legislative analysis of the bill, traditional escrow agents are uncomfortable with the potential risks and liabilities that Internet escrow agents pose, thus threatening their own protection by the EAFC. The bill recognizes the differences between traditional and Internet escrow activities, and attempts to "protect" these differences by mandating separate "insurance" and bonding requirements for non-traditional escrows. *[A. Appr]*

AB 583 (Papan), as introduced February 19, would specify that it is unlawful for any person to engage in business as an escrow agent or Internet escrow agent within this state except by means of a corporation duly organized for that purpose and licensed by the Corporations Commissioner as an escrow agent. *[A. B&F]*

AB 653 (Hertzberg), as amended April 22, would repeal Financial Code section 50704, which currently limits the number of loans which a DOC-licensed residential mortgage lender may broker to an amount up to 5% of its mortgage lending business. This limitation was enacted in 1996 as part of a new law known as the California Residential Mortgage Lending Act (RMLA), administered by DOC. Prior to that time, mortgage bankers were licensed by the Department of Real Estate (DRE). Mortgage bankers are now licensed by DOC under the RMLA, and it permits them to make or broker residential mortgage loans (one to four units), or service residential mortgage loans. According to both DOC and DRE, the licensing and regulation of mortgage bankers is confusing and "overlap" exists. At present, a mortgage banker who wants to operate as a residential mortgage lender (RML) is permitted to loan its own money to borrowers, or broker and obtain loans for borrowers. When a mortgage banker brokers loans, the maximum allowed is not more than 5% of the total loans made during the first year of operation under the RMLA. Thereafter, the percentage level may not exceed the greater of 5%, or 10% less the percentage level of brokerage services done in the prior year. Individuals working as mortgage bankers, or for mortgage banking companies, also may be licensed by DRE as real estate brokers. When operating with a DRE license, a mortgage banker is not subject to the above RML brokered loan percentage limitations. This bill, sponsored by the California Mortgage Bankers Association, would repeal the 5% limitation on brokered loans and effectively repeal the "requirement" that mortgage bankers be dually licensed by DOC and DRE.

AB 653 would also amend a provision in Financial Code section 50707 which sunsets the provisions that permit mortgage bankers to operate under DOC jurisdiction (Financial Code section 50700 *et seq.*) on June 30, 2001; AB 653 would extend the sunset date to June 30, 2006. *[A. Appr]*

SB 579 (Dunn). The California Finance Lenders Law provides for licensing and regulation by the Commissioner of Corporations of persons engaged in the business of making consumer or commercial loans. Under these provisions, a licensed lender generally may not take a deed of trust, mortgage, or lien upon real property as security for a loan if the principal amount of the loan is less than $5,000. As introduced February 23, this bill would provide that a licensed lender may not take a deed of trust, mortgage, or lien upon real property as security for a loan if the bona fide principal amount of the loan is less than $5,000. *[S. FI&IT]*

SB 459 (Johnson), as introduced February 17, would exempt from the registration requirement of the Franchise Investment Law any offer, sale, or other transfer of a franchise or any interest therein if the franchise is a "fractional franchise." A "fractional franchise" is defined as any relationship in which the franchisee or any of the current directors or executive officers thereof has been in the type of business represented by the franchise relationship for more than two years and the parties anticipated, or should have anticipated, at the time the agreement establishing the franchise relationship was reached, that the sales arising from the relationship would represent no more than 20% of the sales in dollar volume of the franchisee. *[A. B&F]*

SB 1124 is sponsored by E*Trade Securities, Inc., a California corporation, which reports that it is one of the largest online brokerage firms in the world, now servicing over one million accounts.

SB 1124 (Vasconcellos), as amended April 14, provides that an application by a prospective customer to enter into a brokerage agreement with a broker-dealer licensed by DOC under the Corporate Securities Law (or exempt from licensure pursuant to that law), which is transmitted electronically and is accompanied by the prospective customer's digital signature, would be deemed to be a valid contract. For purposes of this bill, the term "digital signature" means an electronic identifier, created by a computer, that is intended by the party using it to have the same force and effect as a manual signature. Under this proposal, a digital signature would have the same force or effect as a manual signature if it embodies all of the following attributes: (1) it is unique to the person using it; (2) it is capable of verification; (3) it is under the sole control of the person using it; and (4) it is linked to data in a manner that if the data is changed, the digital signature is invalidated. This bill would also require a broker-dealer to make certain disclosures required by federal law if the broker-dealer accepts electronic applications from prospective customers.

SB 1124 is sponsored by E*Trade Securities, Inc., a California corporation, which reports that it is one of the largest online brokerage firms in the world, now servicing over one million accounts. It is growing at the rate of 2,000–3,000 new accounts per day, which are opened by potential investors who request applications by mail and others who download applications from E*Trade's website, fill them out, and send the applications back by mail. Because E*Trade's choice of law in its brokerage agreements is California, all of the accounts opened with E*Trade, whether from California investors or not, are governed by California law. However, nothing in existing state law defines or regulates digital or electronic signatures except for digital signatures affixed to public documents filed with the Secretary of State. *[S. Jud]*

SB 820 (Sher and Bowen), as amended April 15, would enact the Electronic Transactions Act, which would generally apply to all electronic transactions (including online investing transactions) except to the creation and execution of wills and testamentary trusts and certain other transactions. The bill would provide that a record or signature may not be denied legal effect or enforceability solely because it is in electronic form. If a law requires a record to be in writing, or provides consequences if it is not, an electronic record would satisfy the law. If a law requires a signature, or provides consequences in the absence of a signature, the law would be satisfied with respect to an electronic record if the electronic record included an electronic signature. The bill would authorize the provision of written information by electronic record. The bill would set forth provisions governing changes and errors, the effect of electronic signatures, and admissibility into evidence. *[S. Jud]*

LITIGATION

In *Diamond Multimedia Systems Inc. v. Superior Court*, 19 Cal. 4th 1036 (Jan. 4, 1999), the California Supreme Court affirmed a ruling of the Sixth District Court of Appeal in what the high court termed "a case of first impression." The court's ruling effectively kept alive more than 50 securities fraud class actions filed by out-of-state investors currently pending in California state courts.

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Diamond Multimedia Systems, Inc. (Diamond) is a manufacturer and supplier of graphics accelerator and modem products based in San Jose. Its shares are publicly traded. Plaintiff Joanne Pass and a class of similarly situated investors in California as well as throughout the United States sued Diamond and some of its individually named officers in Santa Clara County Superior Court, alleging "market manipulation": that defendants were aware of adverse nonpublic information about Diamond's business, finances, product, markets, and present and future business prospects, but approved false statements issued by Diamond. The complaint alleged a cause of action under California Corporations Code section 25400(d), which broadly provides that "it is unlawful for any person, directly or indirectly, *in this state*...selling or offering for sale or purchasing or offering to purchase securities...to make any false or misleading statement with respect to a material fact or an omitted fact..." (emphasis added). The Corporations Commissioner is authorized to enforce section 25400; additionally, section 25500 creates a civil remedy for violation of section 25400.

Defendants demurred to the complaint, arguing that plaintiffs failed to state a cause of action because they failed to allege that all plaintiffs are domiciled in California and that their purported Diamond stock transactions took place in California. At the hearing on the demurrer, defendants produced legislative history of sections 25400 and 25500 and argued that it reflects the legislature's intent to protect California investors—that is, California residents or persons who purchase stock in California. The superior court overruled defendants' demurrer, and defendants filed a petition for writ of mandate in the Sixth District. The appellate court summarily denied defendants' petition, and the state Supreme Court granted review.

Before the Supreme Court, plaintiffs argued that the phrase "in this state" in subsection 25400(d) defines only the place where the proscribed acts occur, and does not limit the liability for violation of the section to persons who bought or sold affected stock in California. Defendants argued that the phrase requires not only the act(s) of stock manipulation, but also the sale or purchase as well as all the plaintiffs to have been located in California. Further, defendants urged the court to construe the civil remedy afforded by section 25500 narrowly so that California would not provide a more attractive forum and afford more expansive remedies for market manipulation than does federal securities law.

Finding the plain language of the statute "very clear" and examining some of the legislative history produced by defendants, the court held that "out-of-state purchasers and sellers of securities whose price has been affected by the unlawful market manipulation proscribed by section 25400 may avail themselves of the remedy afforded by section 25500. The remedy is not limited to transactions made in California."

Prior to 1995, the vast majority of class action securities fraud lawsuits were filed in federal courts. However, passage of the Private Securities Litigation Reform Act of 1995, P.L. No. 104-67, imposed procedural barriers to the filing of such cases and blocked most discovery which had previously been available. As a result, the number of securities fraud class actions filed in state courts increased by 65% during the first ten months of 1996. Perceiving this activity to be an attempt to evade the 1995 act, Congress then passed the Securities Litigation Uniform Standards Act of 1998, which prohibits the filing of state court class actions based on state statutory or common law by a private party alleging "an untrue statement or omission of a material fact in connection the purchase or sale of a covered security" or "that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security." The 1998 Act, however, is inapplicable to pending state court actions and to individual securities fraud actions.

Diamond has filed a petition for *certiorari* in the U.S. Supreme Court.

On February 25 in ***Partnership Exchange Securities Company v. National Association of Securities Dealers, Inc.***, 169 F.3d 606, the U.S. Ninth Circuit Court of Appeals affirmed the district court's ruling that the NASD is absolutely immune to claims against it which arise from the disciplinary actions it has taken against traders.

The NASD is a nonprofit, self-regulating organization registered with the federal Securities and Exchange Commission, and is the primary regulatory body for the broker-dealer industry. Under the federal Securities and Exchange Act of 1934, the SEC has broad supervisory responsibilities over the NASD. In 1991, the NASD filed a complaint with the District Business Conduct Committee, a disciplinary body of the NASD, against Partnership Exchange Securities Company (Partnership), alleging violations of the NASD's fair pricing rule, misrepresentation of the amount of gross profits Partnership made in connection with transactions with customers, and failure to disclose its mark ups and mark downs in transactions with its customers. Following a lengthy administrative proceeding which included appeals to both the National Business Conduct Committee (NBCC) (the next level of review within the NASD) and the SEC, the SEC ultimately ruled for Partnership.

Partnership then sued the NASD for money damages in federal court, alleging (among other things) that the NASD had filed the complaint against Partnership to force member firms to conform to the NASD's preferred procedures, that the NASD had filed an improper complaint against Partnership, and that the NASD's officers had failed to afford substantive due process when they investigated Partnership. The district court denied Partnership's claim on grounds that the NASD is protected by absolute immunity. Citing *Sparta Surgical Corp. v. National Association of Securities Dealers, Inc.*, 159 F.3d 1209 (9th Cir. 1998), the Ninth Circuit affirmed, holding that the NASD is absolutely immune from money damages liability when it is acting "under the aegis of the Exchange Act's delegated authority."