

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1991

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HOUSE BILL 535*

Short Title: Enhance Securities Enforcement.

(Public)

Sponsors: Representative R. Hunter.

Referred to: Judiciary III.

April 1, 1991

A BILL TO BE ENTITLED

AN ACT TO ENHANCE THE ENFORCEMENT PROVISIONS OF THE NORTH CAROLINA SECURITIES ACT AND THE INVESTMENT ADVISERS ACT.

The General Assembly of North Carolina enacts:

Section 1. Article 2 of Chapter 78A of the General Statutes is amended by adding two new sections to read:

"§ 78A-11. Unlawful telephone rooms.

It is unlawful for any person to willfully manage, supervise, control, or own, directly or indirectly, either alone or in association with others, any telephone room in this State. For purposes of this section, 'telephone room' means an enterprise in which two or more persons engage in telephone communications with members of the public using two or more telephones at one location, or more than one location in a common scheme or enterprise, in violation of G.S. 78A-8 or G.S. 78A-12. It is an affirmative defense to a prosecution under this section that the person acted in good faith and did not directly or indirectly induce an act or acts constituting a violation of G.S. 78A-8 or G.S. 78A-12.

"§ 78A-12. Manipulation of market.

(a) In addition to the prohibitions of G.S. 78A-8, it is unlawful for any person to:

- (1) Willfully quote a fictitious price with respect to a security;
- (2) Effect a transaction in a security which involves no change in the beneficial ownership of the security, for the purpose of creating a false or misleading appearance of active trading in a security, or a false or misleading appearance of activity with respect to the market for the security;

- 1 (3) Enter an order for the purchase of a security with the knowledge that,
2 at substantially the same time, an order of substantially the same size,
3 and at substantially the same price, for the sale of the security has
4 been, or will be, entered by or for the same person, or an affiliated
5 person, for the purpose of creating a false or misleading appearance of
6 active trading in a security, or a false or misleading appearance of
7 activity with respect to the market for the security;
- 8 (4) Enter an order for the sale of a security with knowledge that, at
9 substantially the same time, an order of substantially the same size,
10 and at substantially the same price, for the purchase of the security has
11 been, or will be, entered by or for the same person, or an affiliated
12 person, for the purpose of creating a false or misleading appearance of
13 active trading in a security, or a false or misleading appearance of
14 activity with respect to the market for the security; or
- 15 (5) Employ any other deceptive or fraudulent device, scheme, or artifice to
16 manipulate the market in a security.

17 (b) A transaction effected in compliance with the applicable provisions of the
18 Securities Exchange Act of 1934 and the rules and regulations of the Securities and
19 Exchange Commission thereunder is not manipulation of the market under subsection
20 (a) of this section."

21 Sec. 2. G.S. 78A-46(a) reads as rewritten:

22 **"§ 78A-46. Investigations and subpoenas.**

23 (a) The Administrator in his discretion

- 24 (1) May make such public or private investigations within or outside of
25 this State as he deems necessary to determine whether any person has
26 violated or is about to violate any provision of this Chapter or any rule
27 or order hereunder, or to aid in the enforcement of this Chapter or in
28 the prescribing of rules and forms hereunder,
- 29 (2) May require or permit any person to file a statement in writing, under
30 oath or otherwise as the Administrator determines, as to all the facts
31 and circumstances concerning the matter to be investigated, ~~and~~
- 32 (3) May publish information concerning any violation of this Chapter or
33 any rule or order ~~hereunder.~~ hereunder, and
- 34 (4) May appoint employees of the Securities Division as securities law
35 enforcement agents and as other enforcement personnel.
- 36 a. Subject matter jurisdiction – The responsibility of an agent shall
37 be enforcement of this Chapter and Chapters 78C and 78D of
38 the General Statutes.
- 39 b. Territorial jurisdiction – A securities law enforcement agent is a
40 State officer with jurisdiction throughout the State.
- 41 c. Service of Orders of the Administrator – Securities law
42 enforcement agents may serve and execute notices, orders, or
43 demands issued by the Administrator for the surrender of
44 registrations or relating to any administrative proceeding.

1 While serving and executing such notices, orders, or demands,
2 securities law enforcement agents shall have all the power and
3 authority possessed by law enforcement officers when
4 executing an arrest warrant."

5 Sec. 3. G.S. 78A-47(a) reads as rewritten:

6 **"§ 78A-47. Injunctions; cease and desist orders.**

7 (a) Whenever it appears to the Administrator that any person has engaged or is
8 about to engage in any act or practice constituting a violation of any provision of this
9 Chapter or any rule or order hereunder, he may in his discretion bring an action in any
10 court of competent jurisdiction to enjoin the acts or practices and to enforce compliance
11 with this Chapter or any rule or order hereunder. Upon a proper showing a permanent or
12 temporary injunction, restraining order, or writ of mandamus shall be granted and a
13 receiver or conservator may be appointed for the defendant or the defendant's assets. In
14 addition to any other remedies provided by this Chapter, the Administrator may apply to
15 the court hearing this matter for an order of restitution whereby the defendant in such
16 action shall be ordered to make restitution of those sums shown by the Administrator to
17 have been obtained by him in violation of any of the provisions of this Chapter. Such
18 restitution may be payable, at the option of the court, to the Administrator or receiver
19 appointed pursuant to this section or directly to those persons whose assets were
20 obtained in violation of this Chapter. The court may not require the Administrator to
21 post a bond."

22 Sec. 4. G.S. 78A-47 is amended by adding a new subsection to read:

23 "(c) The Administrator may issue an order against an applicant, registered person,
24 or other person who willfully violates this Chapter or a rule or order of the
25 Administrator under this Chapter:

- 26 (1) Imposing a civil penalty of up to two thousand five hundred dollars
27 (\$2,500) for a single violation or of up to twenty-five thousand dollars
28 (\$25,000) for multiple violations in a single proceeding or a series of
29 related proceedings; and
30 (2) Requiring reimbursement and the costs of investigation.

31 Any civil penalty or reimbursement imposed under this subsection shall be paid into
32 the General Fund. No order under this subsection may be entered without prior notice
33 of an opportunity for hearing."

34 Sec. 5. G.S. 78A-56 reads as rewritten:

35 **"§ 78A-56. Civil liabilities.**

36 (a) Any person who:

- 37 (1) Offers or sells a security in violation of G.S. 78A-8(1), 78A-8(3), 78A-
38 10(b), 78A-12, 78A-24, or 78A-36(a), or of any rule or order under
39 G.S. 78A-49(d) which requires the affirmative approval of sales
40 literature before it is used, or of any condition imposed under G.S.
41 78A-27(d) or 78A-28(g), or
42 (2) Offers or sells a security by means of any untrue statement of a
43 material fact or any omission to state a material fact necessary in order
44 to make the statements made, in the light of the circumstances under

1 which they were made, not misleading (the purchaser not knowing of
2 the untruth or omission), and who does not sustain the burden of proof
3 that he did not know, and ~~did not act in reckless disregard, in the~~
4 exercise of reasonable care could not have known, of the untruth or
5 omission,

6 is liable to the person purchasing the security from him, who may sue either at law or in
7 equity to recover the consideration paid for the security, together with interest at the
8 legal rate from the date of payment, costs, and reasonable attorneys' fees, less the
9 amount of any income received on the security, upon the tender of the security, or for
10 damages if he no longer owns the security. Damages are the amount that would be
11 recoverable upon a tender less the value of the security when the purchaser disposed of
12 it and interest at the legal rate as provided by G.S. 24-1 from the date of disposition.

13 (b) Any person who purchases a security by means of any untrue statement of a
14 material fact or any omission to state a material fact necessary in order to make the
15 statements made, in the light of the circumstances under which they are made, not
16 misleading (the seller not knowing of the untruth or omission), and who does not sustain
17 the burden of proof that he did not know, and in the exercise of reasonable care could
18 not have known, of the untruth or omission, shall be liable to the person selling the
19 security to him, who may sue either at law or in equity to recover the security, plus any
20 income received by the purchaser thereon, upon tender of the consideration received, or
21 for damages if the purchaser no longer owns the security. Damages are the excess of the
22 value of the security when the purchaser disposed of it, plus interest at the legal rate
23 from the date of disposition, over the consideration paid for the security.

24 (c) Every person who directly or indirectly controls a person liable under
25 subsection (a) or (b), every partner, officer, or director of such a person, every person
26 occupying a similar status or performing similar functions, every employee of such a
27 person who materially aids in the act or transaction, and every dealer or salesman who
28 materially aids in the sale are also liable jointly and severally with and to the same
29 extent as such person, unless the person who is so liable sustains the burden of proof
30 that he did not know, and ~~did not act in reckless disregard, in the exercise of reasonable~~
31 care could not have known, of the existence of the facts by reason of which the liability
32 is alleged to exist. There is contribution as in cases of contract among the several
33 persons so liable.

34 (d) Any tender specified in this section may be made at any time before entry of
35 judgment. Tender shall require only notice of willingness to exchange the security for
36 the amount specified. Any notice may be given by service as in civil actions or by
37 certified mail addressed to the last known address of the person liable.

38 (e) Every cause of action under this statute survives the death of any person who
39 might have been a plaintiff or defendant.

40 (f) No person may sue under this ~~section more than two years after the sale or~~
41 ~~contract of sale.~~ section:

42 (1) Based upon a violation of G.S. 78A-24, G.S. 78A-36(a), or any rule or
43 order under G.S. 78A-49(d) that requires the affirmative approval of
44 sales literature before it is used, or any condition imposed under G.S.

- 1 78A-27(d) or G.S. 78A-28(g) unless such action is brought within two
2 years after the sale or contract of sale; or
3 (2) Based upon a violation of G.S. 78A-8(1), 78A-8(3), 78A-10(b), or
4 78A-12, unless such action is brought within the lesser of:
5 a. Three years after the sale or contract of sale, or
6 b. Two years after the plaintiff receives actual notice of, or with
7 the exercise of reasonable diligence should have known of, the
8 facts constituting the violation.
- 9 (g) (1) No purchaser may sue under this section if, before suit is
10 commenced, the purchaser has received a written offer stating the
11 respect in which liability under this section may have arisen and
12 fairly advising the purchaser of his rights; offering to repurchase the
13 security for cash payable on delivery of the security equal to the
14 consideration paid, together with interest at the legal rate as provided
15 by G.S. 24-1 from the date of payment, less the amount of any
16 income received on the security or, if the purchaser no longer owns
17 the security, offering to pay the purchaser upon acceptance of the
18 offer an amount in cash equal to the damages computed in
19 accordance with subsection (a); and stating that the offer may be
20 accepted by the purchaser at any time within 30 days of its receipt;
21 and the purchaser has failed to accept such offer in writing within
22 the specified period.
- 23 (2) No seller may sue under this section if, before suit is commenced, the
24 seller has received a written offer stating the respect in which liability
25 under this section may have arisen and fairly advising the seller of his
26 rights; offering to return the security plus the amount of any income
27 received thereon upon payment of the consideration received, or, if the
28 purchaser no longer owns the security, offering to pay the seller upon
29 acceptance of the offer an amount in cash equal to the damages
30 computed in accordance with subsection (b); and providing that the
31 offer may be accepted by the seller at any time within 30 days of its
32 receipt; and the seller has failed to accept such offer in writing within
33 the specified period.
- 34 (3) Offers shall be in the form and contain the information the
35 Administrator by rule prescribes. Every offer under subsection (g)
36 shall be delivered to the offeree or sent by certified mail addressed to
37 him at his last known address. If an offer is not performed in
38 accordance with its terms, suit by the offeree under this section shall
39 be permitted without regard to this subsection.
- 40 (h) No person who has made or engaged in the performance of any contract in
41 violation of any provision of this Chapter or any rule or order hereunder, or who has
42 acquired any purported right under any such contract with knowledge of the facts by
43 reason of which its making or performance was in violation, may base any suit on the
44 contract.

1 (i) Any condition, stipulation, or provision binding any person acquiring any
2 security to waive compliance with any provision of this Chapter or any rule or order
3 hereunder is void.

4 (j) The rights and remedies provided by this Chapter are in addition to any other
5 rights or remedies that may exist at law or in equity, but this Chapter does not create any
6 cause of action not specified in this section or G.S. 78A-37(d)."

7 Sec. 6. G.S. 78A-57 reads as rewritten:

8 **"§ 78A-57. Criminal penalties.**

9 (a) Any person who willfully violates any provision of this Chapter except G.S.
10 78A-8, 78A-9, 78A-11, or 78A-12, or who willfully violates any rule or order under this
11 Chapter, or who willfully violates G.S. 78A-9 knowing the statement made to be false
12 or misleading in any material respect, shall upon conviction be punished as a Class I
13 felon; but no person may be imprisoned for the violation of any rule or order if he
14 proves that he had no knowledge of the rule or order. Any person who willfully violates
15 G.S. 78A-8, 78A-11, or 78A-12 shall, upon conviction be punished as a Class H felon.

16 (a1) In lieu of a fine otherwise authorized by law, a person who has been
17 convicted of or who has pleaded guilty or no contest to having engaged in conduct in
18 violation of the provisions of this Chapter may be sentenced to pay a fine that does not
19 exceed the greater of three times the gross value gained or three times the gross loss
20 caused by such conduct, plus court costs and the costs reasonably incurred in
21 investigation and prosecution.

22 (b) The Administrator may refer such evidence as is available concerning
23 violations of this Chapter or of any rule or order hereunder to ~~the Attorney General or the~~
24 proper district attorney, who may, with or without such a reference, institute the
25 appropriate criminal proceedings under this Chapter. Upon receipt of such reference,
26 the district attorney may request that a duly employed attorney of the Administrator
27 prosecute or assist in the prosecution of such violation or violations on behalf of the
28 State. Upon approval of the Administrator, such employee shall be appointed a special
29 prosecutor for the district attorney to serve without receiving compensation from the
30 district attorney. Such special prosecutor shall have all the powers and duties prescribed
31 by law for district attorneys and such other powers and duties as are lawfully delegated
32 to such special prosecutor by the district attorney.

33 (c) Nothing in this Chapter limits the power of the State to punish any person for
34 any conduct which constitutes a crime by statute or at common law."

35 Sec. 7. G.S. 78C-28 reads as rewritten:

36 **"§ 78C-28. Injunctions; cease and desist orders; ~~orders~~; civil penalties.**

37 (a) Whenever it appears to the Administrator that any person has engaged or is
38 about to engage in any act or practice constituting a violation of any provision of this
39 Chapter or any rule or order hereunder, he may in his discretion bring an action in any
40 court of competent jurisdiction to enjoin the acts or practices and to enforce compliance
41 with this Chapter or any rule or order hereunder. Upon a proper showing a permanent
42 or temporary injunction, restraining order, or **writ of mandamus** shall be granted and a
43 receiver or conservator may be appointed for the defendant or the defendant's assets. In
44 addition to any other remedies provided by this Chapter, the Administrator may apply to

1 the court hearing this matter for an order of restitution whereby the defendant in such
2 action shall be ordered to make restitution of those sums shown by the Administrator to
3 have been obtained by him in violation of any of the provisions of this Chapter. Such
4 restitution shall, at the option of the court, be payable to the Administrator or receiver
5 appointed pursuant to this section or directly to the person or persons whose assets were
6 obtained in violation of this Chapter. The court may not require the Administrator to
7 post a bond.

8 (b) (1) If the Administrator determines after giving notice of an
9 opportunity for a hearing, that any person has engaged in, or is about
10 to engage in, any act or practice constituting a violation of any
11 provision of this Chapter or any rule or order hereunder, he may
12 order such person to cease and desist from such unlawful act or
13 practice and take such affirmative action as in the judgment of the
14 Administrator will carry out the purposes of this Chapter.

15 (2) If the Administrator makes written findings of fact that the public
16 interest will be irreparably harmed by delay in issuing an order under
17 G.S. 78C-28(b)(1), the Administrator may issue a temporary cease and
18 desist order. Upon the entry of a temporary cease and desist order, the
19 Administrator shall promptly notify in writing the person subject to the
20 order that such order has been entered, the reasons therefor, and that
21 within 20 days after the receipt of a written request from such person
22 the matter shall be set down for hearing to determine whether or not
23 the order shall become permanent and final. If no hearing is requested
24 and none is ordered by the Administrator, the order shall remain in
25 effect until it is modified or vacated by the Administrator. If a hearing
26 is requested or ordered, the Administrator, after giving notice of an
27 opportunity for a hearing to the person subject to the order, shall by
28 written findings of fact and conclusion of law, vacate, modify, or make
29 permanent the order.

30 (3) No order under subsection (b) of this section, except an order issued
31 pursuant to G.S. 78C-28(b)(2), may be entered without prior notice or
32 an opportunity for hearing. The Administrator may vacate or modify
33 an order under subsection (b) of this section upon his finding that the
34 conditions which required such an order have changed and that it is in
35 the public interest to so vacate or modify.

36 (4) A final order issued pursuant to the provisions of subsection (b) of this
37 section shall be subject to review as provided in G.S. 78C-29.

38 (c) The Administrator may issue an order against an applicant, registered person,
39 or other person who willfully violates this Chapter or a rule or order of the
40 Administrator under this Chapter:

41 (1) Imposing a civil penalty of up to two thousand five hundred dollars
42 (\$2,500) for a single violation or of up to twenty-five thousand dollars
43 (\$25,000) for multiple violations in a single proceeding or a series of
44 related proceedings; and

1 (2) Requiring reimbursement of the costs of investigation.

2 Any civil penalty or reimbursement imposed under this subsection shall be paid into
3 the General Fund. No order authorized by this subsection may be entered without prior
4 notice of an opportunity for hearing."

5 Sec. 8. G.S. 78C-38(b) reads as rewritten:

6 "(b) Every person who directly or indirectly controls a person liable under
7 subsection (a) of this section, including every partner, officer, or director of such a
8 person, every person occupying a similar status or performing similar functions, every
9 employee or associate of such a person who materially aids in the conduct giving rise to
10 the liability, and every dealer or salesman who materially aids in such conduct is liable
11 jointly and severally with and to the same extent as such person, unless able to sustain
12 the burden of proof that he did not know, and ~~did not act in reckless disregard in the~~
13 exercise of reasonable care could not have known of the existence of the facts by reason
14 of which the liability is alleged to exist. There is contribution as in cases of contract
15 among the several persons so liable and as provided among tort-feasors pursuant to
16 Chapter 1B of the General Statutes."

17 Sec. 9. G.S. 78C-39 reads as rewritten:

18 **"§ 78C-39. Criminal penalties.**

19 (a) Any person who willfully violates any provision of this Chapter except G.S.
20 78C-8(a)(1), 78C-8(a)(2), 78C-8(b), or 78C-9 or who willfully violates G.S. 78C-9
21 knowing the statement made to be false or misleading in any material respect, shall
22 upon conviction be punished as a Class I felon. Any person who willfully violates G.S.
23 78C-8(a)(1), 78C-8(a)(2), or 78C-8(b) shall, upon conviction, be punished as a Class H
24 felon.

25 (a1) In lieu of a fine otherwise authorized by law, a person who has been
26 convicted of or who has pleaded guilty or no contest to having engaged in conduct in
27 violation of the provisions of this Chapter may be sentenced to pay a fine that does not
28 exceed the greater of three times the gross value gained or three times the gross loss
29 caused by such conduct, plus court costs and the costs reasonably incurred in
30 investigation and prosecution.

31 (b) The Administrator may refer such evidence as is available concerning
32 violations of this Chapter or of any rule or order hereunder to ~~the Attorney General or the~~
33 proper district attorney, who may, with or without such a reference, institute the
34 appropriate criminal proceedings under this Chapter. Upon receipt of such reference, the
35 district attorney may request that a duly employed attorney of the Administrator
36 prosecute or assist in the prosecution of such violation or violations on behalf of the
37 State. Upon approval of the Administrator, such employee shall be appointed a special
38 prosecutor for the district attorney to serve without compensation from the district
39 attorney. Such special prosecutor shall have all the powers and duties prescribed by law
40 for district attorneys and such other powers and duties as are lawfully delegated to such
41 special prosecutor by the district attorney.

42 (c) Nothing in this Chapter limits the power of the State to punish any person for
43 any conduct which constitutes a crime by statute or at common law."

44 Sec. 10. This act is effective upon ratification.