2011 HOUSE INDUSTRY, BUSINESS AND LABOR

HB 1140

2011 HOUSE STANDING COMMITTEE MINUTES

House Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1140
January 12, 2011
12811

☐ Conference Committee

Committee Clerk Signature Ellen LeTang

Explanation or reason for introduction of bill/resolution:
Prohibition of imposition by the securities commissioner of restrictions on income or assets of investors or potential investors in real estate investment trusts.

Minutes:

Chairman Keiser: Opens the hearing of HB 1140.

Representative Klemin~District 47 in Bismarck: (See attached testimony 1).

Chairman Keiser: Anyone else in support of HB 1140.

Gary Pierce~Owner of Garry Pierce Financial Services, LLP: (See attached testimony 2). Also read testimony for **Roger W. Domres~INREIT Real Estate Investment Trust,** who could not make the hearing.

Vice Chairman Kasper: What I did not hear from your testimony is, what is the problem as far as the ability of the citizen of North Dakota right now to be able to purchase something that they should purchase, compared to the rules that are being put upon you whether they can or cannot. What are the income limitations that you need to abide by and where do you think those limitations should be, even though the rules process has not been gone through yet?

Gary Pierce: The certibility standards for INREIT and Dakota REIT are at the end of this presentation. They appear in the perspectives. What we are basically says is a person must a net worth of 145,000 dollars or income of 45,000 dollars. Take for example a younger person, who is 25 years old, they have a 5,000 IRA account that they already have. Now this is essentially already an illiquid investment because if you are in an IRA and under the age of 59 ½, you can't take the money out unless there is a 10% penalty. You want to move that IRA from another investment that isn't doing well, into a real estate investment trust here in North Dakota. Well, according to these guide lines, they do make an exception to these people, but what it says is that person has to demonstrate a net worth at least 10 times what they are transferring in. For a 25 years old to demonstrate that they have to have a 50,000 dollar net worth excluding their house and home, is pretty difficult. Over the years when I worked with people and I told them that you have to meet these certain requirements, I always get the same puzzled look, it their money and they are purchasing property. What we are saying is it's "basically wrong". Those people should

have the right to purchase what they wish. Through FINRA, when we submit business to the compliance officer, if the compliance officer said "this doesn't look really appropriate for this person" then it's up to the broker to say to that person, "are you sure you want do this?". If they say yes, we are going to that; the representative would mark that as an unsolicited order. Basically say, we didn't make the suggestion. Before the suitability standards were enforced, they wouldn't have been able to invest and they did very well over the years. What I'm saying is people have a right to do what they wish.

Vice Chairman Kasper: What are the investment results of REITs?

Gary Pierce: Compounded on quarterly, they issue quarterly, we just calculated just recently, they would have produced their total return, including dividends and capital gains, would have been 8.13%. INREITs starting in 2002 until the middle of this last year, would have been 13.92%. That's compounded quarterly.

Vice Chairman Kasper: The last couple of years the market took the big dump 2007,2008, some retirement account lost value, what did the REITs do during the same time?

Gary Pierce: They did not take the dive. They are non-publicly traded, which means on the stack market. Real estate state investment trusts are non-publicly traded. When they come out with a new issue of shares, they take a look at the properties and if they increased in value, then there is a share increase. In 2009 when the stock market was down, I called Jim and asked him "what do you think about you dividend"?

Vice Chairman Kasper: In the liquidity in REITs, if someone owns their REIT's shares and all of a sudden I going to go to a mutual fund, what's the liquidity for them to get out if they are in?

Gary Pierce: In any non publically traded real estate investment trust, they are not as liquid as the public market, however both INREIT and Dakota REIT, will redeem shares. FINRA allowed us to do this.

Vice Chairman Kasper: Let's talk about American fund? If you were going to sell an American Mutual fund, what would be the suitability standards compared to the REIT's standards right now?

Pierce: There are none. The reason is that the large brokerage firms on Wall Street have the political clout to get perspectives.

Vice Chairman Kasper: Over the years you have been in business, can you contrast the number of concerns you have that own the real-estate investment trust product compared to a mutual funds with the volatility involved in the last 5-7 years.

Gary Pierce: Anyone who followed our advice didn't lose any money over the last 3 or 4 years. Real estate investment trust, there hasn't been any problem because North Dakota is doing well and both are manages well.

Chairman Keiser: Currently was have the limitation on your prospectus of 45, 000 and 150,000, you say that a NASA standard, are those same amounts used in every state? Is that the national standard or did we adjust it for North Dakota?

Gary Pierce: I think the securities department would be the one to answer that.

Chairman Keiser: North Dakota based companies are reliable and honest, generally, are there outside REITs that will have the opportunity to into North Dakota that should be regulated to protect our citizens that may not be as good as our North Dakota companies?

Gary Pierce: Certainly, there are real estate trusts that are not well managed. FENRA is sufficient to take care of that. What we object to is that these suitability standards is that they take away a person's right to do what they want.

Chairman Keiser: One of the alternatives that were not taken legislation, but one of the alternatives would be formally adopt the NASA standards and put that in the prospectus to protect our citizens but also provide an option for a request for waiver. Is that an alternative to consider?

Gary Pierce: My thinking, no, because the problem still remains that there are people who are deprived of the right to do what they want.

Chairman Keiser: Is there anyone else here to testify in support, opposition of HB 1140? Do you have a handout that you are passing out?

Karen Tyler: I don't.

Karen Tyler~North Dakota Securities Commissioner: Just to give fair warning to the folks in the room who are waiting to discuss health care, my testimony will be extensive.

The securities department currently has 102 open enforcement cases involving 173 North Dakota investors who have lost or damages collectively of over 30 million dollars. I present this data to you to underscore the fact that to have to divert resources away from our enforcement work, in order to address legislation, that substantially we can the authority of our department, substantially weakens protections for investors, in order to accommodate an exceedingly narrow special interest. To have to convince you that this is bad policy is beyond disappointing. This is without a doubt truly, the low point in my 10 years as securities commissioner. As non of the sponsors of this bill had time to seek the opinion of the department on the ramifications of this legislation on our investor constituents, as I state earlier, my testimony this morning will be quite extensive.

I wonder how many of you have had an investor constituent tell you, that they are being over protected by the state securities commission and they would like you to pass legislation to reduce the level of protection afforded them when they entrust their money to a financial advisor? This is precisely the affect of HB 1140.

HB 1140 eliminates protections for your investor constituents that are available to investors across the rest of country. It eviscerates the ability of the State Securities Commissioner to

bring a suitability case against a securities agent who has inappropriately sold a real estate investment trust to a North Dakota investor. HB 1140 renders the Principle of Suitability, the very bedrock of securities sales regulation, meaningless, by removing from the suitability analysis the requirement to consider the components of Net Income and Net Worth. HB 1140 establishes a new section of the North Dakota Securities Act that sets forth unprecedented restrictions on the authority of the State Securities Commissioner. HB 1140 is premised on the misleading notion that North Dakota investors are restricted by the Securities Commissioner from accessing Real Estate Investment Trust alternatives. HB 1140 places the interests of the investment industry before the interests of your investor constituents. HB 1140, if passed, will give this legislature the distinction of being the first legislative body in the country to pass a law that weakens investor protection in the wake of the most damaging financial crisis since the Great Depression.

At the outset, I will address what I believe to be a very serious misperception that has been fostered by the proponents of this bill. We do not regulate or restrict investors. We have no autiority over investors. They will do what they want, when they want. Investors are not regulated by the securities department. I want to give you specific example of this. We have a company in Logan County that was raising capital around the Napoleon area. They were using a federal registration exemption. A federal registration exemption called Regulation Rule D 506. It's a very common exemption used by companies to raise capital. That exemption requires of the conduct of securities issuer, that they cannot sell securities to investors that are not accredited investors. This is another regulatory concept that is based on net income and net worth. You have to have a net income of at least 200,000 dollars and a net worth of a million dollars. So the issuer cannot sell to anyone who does not fit that requirement. Again, this applies to the conduct of the issuer, not the conduct of the investor. The investor can and will, as I said before, do whatever they want. Things are not going well, this company does not appear to be successful unless they are able to raise additional capital. It has been brought to our attention many of our investors who put their money into this investment, I think the total is around four million dollars, many of them were not accredited investors, but they signed the subscription agreement stating, certifying that they were accredited investors. Again, investors will do what they want. Did they violate some regulatory rule or policy enforced by the Securities Commissioner when they certified that they accredited investors, absolutely not. Did they make it next to impossible for us to help them, absolutely, but my point is, we do not regulate investors. We place no restrictions on investors. The laws, rules, regulation policies administered by this agency govern the conduct of securities issuers, securities firms and securities agents. Please let me make that very clear to you.

As to the idea that we specifically restrict investor's access to North Dakota based investment trust, this also is false. In addition to the accommodations that we have made to the two North Dakota non-exchanged REITs which make them accessible to small investors, small investors also have access to the publicly traded Investors Real Estate Trust which has been around for 40 years and a publicly traded company provides secondary market liquidity so critically important for the small investor. It can be purchased through a full service, discount, or on-line broker. Granted, the REIT proponents of this bill won't make a sale, and the financial advisor does not make the 8% commission, he would make with the non-exchange traded RIETS, but the small North Dakota investor gets

access to a large, diverse portfolio of North Dakota real estate. There is no limit to access for North Dakota investors.

I want to talk to you about the scope of this legislation. If the sponsors of this bill have made the mistake, and I believe they have, of localizing this issue, it is easy to see why. The proponents of this bill have been working to eliminate these investor protection provisions for two or three years now. Over the course of that time we have had a number of conversation with the two exchange traded REIT entities, I'm sure they have talked to a number of sponsors of the bill, it would be understandable that the sponsors have developed a certain comfort level with these professionals and their business reputation. But I must ask all of you to take a step back from these local professionals and entities, and appropriately focus your attention on our marketplace realities.

HB 1140 eliminates important suitability measurements for ANY and ALL Real Estate Investment Trusts sold to North Dakota investors. Please understand the scope of this legislation. L Dakota REIT and INREIT are 2 of 45 non-exchange traded REITS that can currently be sold to your constituents. We have an additional 23 registration applications pending for non traded REITS. Mr Pierce is one of over 65,000 securities agents that can sell REITS to constituents. Over 65,000 securities agents to whom suitability standards in the sale of any REIT, to any of your constituents, will no longer apply. Over 65,000 reps for whom North Dakota is lowering the standard of conduct, elimination important suitability measures that, although will govern their conduct across the rest of the country, will no longer be applicable here. We will have won the race to the bottom in this area.

More the 25 years ago, following a period of massive fraud in the investment industry perpetrated through the sale of limited partnership investments, regulators on a national scale determined that certain issuers such as non-exchange traded REITs along with Direct Participation Programs, such as asset backed securities, mortgage programs, commodity pools, equipment programs and oil & gas DPPs, that these issuers needed standardized registration policies, to include suitability standards. One reason of course was to promote uniformity among the states, to the benefit of the issuer. The other was because these securities carry unique risks that can make them inappropriate for small investors. I want to make something very clear here, regulators develop these standards, not a national trade association called NASAA regulators developed these standards.

Among the risks specific to non-exchange traded REITs; REITs are blind pool investments- they do not own any property at the time they are raising funds, or an established REIT will not have not identified new properties when raising new funds. Investors do not know what their money in a REIT; will be invested in at the time they purchase the REIT. They are blind pools.

There is no established secondary market for non-exchange traded REITs. This creates a liquidity risk that may prove especially burdensome for an investor with limited income and limited assets. With the exception of limited share reduction programs, investor can only exit the REIT, if they can find a private buyer, if the REIT eventually lists itself on an exchange or sells itself or merges with another REIT,

Another risk, REITs expose investors to high commission and fees. As an example, investors purchasing Dakota REIT and INREIT pay an 8% commission to the financial advisor selling them the investment. If an investor must liquidate through one of the REITs limited share redemption programs, it will cost them 10% on the way out. 8% in, 10% out; these commission and fees are not inconsequential for the small investor.

REITs can and do pay dividend distributions from any source, including, including the proceeds it raises from new investors in new REIT offerings. This bears repeating; REITs can pay a return to existing investors with funds raised from new investors. If that sounds like it has a ponzi flavor to it, it is because it does.

To address these and other risks inherent in non-exchange traded REITS, as well as the investments I mentioned earlier, a comprehensive registration policy was constructed by a committee of regulatory experts from across the country, published from lpublic comment, adopted by state regulators, either by law, rule or policy and is applied across the country. These standards are not arbitrary and capricious. Very significantly, these standards that are so objectionable to the industry interest behind this bill are supported by the largest industry trade association in the United States. The largest security industry association in the country support these standards.

Through the authority vested in the Securities Commissioner by this legislature, under 10-04-08.1 of the North Dakota Century Code, the department applies this comprehensive registration policy, which includes the suitability standards, to the registration of non-exchange trades REITs, without issue, problems or complaint for 24 years. Over the last several years the department has handles complaints involving real estate back investments, from over 80 investors with 6 million dollars in losses. We don't break out non-exchanged REITs as a separate enforcement category, but I can tell you, that I'm not aware of any investor complaints regarding Dakota REIT or INREIT. I can also tell you, without absolute conviction that this is due to the effectiveness of the suitability standards that we have in place for these investors. The standards prevent the inappropriate sale of these alternatives from occurring in the first place. An 8% commission on a securities transaction is a high commission. An aspect of this issue, that should not be marginalized or overlooked. As a comparison, a broker might make 1% on a stock trade, 1% on a bond trade, in regards to mutual funds, they might make 1% on a C share and up to 5 ¾% on A share. An 8% commission on a REIT transaction is a high commission and could certainly serve to incentivized a financial advisor to make an inappropriate sale. The issuer, the REIT, must abide by the suitability standards in these transactions. They run the risk of losing the registration of the entire offering if they don't. As Such, the REIT issuers themselves, such at Dakota and INREIT, they uphold the suitability thresholds and they act as a gatekeeper, an important gatekeeper in preventing unsuitable sales that could be driven by the financial interests of the third party financial advisor selling the investment.

I want to talk about some accommodations that we have made for Dakota and INREIT. Dakota Real Estate Investment Trust made its first offering registration with the department in 1997. It has been subject to the REIT policy, including the suitability provisions, fro close to 14 years and has filed for the offering of 36,790,000 in REIT shares during that time. INREIT made its first offering registration with the department in late 2002. It has been subject to the REIT policy, including the suitability provisions, for eight years and has filed

for the offering of 49,500,000 in REIT shared during that time. At no time, has either entity represented to the department that the suitability standards are a barrier to sales.

The department has worked with these companies for many years. Harold Kocher, our chief securities examiner has been with the department for 45 years and has worked with the officers of these REITs since their inception and have made numerous accommodations for them. In 2007 the net income and net worth thresholds in registration policies were adjusted for inflation. I want to clear up the numbers. The original suitability standards were as such, an investor needs to have 45,000 dollars in income and 45,000 net worth or in the absence of income, 150,000 dollar net worth. 45, 45, 150. To adjust for inflation a few years ago, the standards were raised to 70,000 dollars in income, 70,000 net worth or in the absence of income, 250,000 net worth. Again, this was a process, the adjustments and threshold, were the process policy construction by a national committee of regulatory experts, publishing for public comment, everyone in the country had the opportunity to comment and the adoption by state regulators. Again the largest security trade industry in the country supported the change.

Both Dakota REIT and INREIT requested to keep in place the net income and net worth thresholds that had previously been established and we accommodated both requests. So the thresholds applied to them are 45,45, 150. Additionally, the department has allowed another exception. The net income and net worth standards need not be applied to investments of less than 25,000 dollars, if the investment does not exceed 10% of the investor's net worth. These accommodations are more than adequate to allow for a sale to a small investor if appropriate. Is this accommodation satisfactory? It most certainly is. You will find very few asset managers or very financial advisors, who when structuring a well diversified portfolio for a small retail investor, would recommend more than 10% exposure to real estate. If a financial advisor is recommending that a small investor with limited income and limited assets position more than 10% of their portfolio in a sector concentrated investment that affords limited liquidity, it will certainly raise red flags for regulators.

On the point of appropriate asset allocation, I was recently visiting with a friend of mine who is the chief investment officer for the University of Notre Dame. I asked Scott, how much of the 8 billion dollars endowment does he currently have exposed to real estate? Scott told me he currently has 7%. 7% of the 8 million dollars endowment is allocated to real estate. He said that's high. That high compared to my peers. Most of the large endowments in the country have approximately 4% of their portfolio, their endowment exposed to real estate. So these are large institutional investors keeping their real estate allocation at less than 7%. We are allowing financial advisors to take small investors to 10%. I think our accommodations have been more than adequate.

I share the underscore the point again that these accommodations are more than adequate and render the pursuit of this abolishment of the suitability standards, as best, entirely unnecessary, in my view, unreasonable and inappropriate.

I want to talk to next about our enforcement authority and what this bill does to our enforcement authority, but before I do that I want to make one more point on these two issuers. I just received a filing from one of them, I can't remember which one, in their

perposed perspective document, they disclosed that they are raising the minimum investment amount. The minimum investment that the investor has to have in order to access the REIT, they are raising it to 50,000 dollars. So here we are discussing getting rid of a 45,000 dollar net worth threshold and the REIT itself has raised the minimum investment requirement to 50,000 dollars.

Back to our enforcement authority. As I stated earlier, it will eviscerate our ability to bring a lack of suitability case against a broker who has made an unsuitable sale of a REIT. It eliminates our authority to require a broker to consider net income and net worth in selling the instrument. We will therefore be unable to consider these measures in the assessment of an investor complaint. How can we possibly determine the suitability or lack thereof of an investment for our complainant, if we cannot consider how much money they make or how much money they have? How can we possibly determine if they have been sold into an over-concentrated position, if we cannot contemplate their net worth in our analysis? How will we help your 85 year old constituent living on Social security with 40,000 in saving, who is sold into a New Jersey REIT by a Florida broker, who has no legal obligation in North Dakota to consider the investor's net income and net worth?

Understand that this legislation will not only prevent uks from applying the suitability standards to the issuer, but also from contemplating net income and net worth in the analysis of a potential violation of the FINRA suitability rule that applies to the conduct of the broker/dealer/agent. To give you an idea how important suitability standards are to our enforcement work, of our current cases, 23 involve complaints by investors of unsuitable sale of a security, with damages totaling just shy of 13 million dollars. This is a very big impact on the department.

So what authority will we have left? Fraud Authority. Fraudulent practices cases are much more difficult cases to bring, but when the facts and circumstances warrant, we of course will bring them. Were there misrepresentations made by the broker in selling the REIT? Were there material omissions made by the broker regarding the risks of the investment when selling the REIT? Making misrepresentations and material omissions in the offer and sale of securities is a fraudulent practice. In terms of administration and resources, suitability cases are easier to pursue. They usually cost less for all parties and are resolved more quickly. But in the absence of this alternative, when facts and circumstances warrant, a fraudulent practice case will be the remaining course of action.

Now perhaps this falls in the category of unintended consequences, I want to make sure the committee understands the ramifications of this legislation, not only for your investor constituents, but also for the industry. When a regulator issues a final order, setting forth a finding of unsuitable sale made by a broker, the effect on the broker's record is comparatively speaking, a slap on the wrist. When a regulator issues a final order setting forth a finding of a fraudulent practice by a broker, this can be a career ending event.

Now I will address the rulemaking component of this bill. This legislation eliminates important investor protections for your constituents, but allows us to attempt to restore them through rulemaking if we can prove by, quote, "substantial evidence", they are in the public interest and in the best interest of investors. The entire regulatory system in the United States, the entire regulatory system that governs the offer and sale of securities and I mean

"ALL SECURITIES" is based on three fundamental principles; suitability, disclosure and anti-fraud. Every law, rule, regulation and policy in existence has been built on these three principles.

HB 1140 eliminates our ability to apply the first of these principles to the sale of REITS to North Dakota investors. I do not know why the sponsors of this bill believe that North Dakota don't need these protections, but I submit to you, you cannot build a wall around this state. Your investor constituents participate in, are exposed to, are affected by, a national and global securities industry and market place. The protections afforded the rest of the country should apply here too.

For the department, this legislation of course begs the question "what's next"? HB 1140 creates an unprecedented restriction on the authority of the securities commissioner; language you will not find in any other state securities acct and it does so at the behest of one financial advisor.

The bar could not have been set any lower. Mr Chairman and members of the committee, the department has serious work to do. To have the North Dakota securities act trifled with in this manner. To suggest that it's a prudent use of our resources to prove that our constituents deserve the same protections afford the investors in every other state, is in my view, exceedingly frivolous and it is certainly is not a prudent dispatch of the responsibility entrusted to our agency and to this legislature by the citizens of North Dakota.

Given that HB 1140 wipes out these single most important element of investor protection, in the offer of sale and REITs and wipes out single most important mechanism we have for helping harmed investors. I must ask if the sponsors of this bill have been convinced. Have the sponsors made the adjustment that all real estate investment trusts are appropriate investments alternatives for all small investors? I ask the rest of the committee members if are prepared to make that judgment. I ask the committee members if you are prepared to tell the small investors in your district, that you firmly believe that all real estate investment trusts are safe, suitable investments for them, for all small investors. So you help pass legislation, to eliminate protections for them that you decided were unnecessary. I hope the answer to this is question is NO. HB 1140 is unnecessary, inappropriate, does not serve the public interest and does not serve the interests of North Dakota investors. I ask you to vote "do not pass" on HB 1140.

Chairman Keiser: Karen Tyler was the head of the National FENRA organization. We thank you for your appearance here today.

Vice Chairman Kasper: The power of the securities department as far as approving securities for sale in North Dakota, does the securities department have to approve all securities investment to be offered in North Dakota or can a company come in and sell their product without your approval and inspection of property including the commissions?

Karen Tyler: There a number of different regulations that applies. The non-exchanged REITs have to be registered. Publically traded companies do not. Mutual funds have to go through a process call "notice filing". There are many exemptions to registration, there whole variety of registrations scenarios that apply.

Vice Chairman Kasper: The two REITs in North Dakota, have they had to file with you including the commission levels in those registrations?

Karen Tyler: It an example to demonstrate that investors are not regulated by our agency; they will do what they want. As far as the REITs, do they register with the department, yes they do.

Chairman Keiser: Do you have to approve their rates?

Karen Tyler: We do not have to but we can approve them. We can restrict them, based on the authority we have under title 100408.1. We do not pass on the merits of an investment. That is not our rule and you will see as the most prominent disclosure in a prospectus. We insure they disclose all material information necessary for an investor to make informed investment.

Vice Chairman Kasper: Ask again, in the real estate investment trust registration of the two North Dakota companies, were you made aware of the registration of the commission being paid to these sales person 8%?

Karen Tyler: Yes we are, that is industry standard.

Vice Chairman Kasper: Could you have asked them to reduce that commission if you felt it was inappropriate or excessive.

Karen Tyler: Yes, I suppose we would.

Vice Chairman Kasper: I heard in your testimony that your powers taken, read the bill, the bill simply says, that in order for you to rules and regulations, on the real estate investment area, you must go through the rule making process. I don't see anywhere in this bill where any of your power is taken away, it's simply asking to go through the rules process to have it before the legislature. Do you read this bill differently from that?

Karen Tyler: I do because we know what's coming here. This is a temp to get rid of the suitability standards. Legislation wipes out our ability to enforce them by going through. Then we go through the rule making process again which we have been dealing with for about three years. We don't have any objection to rule making, but to wipe out these projections suggest that we prove that they are necessary, I do object to that.

Vice Chairman Kasper: It is not my objective to wipe out the suitability standards, never has been, never will be. We are not looking to suitability requirements or standards in North Dakota. I would be open to an amendment to this bill to assure you that this is not the case. You are going to go through the rules process like other agencies to get desires implemented. If you can tell me where it is, I would be happy to be pointed to sentence or phrase where it says that.

Karen Tyler: Is that a question you want me to answer?

Vice Chairman Kasper: Could you point to me in this bill where this bill is saying to you "your power and authority to regulate anything in the securities area is gone".

Karen Tyler: The effect of the legislation will be when it becomes law, to take away these authorities, authorities that are already set out for us, in 10408.1 by the legislature. Then we have to go through the process of attempting to replace them and we can do that. I just am suggesting that this is an unnecessary exercise. Given the fact that we have never had a complaints from re-issuers to whom these suitability standard apply about the suitability standards being a barrier to their sales. They have never been objected to, never been challenged in any regulatory administrative process. We feel the entire exercises are unnecessary of happening at best, one financial advisor.

Vice Chairman Kasper: You mentioned earlier about one of the REITs wanted to raise to minimum investment to 50,000, did that apply to IRA investments as well, or was that simply to people who were going to make initial deposit that was not a qualified plan investment?

Karen Tyler: I believe that standing investment, Harold, do you recall if they singled out IRA's? One thing that the issuers are doing is creating something called a class b share for their investments. However, the investors in the class b shares will not have voting rights for the REITs. So that may be their way of addressing this act, that they are raising the thresholds so high for investors.

Vice Chairman Kasper: I wonder if you may be able to go back and research the filing you indicated and filing that's on file for the REITs in North Dakota to see if any, as a result of their filings, their IRA people cannot invest in much smaller amounts because I, maybe it's a class a share, maybe a class c share, maybe a class c share, maybe a class x share, but I would like to have on the record, if these REITs are not going to allow these a smaller investors to use their Ira to invest in them.

Karen Tyler: Happy to do that for you.

Chairman Keiser: I think you were a hero when we heard 1083 and I'm using it as an example, that was a bill form the insurance department where they were asking the Legislature considering implementing standards developed by the NAIC, relative to risk base capital formula. The NAIC has adopted these new standards and as they frequently do, in case of the insurance department, they then bring in the form legislation, a request because it is a policy issue for the legislature to address; it's the process I'm talking about. The think the problem we have is the process that these standards and they may be absolutely appropriate, were adopted by a national organization and then implemented without the opportunity for the legislature to react, either in the form of legislation or the administrative rules process, which would be available to you. We have a lot of alternatives, pass the bill the way it is or kill the bill. One of the thing that does strike me, if it were to pass as it is, we should put an amendment on for the implementation date to be extended, so you would have the opportunity to go through rules process, it takes a long time to go administrative rules, up to a year or a year and a half or two. We could certainly amend this and say "yes, go through the administrative rules process but we will give you extra time" or we could adopt amendment that corresponds to the current policy that you'r e

are using which is the 45, 45, 150 and 10%. We put that right into the statue and have that debate from a policy standpoint. The question I'm asking, other killing the bill, if we took the bill forward, is there any approach that might consider that would be appropriate?

Karen Tyler: As I stated before, we don't have any issue in making the rules. When we make the rules though, what we will be looking at is what is happening on a national level and the standardized recommendations set forth by national committee work, public comment, and support of the industry. That is 70,000 dollars income, 70,000 net worth, and 250,000 in the absence of income, 250,000 net worth. The policies that we have administered for 24 years, have given us the flexibility to work with these REIT issuers. In the case of Dakota and INREIT, they asked us to keep the levels lower, because they current investors who falls between those levels. It allows us to work, more specifically with the North Dakota issuers because they are not set forth in rule. If rule making is the will of the legislature, I suppose an extension of the effectiveness would be helpful. We are very concerned about this regulatory gap. It does indeed wipe out our authority in that interim period, between the time of the legislation going into effect and a time of getting the rules through. Make no mistake, the special interest behind this bill, isn't interested whether it's in policy or rule. They don't want the standards at all. We will continue to fight this battle. We will continue to have this discussion. We know that is what will result from this. I apologize if I was personalizing to you, but I'm trying to impress upon the committee that this has taken up our time. We have serious work to do and this is happening for such a narrow special interest, that we are finding it quite objectionable.

Chairman Keiser: Further questions from the committee? I have to compliment you, commissioner; you are comparable to the presenters for the support side, very nice job.

Chairman Keiser: Is there anyone in opposition to HB 1140, neutral position? Closes the hearing on HB 1140.

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Committee Work Minutes:

Chairman Keiser: Opens the committee work on HB 1140.

Vice Chairman Kasper: You heard Commissioner Tyler, the intent was not at all to take away the authority that she has to have to regulate securities properly and protect the citizens of North Dakota. The commissioner made some ligament points about the potential in the bill. I wonder, if we could meet with Commissioner Tyler to see if there is some common ground and get into some discussion on the rule making process.

Chairman Keiser: I don't think that is a too unreasonable suggestion. The options here are, take bill as is, send it out with a recommendation with a do pass or a do not pass. I did talk with Representative Klemin and he said "this is one case, one time; it was discovered during the interim rules making committee. We were directed to review every department and see whether or not there were any rules being implemented that did not go through the formal rules making process. This is the one case where a rule developed at a national level by an organization has been brought back to North Dakota and implemented without going through the formal process of rule making. Representative Klemin's concern was that this department has to follow the same rules as any other department. I could not in good conscious to take this bill as it is. If we are going to take this bill forward to draft an amendment to make the effective date January 1, 2012. The third option, we would take the rule and put it in the statue.

Vice Chairman Kasper: I don't feel comfortable putting that in statue; I do believe that is the oversight of the commissioner of securities to work in that area. I think the title of the bill is not what the intent from the perspective of Representative Klemin and me. The title of the bill is talking about restriction on income of assets of investors, but we are really talking about the fact that we need rules to be established to provide the guideline for that which we don't have. My intent is to visit with the staff and talk about the rules and modification of rules in general. It would be worth a discussion.

Karen Tyler: To be clear, based on Sen Klemin's central of department enforcing polices, so they are without being adopted as rules. We have 30 different policies that we have administered that are based on NAIC model rules. This speaks to one page of a 30 page policy, so if the true issue is, you don't want us administrating policy that haven't been adopted by rules, this legislation doesn't solve the problem. We see a simple fix that is similar to what the insurance has; we could very specifically identify the NAIC policies. You already given the authority under 10048.1 to apply other restrictions, limitations and go further and specifically identify NAIC as one of the sources because we draw from the policies to do that. That would be a simple fix. This legislation speaks to one page of 30 page policy out of 30 policies.

Chairman Keiser: I do understand what you are suggesting, we've done an assessment and there are 17 different places in the North Dakota century code where we have granted the authority to the NAIC which is designated as the official depository for rate forms filing. Representative Klemin would like to see this bill move forward as is.

Representative Nathe: As far as the bill is the it is, I have a problem with it, as the commissioner stated, we are dealing with just a very small of investors. The industry on the whole, is not screaming for change, so that part I'm having a hard time with. I like Vice Chairman Kasper idea of focusing on the rules and going through that process. The bill as is, I have a problem with it.

Representative Boe: Do we need legislation for them to go through the rules process where the commissioner has the authority at this time to go through the rules process if they choose to.

Chairman Keiser: The commissioner has concurrently goes through the rules process to do that.

Representative Boe: We do need some kind of legislation to fill that gap? Is that where we are at now?

Chairman Keiser: That is what Representative Klemin believes and believes this bill does that.

Representative Ruby: Do you know why it affected only one area?

Chairman Keiser: No, the industry is in opposition and there are only 3 of them.

Gary Pierce~Financial Services here in Bismarck: Is the industry unanimously in support.

Representative Ruby: I have a hard time supporting this in anyway if it didn't at least have that application date on it.

Representative Ruby: Moves to amend to put a date on, page 1, after line 12, insert an effective date, January 12, 2011.

Vice Chairman Kasper: Second.

Voice Vote taken, motion carries.

Vice Chairman Kasper: I suggest you have a subcommittee to meet with the commissioner. I would like to have that discussion with her.

Chairman Keiser: I will appoint Representative Kreun and Representative M Nelson on committee. If possible would you invite Representative Klemin as the bill sponsor.

Chairman Keiser: Closes the work session.

2011 HOUSE STANDING COMMITTEE MINUTES

House Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1140
January 19, 2011
13108

☐ Conference Committee

Committee Clerk Signature Ellen LeTang

Explanation or reason for introduction of bill/resolution:

Prohibition of imposition by the securities commissioner of restrictions on income or assets of investors or potential investors in real estate investment trusts.

Work Session Minutes:

Chairman Keiser: This is the bill that involves the security commissioner relative to the application of rules and we have been working with various people including the attorney general's office. We were under the assumption that securities department was like other departments and had some obligation to follow administrative rules policies.

Tom Trenbeath~Chief Deputy Attorney General of North Dakota: We have been asked if the securities commission is exempt from the rule making of 2832 and if so if that's the only agency that enjoyed that status. The interpretation over the course of a short period of time is that it does have in fact exempted. That interpretation is based on the language appears in several area subsections in the body of law that regulates the activities of the commissioner that says by rule, order or directive. We all know means, it will be followed by a rule making obligation. Order or directive is wide open phraseology and we arrived at using legal maximums of what the North Dakota Supreme Court has said in the past. First of all the legislature means what it says, it doesn't waste words, so the words have to mean something and it has to mean something other than the rule. Secondly, an agency is entitled is entitled over the course of time some deference of their interpretation of the statue, they are the ones that live with it. Most of this body of law appears dated 1959, these word have been in this body of law for 52 years, unaltered. If has been tweaked on occasions over a course of time, nothing of a major nature, and nothing has been done with the powers granted the commissioner.

Chairman Keiser: My copy of the chapter says "the chapter shall be known as the securities act of 1951.

Tom Trenbeath: Looking at the statutory references when you look at the century code, it gives you a series of references where that particular has been dealt with by the legislature and it only goes back to 1951.

Chairman Keiser: I understand this correctly; this section of the code was basically generated in 1951 & 1959 and remained relatively intact since that point not rewritten?

Tom Trenbeath: It's basically the broad cloth that was adopted in its origination.

Chairman Keiser: It helps me understand why the commissioner and I kind of on different pages. During the interim, the administrative rules committee was given the charge the review all agencies and see who was implementing without administrative rules process and the securities was the only agency that popped up. When the question arose and then when we say Representative Klemin's bill, it begged the question, why not. That's where it stands. Questions from the committee?

Chairman Keiser: We have HB 1140 before us and we are not going to take specific action.

Karen Tyler~Securities Commissioner of North Dakota: In anticipation with a meeting of the subcommittee, we have put together some language that we would recommend as an amendment to the bill that would serve the purpose of bringing some clarity. It would address your concerns about due process and it's consistent with language in insurance act regarding the insurance commissioner's ability to utilize standards set forth by the NAIC. If that would be useful and constructive to help bring some finality to this issue, we would appreciate some finality. I just mentioned that if we are going to go ahead with a subcommittee meeting, that we have that ready.

Chairman Keiser: Vice Chairman Kasper is heading that committee and we will have that subcommittee work. I suggest that when you meet, that you bring that language forward. I will also tell the committee, I have had a discussion with Legislative Council and said, could we add an amendment that would bring this agency under administrative rules just like the other agencies. They are looking at that as an amendment for subcommittee to make some recommendations and Karen you are welcome to come. This is a big policy decision. I will share with you that we have an emergency provision in the administrative rules process that works well and it we were to go in that direction, there will be a significant delay in the implementation date to allow the commissioner to go forward.

Chairman Keiser: Anymore comment? Closes the work session on HB 1140.

2011 HOUSE STANDING COMMITTEE MINUTES

House Industry, Business and Labor Committee
Peace Garden Room, State Capitol

HB 1140
January 25, 2011
13362

☐ Conference Committee

Committee Clerk Signature Ellen LeTang

Explanation or reason for introduction of bill/resolution:

Prohibition of imposition by the securities commissioner of restrictions on income or assets of investors or potential investors in real estate investment trusts.

Committee Work Sessions Minutes:

Chairman Keiser: Passes out amendments drafted. Vice Chairman Kasper, you are carrying this bill and you may have had some conversation with the commissioner on this. They were going to draft some amendments and what I have here is an amendment that I have informed the commissioner at the final meeting that I would have drafted and it supports my position. It's up to the committee to do with it what they wish to do with it. The amendment is simple and what it does is brings the office the securities and her staff under administrative rules and law. The key is (reads the attached amendment testimony).

Representative Boe: Moves the amendment 11.0193.2001.

Representative Ruby: Second.

Representative Boe: This amendment would refrain the securities commissioner from acting upon policy and have to work upon rule.

Chairman Keiser: Her section of the code has not been changed since 1951. It is one of the few sections of the code that has not been adjusted and there was a reason, they like what they had going. They saw no need to stir up that hornet's nest. During the interim required during the previous session, to review every state agency and identify that were implementing rules without going through the administrative rules process, her department was the only one that came up on the radar screen.

Representative Ruby: Was she exempted only in one area that she regulates or was this across the board?

Chairman Keiser: Across the board.

Representative Nathe: Does this have any effect on lines 9-12?

Chairman Keiser: No, this is just adding to. Further discussion?

Voiced vote taken, motion carried.

Chairman Keiser: What are the wishes of the committee?

Representative Ruby: Do Pass Amended.

Representative Clark: Second.

Chairman Keiser: Further discussion?

Representative Amerman: I think it's a good amendment. I remember yesterday we took the treasurer out of the rules making process, I'm not too sure we are being consistent about this.

Roll call was taken on HB 1140 for a Do Pass as Amended with 11 yeas, 3 nays, 0 absent and Representative Clark is the carrier.

FISCAL NOTE

Requested by Legislative Council
03/03/2011

Amendment to: HB 1140

1A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2009-2011 Biennium		2011-2013 Biennium		2013-2015 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures	$118,000		$354,000			
Appropriations	$118,000		$354,000			

1B. **County, city, and school district fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

2009-2011 Biennium			2011-2013 Biennium			2013-2015 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

The department would require substantial contract hours with experienced securities attorney(s) to redraft current policies and guidelines into administrative rules before the effective date.

B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*
   A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

   B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

   C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

The department would require substantial contract hours with experienced securities attorney(s) to redraft current policies and guidelines into administrative rules before the effective date.

Name:	Diane Lillis	**Agency:**	ND Securities Department
Phone Number:	328-4712	**Date Prepared:**	02/03/2011

FISCAL NOTE

Requested by Legislative Council
01/20/2011

Bill/Resolution No.: HB 1140

1A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2009-2011 Biennium		2011-2013 Biennium		2013-2015 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
Revenues						
Expenditures	$118,000		$354,000			
Appropriations	$118,000		$354,000			

1B. **County, city, and school district fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

2009-2011 Biennium			2011-2013 Biennium			2013-2015 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

2A. **Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

The department would require substantial contract hours with experienced securities attorney(s) to redraft current policies and guidelines into administrative rules before effective date.

B. **Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*
   A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

   B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

   C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

The department would require substantial contract hours with experienced securities attorney(s) to redraft current policies and guidelines into administrative rules before effective date.

Name:	Diane Lillis	**Agency:**	ND Securities Department
Phone Number:	328-4712	**Date Prepared:**	01/28/2011

11.0193.01000
Title.

Prepared by the House Industry, Business and Labor Committee
January 12, 2011

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1140

Page 1, after line 12, insert:

"**SECTION 2. EFFECTIVE DATE.** This Act becomes effective on January 1, 2012."

Renumber accordingly

Date: Jan 12, 2011

Roll Call Vote # 1

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES

BILL/RESOLUTION NO. 1140

House **House Industry, Business and Labor** Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: ☐ Do Pass ☐ Do Not Pass ☐ Amended ☒ Adopt Amendment

Motion Made By Rep Ruby Seconded By Rep Kasper

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser			Representative Amerman		
Vice Chairman Kasper			Representative Boe		
Representative Clark			Representative Gruchalla		
Representative Frantsvog			Representative M Nelson		
Representative N Johnson					
Representative Kreun					
Representative Nathe					
Representative Ruby					
Representative Sukut					
Representative Vigesaa					

Total Yes _____ No _____

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

Voice vote - motion pass

effective date January 1, 2012

VK
1/27/11

11.0193.02001
Title.03000

Prepared by the Legislative Council staff for
Representative Keiser
January 24, 2011

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1140

Page 1, line 1, replace "a" with "two"

Page 1, line 1, replace "section" with "sections"

Page 1, line 2, after "to" insert "requirement of statutory or administrative rules as a basis for action by the securities commissioner and"

Page 1, line 3, after "trusts" insert "; and to provide an effective date"

Page 1, after line 4, insert:

"**SECTION 1.** A new section to chapter 10-04 of the North Dakota Century Code is created and enacted as follows:

Statute or administrative rule basis for actions of commissioner.

Any order, directive, policy, refusal, disapproval, restriction, or requirement made by the securities commissioner must be based on and contain a reference to a state statute or administrative rule provision providing authority for the action taken in the circumstances in which that action is taken."

Page 1, after line 12, insert:

"**SECTION 3. EFFECTIVE DATE.** Section 1 of this Act becomes effective on January 1, 2012."

Renumber accordingly

Date: Jan 25-2011

Roll Call Vote # 1

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES

BILL/RESOLUTION NO. 1140

House **House Industry, Business and Labor** Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number 11.0193.02001

Action Taken: ☐ Do Pass ☐ Do Not Pass ☐ Amended ☒ Adopt Amendment

Motion Made By Rep Boe Seconded By Rep Gruchalla

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser			Representative Amerman		
Vice Chairman Kasper			Representative Boe		
Representative Clark			Representative Gruchalla		
Representative Frantsvog			Representative M Nelson		
Representative N Johnson					
Representative Kreun					
Representative Nathe					
Representative Ruby					
Representative Sukut					
Representative Vigesaa					

Adopt 11.0193.02001
Voice vote -

Total Yes _____ No _____

Absent _____

Floor Assignment _____

If the vote is on an amendment, briefly indicate intent:

Date: Jan 25 - 2011

Roll Call Vote # 2

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES

BILL/RESOLUTION NO. 1140

House **House Industry, Business and Labor** Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken: ☒ Do Pass ☐ Do Not Pass ☒ Amended ☐ Adopt Amendment

Motion Made By Rep Ruby Seconded By Rep Clark

Representatives	Yes	No	Representatives	Yes	No
Chairman Keiser	✓		Representative Amerman	✓ -	
Vice Chairman Kasper		✓	Representative Boe		✓
Representative Clark	✓		Representative Gruchalla	✓	
Representative Frantsvog	✓		Representative M Nelson	✓	
Representative N Johnson	✓				
Representative Kreun	✓				
Representative Nathe		✓			
Representative Ruby	✓				
Representative Sukut	✓				
Representative Vigesaa	✓				

Total Yes 11 No 3

Absent 0

Floor Assignment Rep Clark

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1140: Industry, Business and Labor Committee (Rep. Keiser, Chairman) recommends **AMENDMENTS AS FOLLOWS** and when so amended, recommends **DO PASS** (11 YEAS, 3 NAYS, 0 ABSENT AND NOT VOTING). HB 1140 was placed on the Sixth order on the calendar.

Page 1, line 1, replace "a" with "two"

Page 1, line 1, replace "section" with "sections"

Page 1, line 2, after "to" insert "requirement of statutory or administrative rules as a basis for action by the securities commissioner and"

Page 1, line 3, after "trusts" insert "; and to provide an effective date"

Page 1, after line 4, insert:

"**SECTION 1.** A new section to chapter 10-04 of the North Dakota Century Code is created and enacted as follows:

Statute or administrative rule basis for actions of commissioner.

Any order, directive, policy, refusal, disapproval, restriction, or requirement made by the securities commissioner must be based on and contain a reference to a state statute or administrative rule provision providing authority for the action taken in the circumstances in which that action is taken."

Page 1, after line 12, insert:

"**SECTION 3. EFFECTIVE DATE.** Section 1 of this Act becomes effective on January 1, 2012."

Renumber accordingly

2011 SENATE INDUSTRY, BUSINESS AND LABOR

HB 1140

2011 SENATE STANDING COMMITTEE MINUTES

Senate Industry, Business and Labor Committee
Roosevelt Park Room, State Capitol

HB 1140
March 9, 2011
Job Number 15199

☐ Conference Committee

Committee Clerk Signature Eva Liebelt

Explanation or reason for introduction of bill/resolution:

Relating to requirement of statutory or administrative rules as a basis for action by the securities commissioner and prohibition of imposition by the securities commissioner of restrictions on income or assets of investors or potential investor in real estate investment trusts

Minutes: Testimony Attached

Chairman Klein: Opened the hearing on HB 1140.

Representative Klemin: Written Testimony (1).

Senator Schneider: What would be an example of substantial evidence that establishes the restrictions in the public interests and the best interest of the investors?

Rep. Klemin: Said he didn't know if he could give an example but that would be from the testimony and evidence presented at the public hearing that is required in order to adopt the rule. So what would be presented at the hearing would be then used to meet that standard.

Representative Keiser: He said he came to share what the committee's purpose was in amending the bill with sections one and three. He stated the three ways become law and the second form of law is the administrative rule and he said if it is not challenged it has the force of law. He said that administrative rules would sometimes be in opposition to what the intent of the law was. He said every department has to go through a systematic process before the rule is adopted, they have to do some advertising, hold public hearings, take comment and they provide to the committee all the comments made by the public. He said that this is a question of the securities department being able to take information, rules adopted by NASSAA or any other entity and be able to implement them in the state of North Dakota without any oversight. He said his committee decided this should not be the case. He said the argument was that they are different and they need to have more flexibility than other areas do, to be able to adapt their rules to emerging situations. He said it is probably somewhat legitimate but that the same argument could apply to the insurance commissioner who does go through the administrative rule process. He gave some examples when authority was given to the Insurance Commissioner to implement or use the NAIC. When it comes to any other rule the insurance department does come in and

goes through the administrative rules process. He also said in the administrative rule process is the emergency clause and any department can immediately implement an administrative rule following the emergency rules procedure. Since they have not been doing it they would have an extensive list to implement and that is why they have section three and put a delayed date for the implementation.

Senator Andrist: We do pick up a lot of things in the rules making process. He said some agencies and some rules that are a waste of time because they are beyond their ability. He gave some examples. He said there are quite a few of the administrative rules where he thinks they should just accept the national standards.

Rep. Keiser: Said that frequently they do get sets of administrative rules that are very scientific in nature, and difficult to follow. He said even when it is technical they still play a role.

Gary Pierce, Gary Pierce Financial Services: Written Testimony (2). He commented that North Dakota is number one in the nation in financial strength.

Chairman Klein: Asked if there are suitability standards in other things that he sells.

Gary: Yes, Financial Regulatory Authority it has authority over all brokers around the country, no matter what type of securities they sell. If it is a security it has to be sold by a broker.

Chairman Klein: Stated that if in the administrative rules meetings they adopted all the standards then he would be in the same boat. He would still need to have that minimum investment, how would that be any different?

Gary: He said what Financial Regulatory Authority requires all the securities people to do is to make sure the investment is suitable for the investor. He said it is flexible and different for each person. He went on to say that the NASAA suitability standard is a one size fits all standard. He objects to it because it is the one standard that tells public what to do. It is one thing to regulate the industry, the people that are selling the securities, they should but to regulate the general public is different.

Chairman Klein: Commented that the state does that now by telling people what is bad for them, speed limit. They're using their own funds but in this day of financial collapse isn't this an extra cushion?

Gary: It isn't really a cushion, it tends to restrain trade.

Senator Schneider: Stated that a real estate investment trust is a non-publically traded security and asked if there were any other investment suitability standards for other non-publically traded securities.

Gary: Said that across the country different state security departments have adopted those yes but again most of the state legislatures haven't reviewed those because it is only in about seven Acts of the various state legislatures.

Senator Schneider: Asked for an example of a non-publically traded security with the investor suitability standard.

Gary: Inland, out of Chicago.

Questions and Comments

Karen Tyler, Securities Commissioner: Said what hasn't been made clear was that they are talking about our standards that apply to capital formation by North Dakota companies. She said the REIT's they are talking about are North Dakota companies that are raising capital and the folks that are going to comment in opposition to this are concerned with section one of this bill which will require us to write into rule forms all of these guidelines and policies that apply to capital formation. She said this is really what this bill has become.

Paul Govig, Acting Commissioner, ND Department of Commerce: Written Testimony (3).

Senator Murphy: Asked about the claim that the Securities Commissioner could use the emergency clause.

Paul: Said that the procedure is there for many of these things to be handled but what happens when you have administrative rules you don't have flexibility. It is spelled out specifically how you have to deal with things. He feels because the securities department is unique they need to bend the rules sometimes or they will not be responsive and cannot act in the best interest of the state of North Dakota. There is a process you can go through but you can't do it quickly.

Glen Higley, President, Northern Plains Capital Corporation: Written Testimony (4).

Chairman Klein: Said that what Glen was suggesting that without the flexibility of the department you would have had a hard time organizing.

Glen: Yes and there were a couple of times we almost reached an impasse. If it wasn't for the ability for the department and the commissioner to set aside certain rules, I wouldn't even be in North Dakota.

Karen Tyler, Securities Commissioner: Said she wanted to make a couple of points. One, the representation that they are exempt from the administrative rules process is false. She said that they are bound by the Administrative Rules Procedures Act. She said that what was clarified for House IBL, by the Attorney General, was that this legislature has established for the Securities Commissioner broad statutory authority under, 100408.1, to apply conditions, restrictions and limitations on securities offerings. They have statutory authority to apply these policies and guidelines.

Chairman Klein: Asked her to address Gary Pierson's comment about them cranking down on those folks because of financial investment restrictions to be able to participate.

Commissioner: These suitability provisions regarding net income and net worth were established in the eighties as a result of masses fraud in the limited partnership space. They do not regulate investors. These restrictions apply to the conduct of the stockbroker and the conduct of the real estate investment trust who they can solicit and sell to.

Chairman Klein: He asked why there was a fiscal note of over a quarter of a million dollars.

Commissioner: She said it was just shy of half a million. It is because they don't have the resources to do this. They would have to contract with outside council to get it done.

Senator Andrist: He said that there are some suitability standards that reverse the role.

Commissioner: Said that the suitability standards that apply to these investments are to protect the small investor who has limited income and limited assets.

Chairman Klein: Closed the hearing.

2011 SENATE STANDING COMMITTEE MINUTES

Senate Industry, Business and Labor Committee
Roosevelt Park Room, State Capitol

(Engrossed) HB1140
March 14, 2011
Job #15386

☐ Conference Committee

Committee Clerk Signature Eva Luetett

Explanation or reason for introduction of bill/resolution:

Relating to requirement of statutory or administrative rules as a basis for action by the securities commissioner

Minutes: *Attachments: #1, #2*

Senator Klein: The continuation of Engrossed HB 1140. Committee we heard a lot of testimony and today, Commissioner Karen Tyler will give testimony for this bill.

Karen Tyler, ND Securities Commissioner: (Attachment #1)

Senator Klein: Information handed out suggests that you don't have a lot of rules. He said that it would be a lot of rules to regulate if you had a line for every rule. You do have rules?

Karen Tyler: We do have rules....not sure how many rules we have.

Senator Klein: Gave you copies which are supposedly are all rules that deal with all the things that you do. Is that true?

Karen Tyler: We did go through in 2005 (or 2007) session; we went through an appeal of a number of rules because there was a shift of thinking moving away from a lot of administrative rules. The department did go through the process of illuminating rules that were no longer necessary based on evolution of the industry and regulation. Mike can address that.

Senator Klein: We need a bit of flexibility as when we had the down turn of the financial community and the housing market which is really home. Would you comment that you need every bit of flexibility in light of the economy is gone as what we are seeing across the country?

Karen Tyler: The importance of flexibility comes strictly in the area of capital formation. Everything else is prescriptively set forth. It is the area of capital formation where we have the flexibility.....we don't really have it anywhere else in our body of laws and rules policies and guide lines. Pertains to capital formation....over valued real estate was at the

epicenter of the financial crisis. If you dig through the misconduct on the part of mortgage lenders and misconduct on part of investment banks and packaging these bad mortgages and securitizing them, and large investment companies writing credit to false flops beyond anything reasonable. At the epicenter was the overvalued real estate and subsequent collapse. Our ability to bring enforcement actions based on someone who has been harmed by inappropriate sale isn't affected by flexibility and capital formation. I cannot emphasis enough how important flexibility is for our ND companies. We operate on a national or international stage ...our authority reaches beyond our borders so we are dealing with the friction between creating a regulatory structure that is appropriated for all companies where they are based that want to do business here. Then what can we do for our ND companies? One size fits all does not work.....that's why flexibility and discretion was created and why it has worked for over 50 and should be maintained.

Senator Klein: This issue and issue with investment trust ....that is the one brought this bill before us. You pointed out that is the one that has the most rules. For the committee overview, explain what this investment really is a bunch of buildings sitting around .....how we get to what these groups are?

Karen Tyler: Real Estate investment trust wait for investors to pool their money and have access to real estate that they otherwise couldn't have. Can't afford the building but can buy shares and a trust or interest in a trust. The promoters/administrators/advisor to the trust will identify the properties that are going to be purchased. The investors will have exposure to....the net income and net worth restrictions and entire policy came about after mass of fraud in the limited partnership space in the 1980's. Example: Prudential Base....mass of fraud extraordinary settlement. As a result, regulators started looking at the alternative investments and the unique types of risks they posed to investors, some unique risks that are specifics to these types of investment. The similarities were there so these types of restrictions were placed on them because they are not appropriate for people who don't have a lot of money or assets. The limitation are not onerous ...the stockbrokers can't sell to investors who make less than $45,000 a year or have less than that in net income. It leaves many people they can sell to....but for people who make less than that liquidity constrained investments are problematic. That is why you are seeing the arbitration claims go through the roof.....up 368% since 2008. Because they carry real risks for investors who need to have access to their money.

Senator Klein: If I were selling these....would I know the rules or are the rules hidden? Do the people know who they can sell to?

Karen Tyler: Important to remember suitability's ...2 page policy pertaining to read. These apply to the REITS.....when they want to register their securities to do business in this state, this information will be in their prospectus document. Many REITS sell directly to their investors, and know what their restrictions are in addition to their suitability and other requirements. Some REITS will make arrangements with stockbrokers to sell their product...the stockbroker knows his restrictions. They are not hidden, they are well disclosed. In regard to the suitability standards, if you look at the letters submitted by Dakota REIT....they understand these are necessary and are appropriate and clearly state they have not hindered their ability to raise capital in this state. While debate was going on, one REIT raised the minimum investment to get into the REIT. No detriment to the rates.

We had one stockbroker wanted to get rid of the suitability standards. While we had 65,000 registered stockbrokers to do business in this state. Guidelines applied as rules ....they are not applied as rules; they are being applied under our statutory authority. The desire to get rid of suitability standards on its face does not have merit. We are not applying them as rules; we are applying through our statutory authority.

Senator Nodland: How are Commissions varied to other securities?

Karen Tyler: Commissions will average 6 -8%. Stock trades average 1%. Front end mutual fund 5-5¾. Comparatively speaking, commissions paid on non TEITS are significantly higher than commissions paid on other.

Mike Daily, **Deputy Commissioner and Enforcement Attorney for the Securities Department**: I would like to address one question a few points that were made earlier in testimony as to reference of Representative Klemin to certain case law that would indicate the department is not properly implementing policies we have in the case. With all due respect to Representative Klemin, the cases do not support the assertions that he was trying to make.
Even if the department were going through the vigorous rule making authority and convert these policies into administrative rules, they don't cover everything. We will go back and look at the statuette what is allowed...reasonable conditions and restrictions. It is in the code if someone is unhappy with decision the commissioner, we have the full range of appeals and administrative procedures applies, the order is issued, notice of appeal is filed, we get office of administrative hearings to appoint a hearings officer. We do not take the standards statements of policy....the issue is what was the condition that was placed on the offering and was it reasonable? That's what the OAH hearing officer would have to decide and the district or supreme court if challenged. The premise of these cases that are claiming the agency is doing something wrong is on its face wrong. It is reasonable in the standard that is in its act. The issue there doesn't appear be many administrative rules as applies to the agency at the commissioner correct ...there were more rules in place in 2002 ....the uniform state laws commission adopted new 2002 uniform securities act. In 2005, the agency went through the 2002 uniform act and selected the parts of the act that would be uniform with the rest of the country and implement them into the statute. We are relying on the statute not a separate body of administrative rules. That's the reason it appears not to be many rules....the law set forth in statute.

Senator Klein: Opposition?

Senator Klein: Closed the hearing on HB 1140.

2011 SENATE STANDING COMMITTEE MINUTES

Senate Industry, Business and Labor Committee
Roosevelt Park Room, State Capitol

(Engrossed) HB 1140
March 14, 2011
Job # 15395

☐ Conference Committee

Committee Clerk Signature Eva Luckelt

Explanation or reason for introduction of bill/resolution:

Relating to requirement of statutory or administrative rules as a basis for action by the securities commissioner.

Minutes:

Senator Klein: Committee meeting for Engrossed HB 1140. After listening to the testimonies, I know where I want to be. The submission from the other two Real Estate Trust in the state, it would certainly be hard to do business if we had the handcuffs on and every time something needed to be changed, we would have to make an adjustment.

Senator Schneider: Trying to sum things up....this bill hurts small businesses access to capital, takes away protection for investors, costs much money with no longer supported by the proponents. I move Do Not Pass

Senator Nodland: Second

Senator Klein: We have a Do Not Pass and a second. Any other discussion?

Senator Nodland: It is a one person issue....what it would cause her department. The total change doesn't add up.

Senator Klein: Looking at the two top proponents ...The House made it worse by adding those two sections to it.

Senator Klein: More discussion? Clerk take roll for a Do Not Pass for HB 1140

Clerk: 7-0-0

Senator Klein: Adjourned.

Date: 3/14/11
Roll Call Vote # 1

2011 SENATE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1140

Senate Industry, Business and Labor Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number _____

Action Taken: ☐ Do Pass ☒ Do Not Pass ☐ Amended ☐ Adopt Amendment

☐ Rerefer to Appropriations ☐ Reconsider

Motion Made By Senator Schneider Seconded By Senator Nodland

Senators	Yes	No	Senators	Yes	No
Chairman Jerry Klein	✓		Senator Mac Schneider	✓	
VC George L. Nodland	✓		Senator Philip Murphy	✓	
Senator John Andrist	✓				
Senator Lonnie J. Laffen	✓				
Senator Oley Larsen	✓				

Total (Yes) 7 No 0

Absent 0

Floor Assignment Senator Schneider

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1140, as engrossed: Industry, Business and Labor Committee (Sen. Klein, Chairman) recommends **DO NOT PASS** (7 YEAS, 0 NAYS, 0 ABSENT AND NOT VOTING). Engrossed HB 1140 was placed on the Fourteenth order on the calendar.

2011 TESTIMONY

HB 1140

TESTIMONY OF REP. LAWRENCE R. KLEMIN
HOUSE BILL 1140
HOUSE INDUSTRY, BUSINESS AND LABOR COMMITTEE
JANUARY 12, 2011

Mr. Chairman and Members of the Committee. I am Lawrence R. Klemin, Representative for District 47 in Bismarck. I am appearing before you today to testify in favor of House Bill 1140.

In the 2009 Legislative Session, I introduced a bill which provided that an administrative agency could not apply "standards" to the regulated community that were developed by outside organizations unless those "standards" had been adopted as rules in accordance with the provisions of the Administrative Agencies Practice Act set out in Chapter 28-32 of the North Dakota Century Code. The term "standards" was defined in the bill to include a body of regulatory provisions developed by an association, commission, or other organization which do not have the force and effect of law in this state. Many state agencies objected to the bill in 2009 and claimed that it would be expensive to comply with this requirement. Consequently, in order to determine the extent to which agencies were actually imposing outside "standards" on the regulated community, the bill was converted to an interim study. The study was then assigned to the Administrative Rules Committee.

The Administrative Rules Committee surveyed the agencies and took testimony from numerous state agencies. As a result of the study, the Administrative Rules Committee determined that the only state agency that was imposing outside "standards" on the regulated community was the Securities Commissioner. Consequently, the Committee recommended that no further action be taken as a result of the study. A copy of the report of the Administrative Rules Committee on ths study is attached.

The Securities Commissioner imposes certain "standards" developed by the North American Securities Administrators Association (NASAA) on securities brokers and dealers in North Dakota as a condition for the ability to sell certain registered securities in this state. One of those "standards" imposes income and net worth restrictions on investors in securities. One type of security that is sold in North Dakota by local securities dealers is an interest in a real estate investment trust. The dealers are not able to sell this type of security to North Dakota investors unless the investors meet certain income and asset requirements. A local securities dealer is here this morning to explain this securities requirement to you in more detail and to explain this NASAA "standard".

Outside "standards" imposed by an agency on the regulated community without following well established administrative rulemaking procedures are not rules adopted in accordance with the laws of this State. They are not subjected to public review, comment and hearing before they are implemented; do not have a regulatory or economic analysis to determine the effect on regulated entities; are not reviewed by the

Attorney General to determine legality and conformity with the law; are not subject to review and objection by the Administrative Rules Committee because they are not "rules"; and are not published in the North Dakota Administrative Code so that the regulated community and the public know what they are. These are all requirements that are contained in Chapter 28-32.

These outside "standards" are subject to change at any time by an administrative agency and are imposed upon the regulated community without the approval of the Legislature. A requirement of an agency which is enforced like a rule, is required to be followed by the regulated community as a condition for a permit, license, or other approval, is a rule and must be adopted in accordance with the North Dakota Administrative Agencies Practice Act. Due process of law requires no less. An administrative agency cannot exempt itself from these requirements.

Compliance with this rulemaking procedure has been reviewed and upheld by the North Dakota Supreme Court. In *Huber v. Jahner*, 460 N.W.2d 717 (N.D. 1990), a case involving the Department of Human Services, the North Dakota Supreme Court stated:

> The Department of Human Services is an administrative agency and is subject to the provisions of Chapter 28-32, N.D.C.C. *Pursuant to that chapter, an administrative rule is invalid unless it is adopted in substantial compliance with Section 28-32-02, N.D.C.C.* (emphasis added)

This was a case dealing with child support guidelines that had been enforced by the Department of Human Services, but had not been adopted as rules. A copy of the case is attached. This is the law in North Dakota. It is contained in Section 28-32-13. It applies to all state agencies.

House Bill 1140 simply provides that the Securities Commissioner may not establish any restriction on income or assets of investors in real estate investment trusts unless the restriction is adopted as a rule. I am not here to take a position on whether any outside "standard" is good or bad or whether it should be adopted as a rule or not. The bill does not prevent the Securities Commissioner from adopting NASAA standards as rules, as some other states have done. However, the appropriate administrative procedure should be followed in order to impose these "standards". It is clear from the decision of the North Dakota Supreme Court, that these "standards" will not have the force and effect of law in North Dakota unless there is substantial compliance with the rulemaking requirements of the Administrative Agencies Practice Act. This is a reasonable requirement and one that most, if not all, of the other state agencies are following.

I urge your support for House Bill 1140.

ADMINISTRATIVE RULES COMMITTEE

The Administrative Rules Committee is a statutory committee deriving its authority from North Dakota Century Code (NDCC) Sections 54-35-02.5, 54-35-02.6, 28-32-17, 28-32-18, and 28-32-18.1. The committee is required to review administrative agency rules to determine whether:

1. Administrative agencies are properly implementing legislative purpose and intent.
2. There is dissatisfaction with administrative rules or statutes relating to administrative rules.
3. There are unclear or ambiguous statutes relating to administrative rules.

The committee may recommend rule changes to an agency, formally object to a rule, or recommend to the Legislative Management the amendment or repeal of the statutory authority for the rule. The committee also may find a rule void or agree with an agency to amend or repeal an administrative rule to address committee concerns, without requiring the agency to begin a new rulemaking proceeding.

The Legislative Management delegated to the committee its authority under NDCC Section 28-32-10 to distribute administrative agency notices of proposed rulemaking and to establish standard procedures for agency compliance with notice requirements, its authority under Section 28-32-07 to approve extensions of time for administrative agencies to adopt rules, and its responsibility under Section 28-32-42 to receive notice of final of an administrative agency's rulemaking action. The committee is authorized under NDCC Sections 54-06-32 and 54-06-33 to approve rules adopted by Human Resource Management Services authorizing service awards and employer-paid costs of training to employees in the classified service.

In addition to its statutory duties, the Legislative Management assigned two studies to the committee. House Bill No. 1280 (2009) directed a study of application by administrative agencies of standards from other than state or federal law which have not been adopted as administrative rules. House Concurrent Resolution No. 3051 (2009) directed a study of imposition of criminal and civil penalties, fines, fees, and forfeitures by administrative rule.

Committee members were Senators Jerry Klein (Chairman), John M. Andrist, Tom Fischer, Layton W. Freborg, Joan Heckaman, and Tracy Potter and Representatives Wesley R. Belter, Randy Boehning, Stacey Dahl, Chuck Damschen, Duane DeKrey, Mary Ekstrom, Jim Kasper, George J. Keiser, Kim Koppelman, Joe Kroeber, Jon Nelson, Blair Thoreson, Francis J. Wald, Lonny Winrich, and Dwight Wrangham.

The committee submitted this report to the Legislative Management at the biennial meeting of the Legislative Management in November 2010. The Legislative Management accepted the report for submission to the 62nd Legislative Assembly.

STUDY OF AGENCY APPLICATION OF STANDARDS NOT ADOPTED AS ADMINISTRATIVE RULES

Under NDCC Section 28-32-06, administrative rules adopted in compliance with NDCC Chapter 28-32--the Administrative Agencies Practice Act--have "the force and effect of law until amended or repealed by the agency." The significance of having the force and effect of law is that a valid administrative rule is binding on all persons and on the courts to the same extent as a statute.

The committee identified and obtained testimony from the most active administrative rulemaking agencies regarding the extent to which they require compliance with standards that have not been adopted as administrative rules. Of the agencies responding, only the Securities Commissioner imposes standards that are not contained in state or federal law or rules. The Securities Commissioner applies standards for the securities industry which are the standards adopted by the North American Securities Administrators Association (NASAA). It appears there is one standard of the NASAA applied by the Securities Commissioner which draws criticism. Under that standard, investors in a real estate investment trust (REIT) must have a minimum annual gross income of $70,000 and a net worth of $70,000 or a minimum net worth of $250,000 with no minimum income requirement. That standard drew criticism from several investment professionals who provided testimony to the committee. Those individuals said net worth or income is not an appropriate limitation because for small investors, investment in an REIT may be the best kind of investment in certain market conditions.

After determining that the study of application of standards from other than state or federal law or rules was essentially limited to concern with one standard applied by the Securities Commissioner, the committee recommended to concerned individuals that they seek introduction of legislation to obtain consideration of the issue by the full Legislative Assembly.

Conclusion

The committee makes no recommendation with regard to this study.

STUDY OF IMPOSITION OF PENALTIES BY ADMINISTRATIVE RULES

Most courts have concluded that delegation of legislative authority to administrative agencies is permissible to provide an administrative agency discretion as to implementation, administration, and enforcement of the law as long as the Legislative Assembly by statute provides sufficient standards to guide the agency. Imposition of penalties by an administrative agency under a statutory provision that clearly identifies proscribed conduct and the appropriate sanction avoids the issue of unlawful delegation of legislative authority. The issue of unlawful delegation of legislative authority comes into play when statutory authority leaves it to the discretion of an

William Frederick Huber, Plaintiff, Appellant, and Cross-Appellee v. Joyce A. Jahner, formerly Joyce A. Huber, Defendant, Appellee, and Cross-Appellant
Court of Appeals of North Dakota
460 N.W.2d 717;1990 N.D. App. LEXIS 6
Civil No. 900076CA
September 13, 1990, Filed

Editorial Information: Prior History

Appeal from the District Court for Emmons County, South Central Judicial District, the Honorable William F. Hodny, Judge.

Disposition:

Counsel Rauleigh D. Robinson (argued), Bismarck, North Dakota, for plaintiff, appellant, and cross-appellee.

Wheeler Wolf, Bismarck, North Dakota, for defendant, appellee, and cross-appellant; argued by Arnold V. Fleck.

Judges: Douglas B. Heen, S.J., John T. Paulson, D.J., Wallace D. Berning, D.J.

CASE SUMMARY

PROCEDURAL POSTURE: Plaintiff former husband challenged the decision of the District Court for Emmons County (North Dakota), which amended a judgment by modifying the child support provisions of an original divorce decree. Defendant former wife filed a cross-appeal from the amended judgment.An amended judgment modifying the child support provisions of an original divorce decree was affirmed where there was evidence in the record to support a finding of a material change of circumstances warranting an increase in a former husband's child support obligation, and such finding was not clearly erroneous.

OVERVIEW: The trial court modified the original decree by increasing the husband's child support payments and requiring the wife to provide for all of the children's medical expenses except for necessary dental and eye care which the court ordered the husband to provide for the children. On appeal, the husband asserted that the trial court's finding of a material change of circumstances warranting an increase in his child support obligation was clearly erroneous. The court affirmed. It found that the trial court's findings were supported by the evidence in the record and were not clearly erroneous. On her cross-appeal, the wife asserted that the trial court committed reversible error by setting the husband's obligation at an amount less than specified by the Delaware Department of Human Services' child support guidelines. The court concluded that the guidelines constituted a substantive rule which had to be promulgated in accordance with Chapter 28-32, N.D.C.C., to have validity. The wife did not demonstrate that the child support guidelines were validly promulgated under Chapter 28-32, N.D.C.C., or that they were otherwise binding upon the trial court in the case.

OUTCOME: The court affirmed the judgment.

LexisNexis Headnotes

Family Law > Child Support > Obligations > Modification > Changed Circumstances

The trial court has power to modify the child support provisions of an original divorce decree whenever there is a material change of circumstances. When modification is based on a change of financial circumstances, the supporting spouse's needs and ability to pay, as well as the needs of the children and dependent spouse, must be taken into account, with the court striking a balance between the needs of the children and the ability of the supporting parent to pay.

Family Law > Child Support > Obligations > Modification > General Overview
Family Law > Marital Termination & Spousal Support > Dissolution & Divorce > Procedures

The trial court's determination on a motion to modify a divorce decree will not be set aside on appeal unless it is clearly erroneous. Rule 52(a), N.D.R.Civ.P. A finding of fact is clearly erroneous when, on the entire evidence, the reviewing court is left with a definite and firm conviction that a mistake has been made.

Opinion

Opinion by: PER CURIAM

Opinion

{460 N.W.2d 718} William Huber appealed from an amended judgment, dated January 24, 1990, modifying the child support provisions of an original divorce decree. Joyce Jahner filed a cross-appeal from the amended judgment. We affirm.

William and Joyce were divorced in April 1988. The original judgment, based upon a stipulated agreement, ordered William to pay $ 550 per month to Joyce as child support for their five minor children. It also provided that Joyce was to furnish health insurance for the children under her employer's group health insurance program and that William and Joyce would equally share the children's medical, dental, and eye care expenses not covered by the health insurance policy.

In September 1989, Joyce filed a motion for increased child support payments from William. Following a hearing, the trial court modified the original decree, increasing William's child support payments to $ 680 per month and requiring Joyce to provide for all of the children's medical expenses except for necessary dental and eye care which the court ordered William to provide for the children.

On appeal William asserts that the trial court's finding of a material change of circumstances warranting an increase in his child support obligation was clearly erroneous.

The trial court has power to modify the child support provisions of an original divorce decree whenever there is a material change of circumstances. *Guthmiller v. Guthmiller,* 448 N.W.2d 643 (N.D. 1989). When modification is based on a change of financial circumstances, the supporting spouse's needs and ability to pay, as well as the needs of the children and dependent spouse, must be taken into account, with the court striking a balance between the needs of the children and the ability of the supporting parent to pay. *Skoglund v. Skoglund,* 333 N.W.2d 795 (N.D. 1983). The trial court's determination on a motion to modify a divorce decree will not be set aside on appeal unless it is clearly erroneous. Rule 52(a), N.D.R.Civ.P. A finding of fact is clearly erroneous when, on the entire evidence, the reviewing court is left with a definite and firm conviction that a mistake has been made.

Bloom v. Fyllesvold, 420 N.W.2d 327 (N.D. 1988).

The trial court found that there was a material change in circumstances:

"William's net income has substantially increased since entry of the judgment in this action, in that at the time of entry of the judgment William was unemployed and at the time of hearing he was earning an annual gross income of $ 30,000 and that Joyce's annual net income since **{460 N.W.2d 719}** entry of the judgment had decreased by $ 720. . . ."

William asserts that the increase in his earnings does not justify a finding of a material change in circumstances because the original agreement on child support anticipated William's potential earning capacity. Joyce's testimony at the hearing disputes William's assertion:

"Q. Do you recall one of the major factors for settling for 550?

"A. He was unemployed, he had not worked.

"Q. Was it also explained to you what could happen in the future should he become employed and start raising [sic] a decent salary?

"A. We could reopen and reapply for child support.

"Q. Is that a substantial reason why you accepted the 550 offer?

"A. Yes, it is."

During the hearing the parties reached an agreement with regard to the medical expenses for the children, whereby Joyce agreed to pay all medical expenses except necessary dental and eye care which William agreed to pay. The trial court modified the original decree to reflect this agreement between the parties regarding the sharing of medical expenses for the children. Neither party can now complain about the court's action.

The trial court found that William is currently netting $ 1,875 per month and has the ability to pay $ 680 per month for child support in addition to paying for the children's necessary dental and eye care expenses. Upon reviewing the entire record in the case, we are not convinced that the trial court made a mistake. The trial court's findings are supported by the evidence in the record and are not clearly erroneous.

On her cross-appeal, Joyce asserts that the trial court committed reversible error by setting William's child support obligation at an amount less than specified by the Department of Human Services' child support guidelines.

When this case was heard by the trial court, Section 14-09-09.7, N.D.C.C., as amended in 1989, provided in relevant part:

"14-09-09.7. Child support guidelines.

"1. The department of human services shall establish child support guidelines to assist courts in determining the amount that a parent should be expected to contribute toward the support of the child under this section. . . .

* * * * *

"3. There is a rebuttable presumption that the amount of child support which would result from the application of the child support guidelines is the correct amount of child support. The presumption may be rebutted if a preponderance of the evidence in a contested matter establishes that factors not considered by the guidelines will result in an undue hardship to the obligor or a child for whom support is sought. A written finding or a specific finding on the record must be made if the court determines that the presumption has been rebutted."

The Department of Human Services is an administrative agency and is subject to the provisions of Chapter 28-32, N.D.C.C. Pursuant to that chapter, an administrative rule is invalid unless it is adopted in substantial compliance with Section 28-32-02, N.D.C.C. *Mullins v. Department of Human Services,* 454 N.W.2d 732 (N.D. 1990); *Little v. Spaeth,* 394 N.W.2d 700 (N.D. 1986). Joyce does not argue that the child support guidelines have been promulgated in accordance with Chapter 28-32, N.D.C.C. She asserts that they are binding, nevertheless, upon the trial court, because they are expressly exempted, by the definition of "rule" under Section 28-32-01(6), N.D.C.C., from the rule-making procedures under Chapter 28-32, N.D.C.C. We disagree.

The term "rule" is defined under Section 28-32-01(6), N.D.C.C.:

"'Rule' means the whole or a part of an agency statement of general applicability that implements, interprets, or prescribes law or policy, or the organization, procedures, or practice requirements of the agency. The term includes the amendment, **{460 N.W.2d 720}** repeal, or suspension of an existing rule. The term does not include:

* * * * *

"1. Guidelines, manuals, brochures, pamphlets, and similar statements of policy intended to advise or guide the agency or the public concerning activities of the agency which are otherwise prescribed by rule or statute."

Under the clear and unambiguous language of the foregoing section, only those "guidelines" are exempted from the rule-making process which are "intended to advise or guide the agency or the public concerning activities of the agency. . . ." The child support guidelines clearly do not fall within this narrow definition. The guidelines are not intended to merely "advise or guide" the agency or the public, and they are not guidelines "concerning activities of the agency." Pursuant to Section 14-09-09.7(3), N.D.C.C., the guidelines constitute presumptive evidence of the child support obligation that a trial court must award absent specific findings rebutting the presumption. They are a statutorily authorized schedule for court awarded child support, pursuant to Section 14-09-09.7, N.D.C.C. As such, the guidelines constitute "an agency statement of general applicability that implements . . . law." We conclude that the guidelines constitute a substantive rule which must be promulgated in accordance with Chapter 28-32, N.D.C.C., to have validity. *See Johnson v. North Dakota Workers Compensation Bureau,* 428 N.W.2d 514. (N.D. 1988).

Joyce has not demonstrated that the child support guidelines were validly promulgated under Chapter 28-32, N.D.C.C., or that they are otherwise binding upon the trial court in this case. Consequently, we conclude that the trial court did not err in ordering child support which deviates from the guidelines.

In accordance with this opinion, the judgment of the trial court is affirmed.

Mr. Chairman, Members of the Committee,

My name is Garry Pierce. I own Garry Pierce Financial Services, LLP here in Bismarck. We are a member firm of FINRA, the Financial Regulatory Authority. I am here to support House Bill 1140.

In a letter dated October 23, 2008, Representative Klemin wrote the following to the Securities Commissioner:

"I am writing to you at the request of a constituent who is involved with the sale of interests in Real Estate Investment Trusts (REITS). According to my constituent, the North Dakota Securities Department has adopted investor suitability requirements that must be met by persons who are interested in purchasing an interest in a REIT.

As I understand the process, the Department requires a prospectus for a REIT to include minimum income ($45,000/year) and net worth requirements ($150,000) for investors. The Department also prohibits brokers from selling to persons who do not meet these requirements and thereby puts the burden on brokers to enforce these requirements for the Department. I have been informed that these requirements are not part of any current statute or administrative agency rule, but rather are informal guidelines used by the Department that have been adopted without public input and that a prospectus for a REIT will not be approved by the Department unless these requirements are included.

Is it correct that the Department imposes these REIT suitability requirements on brokers and investors? If so, then please advise me of the specific statutory or other regulatory authority relied upon by the Department for imposing these requirements. If this is an informal guideline used by the Department, please provide me with the specific language of the guideline and also tell me how this guideline is communicated to the public. What is the specific language that must be used in a prospectus for a REIT? Finally, what is the rationale for these requirements?"

In a letter dated October 31, 2008, the Securities Department's Mr. Harold Kocher replied to Representative Klemin's request for more information. He stated that, quote, '"You are correct in that the Securities Department does require certain suitability standards for REITs as well as for securities offered on behalf of entities offering securities in commodity pools, oil and gas ventures, asset-backed securities, equipment leasing and other types of programs or ventures" unquote. He goes on to say that, quote, "Most states follow the many Statements of Policy in an informal manner and a few have adopted them by rule. North Dakota has chosen to follow the many Statements of Policy in an informal manner as a convenience to the industry and thereby can be more flexible during the review of an application."end quote.

Well, North Dakota hasn't adopted the Suitability Standards, rather, the Securities Department has. Then it follows that most other states have not adopted these standards either. Rather their securities departments have, without their legislatures knowing about it. Apparently, twenty three years ago, most state securities departments across the country simply started requiring brokers to enforce these standards without approval of their legislatures. I doubt that NASAA, the North American Securities Administrators Association, the organization that originated these standards, considered the political implications of enforcing these standards upon the public. People have a constitutional right to own property.

The letter goes on to say, quote, "The Securities Department has not received any complaints from REIT issuers, legal counsel representing REIT issuers or broker-dealers marketing REIT securities regarding the imposition of the suitability standards...." unquote. This is hardly surprising since these are the very people who depend upon approval of these offerings for their livelihood. They would hardly risk antagonizing that very authority. Not only REIT issuers but all securities issuers and broker-dealers were denied the protections of a free and open public hearing when these standards should have been brought before the legislature for review.

And, finally, quote, "You asked for the specific statutory or other regulatory authority relied upon by the Department for imposing these requirements.

Section 10-04-08.1 of the North Dakota Century Code states in part, "The Commissioner has the power to place such conditions, limitations and restrictions on any approval or registration as may be necessary to carry out the purposes of this chapter." Unquote.

A reading of the entire chapter will show that it defines the Commissioner's authority over sellers of securities, not purchasers. The only time a purchaser is even mentioned is in Section 10-04-17, Remedies, which defines the rights of an investor who has been the victim of fraud. An yet this citation is used to justify standards which regulate purchasers' investing. The Transportation Department does not require all North Dakota car dealers to obtain proof of a certain income or net worth from a customer before they could purchase a vehicle. Nor does the Real Estate Commissioner require all licensed agents to require proof of a certain income or net worth before someone could purchase a home. In each case, that is the buyer's business – not the State"s. The intent of the Century Code appears to be to protect the public by regulating the industries. The NASAA suitability standards, imposed by an outside organization, appear to regulate the public.

Both members of the Securities Department and we have appeared before the

interim Administrative Rules Committee. The Committee suggested that the Securities Department and Mr. Roger Domres, representing INREIT Real Estate Investment Trust , Mr. Jim Knutson, representing Dakota REIT, and I meet to try to work out our differences. I summarized the results of our meeting in the following letter dated March 2, 2010 which I copied to the members of the Interim Committee:

North Dakota Securities Department
600 E. Boulevard Ave.
Bismarck, ND 58505

Attention: Mr. Harold Kocher, Chief Examiner

Dear Mr. Kocher,

This letter is in response to your request that any further proposals relating to our discussion of your NASAA standards be in writing.

At the December 10, 2009 Legislative Committee meeting, Representative Keiser suggested that we meet with your department representatives to discuss our differences on the above issue. Your attorney, Mike Daley, agreed. Subsequently, you called Garry Pierce and requested that we wait until after the holidays to meet. In early January, you again called Mr. Pierce to request that any meeting be postponed until you had moved from your temporary offices back to the Capitol building which would be after February 1. After not hearing from you, Mr. Pierce called you on February 15 at which time you suggested that, due to parking difficulties at the Capitol, we meet at Mr. Pierce's office in Bismarck. This option, of course was available since December, 10. Since the earliest that Jim Knutson of Dakota REIT in Valley City and Roger Domres of INREIT in Minot could get to Bismarck was February 24, we met with you and Mr. Daley then.

The result of that meeting was that we appeared to have a choice: Either we agree to an exemption of up about $2,500 to $5,000 for small investors or face much stricter limits if the NASAA suitability standards for all types of investments is adopted as a rule by the Legislative Committee. Moreover, you stated that the adoption of the entire body of NASAA standards would also "tie your hands" when approving stock offerings for companies such as Dakota REIT and INREIT. You would no longer have the discretion available to accommodate such offerings which could seriously impact their ability to do business. You also agreed with Mr. Domres that rigidly applying the NASAA rules to business applications could be a "deal breaker" in some cases.

Here is our proposal then, and it is a single sentence. It only amends the standards where they touch the public. As a preface to the NASAA suitability standards in the prospectus the customer receives, you insert: "Although not mandatory, these standards should be considered when determining suitability." Thus, instead of telling the public, " you must do this", (which is a rule) you are saying the public, "here are the standards, now you decide", which is no longer a rule. The public has been informed but not forced to comply with the standards and the examiner can continue to use discretion and flexibility in approving business applications since the standards need not be adopted as rules.

Since, through no fault of ours, we are in a position that we no longer have three months to discuss this issue with you but are now down to two weeks, we intend to request that the Committee delay any decision on adopting the NASAA standards as rules until we may discuss this issue with you during the

coming quarter. And this time, we hope to have a member of the Committee present at our meetings in order to avoid any misunderstandings.

Respectfully,

Garry Pierce, Garry Pierce Financial Services, LLP

Jim Knutson, Dakota REIT

Roger Domres, INREIT

cc. Members of the Legislative Committee

The only part of the many Statements of Policy that we object to are the mandatory suitability standards that appear in the prospectus. I don't think that either the Securities Commissioner or we can give the Committee a definite answer to this issue because, in the final analysis, I believe that this is not a securities issue but a judgment call. How does the Legislature want the Securities Department to treat North Dakota investors. For 23 years, the Securities Department, without the Legislature knowing about it, has been telling investors: "These are the NASAA suitability standards. If you do not meet these standards, we are not allowing you to invest."

The Committee might wonder if the investor is still protected without mandatory standards. On that question, I can give the Committee a definite answer and the answer is yes. Nationwide, all securities must be sold by brokers. All brokers must be members of the Financial Regulatory Authority or FINRA. Every broker/dealer office across the country must have a Compliance Officer. The Compliance Officer is responsible for reviewing all new business submitted by the Registered Representatives. The Compliance Officer reviews new business according to a New Account Form that every investor must complete and sign before they are allowed to invest. The New Account Form lists the investor's income, net worth, investment background and investment goals. That is how the investor is protected, by a trained professional reviewing each particular piece of business according to a signed New Account Form and not by a blind suitability standard such as the NASAA standard. FINRA has been protecting investors since 1940, long before the various state regulators unilaterally imposed these standards upon the public.

Copies of the NASAA suitability standards which appear in the INREIT and Dakota REIT prospectuses are included at the end of this presentation.

Thank you Mr. Chairman and Members of the Committee. Are there any questions?

Dakota REIT

WHO MAY INVEST

This offering is available to residents of the state of North Dakota who have either (i) a minimum annual gross income of at least $45,000 and a minimum net worth (exclusive of home, home furnishings and automobiles) of $45,000; or (ii) a net worth (determined with the foregoing exclusions) of at least $150,000. Assets included in the computation of net worth may be valued at fair market value. Gross annual income is based upon actual income an investor had during the last tax year, or is estimated to have during the current tax year.

This suitability standard will not apply to purchases of less than $25,000 of Shares in cases where such subscription does not exceed ten percent (10%) of the Subscriber's net worth, which in all cases will be calculated exclusive of home, furnishings, and personal automobiles.

WHO MAY INVEST

The Subscriber will become a Shareholder when the following representations are made to the Trust:

1.....The Subscriber is not a minor under the laws of the State of North Dakota and warrants and represents to be a bona fide resident of the State of North Dakota.

2.....The undersigned acknowledges receiving, prior to executing this Subscription Agreement, the Prospectus of the INREIT, to include its exhibits and attachments.

3.....The Subscriber has either (i) a minimum annual gross income of at least $45,000 and a net worth (exclusive of home, home furnishings, and automobiles) of $45,000; or (ii) a net worth (determined with the foregoing exclusions) of at least $150,000. Assets included in the computation of net worth may be valued at fair market value. Gross annual income is based upon actual income an investor had during the last tax year, or is estimated to have during the current tax year.

4.....This suitability standard will not apply to purchases of less than $25,000 of Shares in cases where such subscription does not exceed ten percent (10%) of the Subscriber's net worth, which in all cases will be calculated exclusive of home, furnishings, and personal automobiles.

5.....The Subscriber, if acting in a representative or fiduciary capacity, the above representations and warranties shall be deemed to have been made by the person(s) or entity, any of whom are bona fide residents of the State of North Dakota.

6.....The Subscriber, if acting in a representative or fiduciary capacity for a corporation, limited liability company, partnership, pension plan or trust, or as custodian or agent for any person or entity, has full authority to enter into this agreement in such capacity and on behalf of such entity.

7.....Upon the Subscription Agreement being executed and accepted by the Trust, the sale occurs effective as of that date. When the entire consideration is paid and received by the Trust as required herein, an acknowledgment certificate representing the Shares/Units purchased will thereafter be issued.

8.....The Subscriber hereby acknowledges and agrees that Subscriber is not entitled to cancel, terminate or revoke this subscription or any agreements of the Subscriber hereunder and that such subscription and agreements shall survive the death or disability of the Subscriber.

9.....Upon the execution of the Subscription Agreement and the delivery thereof, the Subscriber covenants and has agreed to be bound by and governed by each and all of the provisions of the Declaration of the Trust, (attached here to as Exhibit A), to the Prospectus, and also to any valid and enforceable amendments thereto which may be subsequently adopted, and that the requested information as disclosed on page 2 of the Subscription Agreement is true and correct and the Trust is entitled to rely upon its accuracy and completeness.

10.....Subscriber will provide the necessary and required information to the Trust so as to qualify the investment as a REIT under Internal Revenue Service laws, rules and regulations.

SUMMARY OF THE OFFERING

The following summary is qualified in its entirety by the detailed information appearing elsewhere in this Prospectus. Certain capitalized terms used in this Summary and throughout this Prospectus are defined under "Glossary."

The Trust. INREIT Real Estate Investment Trust ("INREIT") is a registered but unincorporated business trust and has been formed under North Dakota law. The trust intends to qualify as a REIT. The Trust has a term of existence which qualifies under North Dakota law. The Trust will initially invest in properties primarily in North Dakota that the Board of Trustees considers suitable investments. Properties can and may include commercial properties and multi-family dwellings, such as apartment buildings and senior assisted or independent living centers. The Trust's principal office is located at 216 South Broadway, Suite 202, Minot, North Dakota 58701, phone 701-837-1031.

INREIT

To: Committee Members of House Bill 1140

Fr: Roger W. Domres INREIT Real Estate Investment Trust

Re: House Bill 1140

Committee Members;

I apologize for not being able to be with you today but due to a family medical situation I am unable to attend the Hearing for House Bill 1140. That being said I would like to give you my position regarding this Bill and the conflict I see with the present guidelines that are in place today.

The State of North Dakota has been very fortunate to have an individual like Harold Kocher, within the ND Securities Commissioner Office, bringing common sense to securities related issues in State for many decades and for that I am extremely thankful . That brings me to my point today that we as a State are much better off making our own rules and regulation within this department or any other department in the State of North Dakota then relying on a National Organization such as NASAA "North American Securities Administrators Association" to set rules and regulation upon the individuals of this great State. I believe the State of North Dakota can decide what rules and regulations are right for the citizens of this State and not a National Organization such as NASAA. I believe House Bill 1140 is about giving the right to make rules and regulations back to the citizens of this State and to allow the Legislature to work with the Securities Commissioner Office in forming guidelines that are more in tune to our individual State.

My comments today are based upon the Rules and Regulations that NASAA has thrust upon our REIT "Real Estate Investment Trust" industry today. Presently the investment rules we as an industry have are more stringent than many other groups of investments in the State and yet our industry has had very little investor problems and has a major impact on the economic growth of this State. We as an industry own over One Billion Dollars of real estate within the confines of North Dakota and we employ well over Three Hundred people in this State either directly within our offices or in our property management divisions. Much of our growth can be contributed to our relationship with the Securities Commissioner Office and the people of North Dakota. We have in a sense been able to provide strong investment opportunities for the citizens of North Dakota to invest in the great State of North Dakota and I believe that opportunity should be available to every citizen not just the ones that NASAA deems to be qualified.

What I am asking today is for this Committee to assist our industry and the ND Securities Commissioner Office in giving those rights back to the citizens of this Great State!

Thank You

Roger W. Domres

Roger W. Domres

16 South Broadway, Suite 202 ▪ Minot, North Dakota 58701 ▪ Office (701) 837-1031 ▪ Toll Free 1-877-269-1031 ▪ Fax (701) 837-9444

(1)

HOUSE BILL 1140
TESTIMONY OF REP. LAWRENCE R. KLEMIN
SENATE INDUSTRY, BUSINESS AND LABOR COMMITTEE
MARCH 9, 2011

Mr. Chairman and Members of the Committee. I am Lawrence R. Klemin, Representative for District 47 in Bismarck. I am appearing before you today to testify in favor of House Bill 1140.

In the 2009 Legislative Session, I introduced a bill which provided that an administrative agency could not apply "standards" to the regulated community that were developed by outside organizations unless those "standards" had been adopted as rules in accordance with the provisions of the Administrative Agencies Practice Act set out in Chapter 28-32 of the North Dakota Century Code. The term "standards" was defined in the bill to include a body of regulatory provisions developed by an association, commission, or other organization which do not have the force and effect of law in this state. Many state agencies objected to the bill in 2009 and claimed that it would be expensive to comply with this requirement. Consequently, in order to determine the extent to which agencies were actually imposing outside "standards" on the regulated community, the bill was converted to an interim study. The study was then assigned to the Administrative Rules Committee.

The Administrative Rules Committee surveyed the agencies and took testimony from numerous state agencies. As a result of the study, the Administrative Rules Committee determined that the only state agency that was imposing outside "standards" on the regulated community was the Securities Commissioner. Consequently, the Committee recommended that no further action be taken as a result of the study. I then introduced House Bill 1140 in this Session of the Legislature. The original bill is now Section 2 of the bill. Sections 1 and 3 were added as amendments by the House IBL Committee. I will be discussing Section 2 of the bill. Rep. George Keiser, Chairman of the House IBL Committee, will cover Sections 1 and 3.

Outside "standards" imposed by an agency on the regulated community without following well established administrative rulemaking procedures are not rules adopted in accordance with the laws of this State. They are not subjected to public review, comment and hearing before they are implemented; do not have a regulatory or economic analysis to determine the effect on regulated entities; are not reviewed by the Attorney General to determine legality and conformity with the law; are not subject to review and objection by the Administrative Rules Committee because they are not "rules"; and are not published in the North Dakota Administrative Code so that the regulated community and the public know what they are. These are all requirements that are contained in Chapter 28-32. The Securities Commissioner is not exempted from the requirements of Chapter 28-32.

These outside "standards" are subject to change at any time and are imposed upon the

regulated community without the approval of the Legislature through the Administrative Rules Committee. A requirement of an agency which is enforced like a rule, is required to be followed by the regulated community as a condition for a permit, license, or other approval, is a rule and must be adopted in accordance with the North Dakota Administrative Agencies Practice Act. Due process of law requires no less.

Compliance with this rulemaking procedure has been reviewed and upheld by the North Dakota Supreme Court. In *Huber v. Jahner*, 460 N.W.2d 717 (N.D. 1990), a case involving the Department of Human Services, the North Dakota Supreme Court stated:

> The Department of Human Services is an administrative agency and is subject to the provisions of Chapter 28-32, N.D.C.C. *Pursuant to that chapter, an administrative rule is invalid unless it is adopted in substantial compliance with Section 28-32-02, N.D.C.C.* (emphasis added)

This was a case dealing with child support guidelines that had been enforced by the Department of Human Services, but had not been adopted as rules. This statement by the North Dakota Supreme Court is the law in North Dakota. It is contained in Section 28-32-13. It applies to all state agencies that have not been specifically exempted in Chapter 28-32. It applies to the Securities Commissioner.

The Securities Commissioner imposes certain "standards" developed by the North American Securities Administrators Association (NASAA) on securities brokers and dealers in North Dakota as a condition for the ability to sell certain registered securities in this state. One of those "standards" imposes income and net worth restrictions on investors in securities. One type of security that is sold in North Dakota by local securities dealers is an interest in a real estate investment trust (REIT). The dealers are not able to sell this type of security to North Dakota investors unless the investors meet certain income and asset requirements. A local securities dealer is here today to explain this securities requirement to you in more detail and to explain this NASAA "standard".

Section 2 of House Bill 1140 provides that the Securities Commissioner may not establish any restriction on income or assets of investors in real estate investment trusts unless the restriction is adopted as a rule. The restriction must be supported by substantial evidence and must be in the best interest of investors and the public. The appropriate administrative procedure should be followed in order to impose this "standard". It is clear from the decision of the North Dakota Supreme Court that "standards" will not have the force and effect of law in North Dakota unless there is substantial compliance with the rulemaking requirements of the Administrative Agencies Practice Act in Chapter 28-32. This is a reasonable requirement and one that all of the other state agencies are following.

I urge your support for House Bill 1140.

House Bill 1140 Testimony by Garry Pierce, March 9, 2011

Mr. Chairman and Members of the Committee,

My name is Garry Pierce. I own Garry Pierce Financial Services, LLP at 1929 North Washington Street here in Bismarck. We are a member firm of FINRA or the Financial Regulatory Authority.

I am here to support House Bill 1140.

At the January 12 House Committee meeting, the Securities Commissioner made certain comments which I think should be addressed. Dakota REIT and INREIT do not charge investors twice. It isn't "8 percent going in and 10 percent going out". There is only one charge and that is 10% when the investor redeems their shares. The REIT does pay the selling broker one 8% commission out of their pocket at the time of the sale. This is on page one of the prospectus that the Commissioner's Department reviewed. I am sure Mr. Kocher can confirm this. The Commissioner may have misread page one. It's an easy mistake to make – investors do it all the time.

And she cited Dakota REIT raising their investment amounts as validating the NASAA investor suitability standard. Ironically, over-regulation again is the cause. Dakota REIT has close to five hundred shareholders and would become a reporting company under the Sarbannes-Oxley accounting rules. Jim Knutson of Dakota REIT told me that this is very expensive. So Dakota REIT is, quite reasonably, trying to limit their number of shareholders. They raised the minimum investment to $30,000. One of my customers wanted to gift $5,000. to each of his four children. Normally, this is unquestioned. But Dakota REIT required at least $10,000. gifts because it tends to limit new shareholders, just the opposite of what they would like to do. There must be businesses all across the country in the same situation of having to limit their shareholders at a time when the federal government is exhorting businesses to expand and create jobs. This is an unintended consequence of over-regulation, this time at the national level.

Then the Commissioner commented that the mandatory NASAA investor suitability standard affects only a relatively few people. How many people have to lose the right to vote for it to be important? Only one.

And she said that the mandatory investor suitability standard makes it easier to convict a violator. Does a regulator deny a person's rights in order to make their job easier?

She characterized a REIT as a "blind pool". Of course it is, just as a mutual fund is a "blind pool". The REIT management does not know which properties it will purchase

any more than a mutual fund manager knows which stocks it will buy or sell. But the REIT manager does list in the prospectus what types of properties it intends to buy.

And she said that investors were "free to choose" because she offered them the option of investing in a publicly traded REIT. All investments are not equal. It's the public's business which REIT they decide to invest in - not the Securities Department's. In fact, that would be steering.

And, lastly, she said that there was public input when this investor suitability standard was formulated, perhaps referring to the website of the Commerce Clearing House which few in the public would even be aware of. That's not public input. Rather, This is public input - an open hearing of the Legislature of the sovereign State of North Dakota.

I have surveyed the websites of all fifty state securities departments and find that only about seven states recognize the NASAA investor suitability standard in their securities acts. The other forty three do not, even though their securities departments have been enforcing this standard. So amending this standard would not be amending a universally accepted standard at all. We may be the first state to do so because we discovered it through House Bill 1280, but then we're also first in the nation in financial strength too, so we must be doing something right.

The Commissioner seems to be saying that all of the NASAA policies and guidelines Mr. Kocher uses in evaluating securities offerings need to be adopted as rules. As I understand it, House Bill 1280 was concerned with a rule that tells the public what to do, no matter what the rule is called. That's what we're concerned with here – the investor suitability standard which says who may invest. We have no quarrel with the rest of the NASAA policies and guidelines. After the January meeting, Mr. Kocher called Jim Knutson at Dakota REIT and Roger Domres at INREIT and warned them of dire consequences if the entire body of NASAA policies and guidelines were formally adopted because he would no longer have flexibility in evaluating their stock offerings. Dakota REIT and INREIT depend upon the Securities Department when they need to raise money through stock offerings. Other businesses here in North Dakota depend upon them, too whether they are REIT offerings, common stock or limited partnerships, they're all securities. I wondered how the Insurance Department treats this situation of a body of policies and guidelines. So I called Mike Fix at the Insurance Department and asked him. He said that the North Dakota Insurance Department follows the guidelines of the National Association of Insurance Commissioners selectively. It adopts those policies and guidelines that fit the needs of North Dakota and, if necessary, amends them.

The Insurance Department also conducts forums each year in Bismarck, Fargo, Grand

Forks and Minot for all insurance agents. At those forums, they inform the agents of current areas of concern and any legislation the Department is considering to correct them. The agents are invited to give their input before the legislation is proposed. I started selling securities in North Dakota in 1971 and to my knowledge, the Securities Department has never met with the brokers or registered representatives of this state. If the Securities Department had done this 24 years ago, we would not be here today. And this is not just during Commissioner Tyler's administration, the culture of the Securities Department has always been this way.

Following regulations is one thing. But when we brokers are required to enforce regulations upon the general public, that is ominous and should be debated. I realize that amending this NASAA investor suitability standard may be awkward for the Department since Commissioner Tyler is a past President of NASAA, but I contend that the rights of North Dakota investors are more important than the prestige of an agency.

Thank you Mr. Chairman, Members of the Committee, are there any questions?

(3)

DEPARTMENT OF COMMERCE TESTIMONY ON HOUSE BILL 1140
MARCH 9, 2011, 2:00 P.M.
SENATE INDUSTRY, BUSINESS & LABOR COMMITTEE
ROOSEVELT ROOM
SENATOR JERRY KLEIN, CHAIRMAN

PAUL GOVIG – ACTING COMMISSIONER, ND DEPARTMENT OF COMMERCE

Mr. Chairman and members of the committee, I'm Paul Govig, acting Commissioner of the North Dakota Department of Commerce.

One of the goals of the Securities Department is to "foster the formation of capital for business and economic development." The Department of Commerce recognizes the importance of the efficient formation of capital in establishing new businesses and expanding existing businesses. I believe the passage of House Bill 1140 would hinder that process. Specifically, I believe that requiring the Securities Commissioner to utilize administrative rules removes much needed flexibility.

Adoption of administrative rules provides structure but removes flexibility. Flexibility enables the department to deal with unique issues in unique ways. Development of administrative rules can also be time consuming and may require a considerable amount of staff time devoted to it.

The current system has been in place since 1959 and seems to be working fine. In our dealings with businesses, the Department of Commerce has received no complaints or negative comments concerning the operation of the Securities Department.

The Securities polices and procedures are fairly uniform with other states. This uniformity helps us when we deal with companies, investors and/or individuals from other states.

In summary, I believe requiring administrative rules would reduce the effectiveness and efficiency of the Securities Department and could hinder economic development in this state.

Mr. Chairman and members of the Senate Industry, Business & Labor Committee, that concludes my testimony and I am happy to answer any questions.

(4)

RE: House Bill No. 1140

I am writing in regard to Section 1 of House Bill No. 1140 and the effect it might have on start-up companies in North Dakota.

As president of a newly formed North Dakota company that has filed a registration for an intrastate public offering, we relied on the ability of the Securities Department and Commissioner to negotiate certain aspects of our proposed offering. These negotiations allowed the public offering to proceed, while allowing the Department to carry out its mandate to protect the investors of North Dakota.

My company and the Securities Department were able to come to agreeable terms concerning the amount of capital to escrow, the amount of promoter's equity, and the length of time the promoter's shares would be impounded. Without this flexibility, our company would have had to abandon our business plan in North Dakota and impair the employment of 12 people throughout the state.

In summary, my hope is that this legislation would not limit, or prevent, new business development in North Dakota.

Sincerely,

Glen Higley

Glen Higley
President, Northern Plains Capital Corporation

Engrossed HB 1140

Testimony of Securities Commissioner Karen Tyler

Before Senate Industry, Business and Labor

March 14, 2011

Good afternoon Mr. Chairman and members of the Committee. I am Karen Tyler, the North Dakota Securities Commissioner. I am here to testify in opposition to House Bill 1140.

In my testimony this afternoon, I will address three key issues:

First, I will address the idea or opinion that has been placed before this and other committees - that the securities commissioner does something that no other agency does, in the department's approach to applying national standards in the process of reviewing and registering securities offerings, that the Securities Commissioner seeks special treatment and is exempt from the Administrative Rules Practices Act.

Second, I will address section 2 of the bill, and the ramifications for investors if the legislature creates a statutory prohibition that prevents the Securities Commissioner from applying to the sale of Real Estate Investment Trust securities, one of the most important regulatory principles in place for the protection of the investing public.

And third, I will address section 1 of the bill, the effect of which is a significant policy change that will alter the manner in which the department regulates capital formation by small businesses, a policy change that will constrain the department's discretion in working with North Dakota businesses and create a more rigid system of regulation. The ramifications of this section of the bill, however, reach well beyond the regulation of capital formation, as the language set forth in section 1 effects everything that we do – from the registration of investment firms and professionals, to the enforcement actions we take against regulated persons and con-artists. I will also address the significant fiscal impact the bill will have on our agency.

While clearly every state agency has a unique mission or purpose, in regard to this idea that has been placed before you that the Securities Commissioner does something no other agency does, I must respectfully disagree. The Securities Commissioner administers and enforces the statutory authority vested in the office by this legislature. When we execute our rulemaking authority, we do so in compliance with the Administrative Rules Practices Act. In 1959, this legislature established for the Commissioner broad statutory authority in the regulation of capital formation. Specifically, under 10-04-08.1 of the Securities Act, the Commissioner has the power to place such conditions, limitations, and restrictions on any approval or registration of securities as may be necessary to carry out the purposes of the Securities Act. These conditions, limitations, and/or restrictions may vary with the type, size, and

terms of the proposed offering and the general authority to apply them is set forth in the statute itself. It is under this statutory authority that nationally structured policies and guidelines are enforced. Notably, this broad statutory authority was verified by the Attorney General when the bill was before House IB&L.

In reviewing an application for the registration of securities, in addition to applying statutory requirements and relevant administrative rules, the Commissioner can and does rely on and apply policies and guidelines established by state securities regulators through the North American Securities Administrators Association. (NASAA is an organization made up of all the state securities regulators in the country, and it has been around since 1919.) The securities registration standards that are set forth under such policies and guidelines – such as the suitability standards that are the subject of Section 2 of this bill - are not arbitrary or capricious. They have been constructed by committees of state securities regulators, published for public comment, adopted by state regulators and they are applied across the country. This approach to the regulation of capital formation has been applied by North Dakota Securities Commissioners under this statute for over fifty years without legal challenge because the authority is clearly stated in the law.

Such an approach facilitates uniformity among regulators, while preserving the commissioner's ability to operate with some flexibility when dealing with North Dakota companies. The Commissioner has a statutory

obligation, set forth by this legislature in 1951 under 10-04-03(2) of the Securities Act, to pursue uniformity in the regulation of securities. Specifically, the statute directs that the commissioner shall cooperate with the administrators of the securities laws of other states, and of the United States, with a view toward achieving maximum uniformity. The broad statutory authority set forth under 10-04-08.1 allows the Commissioner to maximize uniformity by applying these policies and guidelines, while at the same time retaining the discretion to make adjustments within the regulatory framework if appropriate.

Last week, Mr. Glen Higley from Northern Plains Capital made a few remarks before the committee – testifying to the fact that if it were not for the discretion afforded the commissioner through statutory authority, the company would not have pursued their securities offering and established itself in North Dakota. Some examples of the adjustment made, within established regulatory framework include: adjustments to impoundment of proceeds requirement, adjustment to promoters equity investment requirement, adjustments to timeframe for effectiveness of registration.

The suitability standards that are the subject of objection, (which is the genesis of this legislation) are part of a comprehensive policy that pertains to the registration of Real Estate Investment Trusts. The approach to getting rid of them has been to make the argument that we don't or shouldn't have the ability to apply them with the force and effect of rule, and that they must be converted to administrative rule form. We do not

apply them as rules, we apply these policies under the broad statutory authority vested in the commissioner by this legislature under 10-04-08.1.

I will now address in more detail the impact of section 2 of the bill. Section 2 eliminates the current statutory authority we have to enforce net income and net worth suitability standards in the sale of real estate investment trusts, creates an unprecedented, non-uniform statutory prohibition from enforcing those standards, and then it provides for a replacement of the eliminated statutory authority with an administrative rule, if it can be proven by substantial evidence that it is in the public interest. This burden of proof language "a finding supported by substantial evidence" is also unprecedented.

A search of the Century Code could not find any comparable language in an agency rulemaking statute. The only place that this type of language is found is in statutes describing the standard of review of the District Court on appeal of agency decisions. This is an extraordinary limitation being placed on the Securities Commissioner. [The standard for review of most agency rules by the Administrative Rule Committee is "arbitrariness and capriciousness", a standard far less stringent than proposed here. N.D.C.C. §28-32-18(1)(e).]

Unlike investment advisors, stock brokers are not bound by a fiduciary duty to their clients. Because stock brokers are not bound by this higher duty,

that of a fiduciary, it is critical for the protection of investors that the obligation of suitability is not compromised. In the governance of stock broker conduct, Suitability is the cornerstone regulatory principle. How can a broker determine if an investment is suitable, if they are not obligated to consider how much money an investor has and how much money an investor makes?

REIT Risks

REITS are blind pool investments – they do not own any property at the time they are raising funds, and an established REIT will not have identified new properties when raising additional funds. Investors do not know what their money will be invested in at the time they purchase the REIT.

There is no established secondary market for non-exchange traded REITS. This creates a level of liquidity risk that may prove especially burdensome for an investor with limited income and limited assets. With the exception of a limited share redemption program, investors can only exit if they can find a private buyer, if the REIT eventually lists its shares on an exchange, or if the REIT sells to or merges with another REIT.

REITs expose investors to high commissions and fees. Commissions paid to a selling stockbroker average 6-8%. And if an investor must liquidate

through one of the REITs limited share redemption programs, it will cost them 10% on the way out. 6-8% in, 10% out - these commissions and fees are not inconsequential for the small investor.

REITs can and do pay dividend distributions from any source, including a return of the investors own principal or the proceeds it raises from new investors in new REIT offerings. This bears repeating – REITs can pay a return to existing investors with funds raised from new investors.

According to recent FINRA dispute resolution data provided to the Department, arbitration complaints involving Real Estate Investment Trusts are up 368% since 2008 and the most common allegation in the arbitration filings is that the REIT investment was unsuitable for the investor. FINRA has identified the unsuitable sale of REITS as a top enforcement priority for 2011. It is truly incongruous to weaken investor protection and regulatory authority at a time when investor complaints are dramatically increasing and REITs across the country are cutting share prices, cutting dividends, and shutting down share redemption programs.

HB 1140 was drafted so broadly that it eliminates important suitability measurements for ANY and ALL Real Estate Investment Trusts sold to ND Investors. There are approximately 200 publicly traded and non-traded REITS that can currently be sold to North Dakota residents. We have

over 65,000 stockbrokers registered to do business in the state. Over 65,000 securities agents to whom suitability standards in the sale of ANY REIT to ANY North Dakota investor, will no longer apply. Over 65,000 reps for whom this legislation would lower the standard of conduct, eliminating important suitability measures that, although will govern their conduct across the rest of the country, will no longer be applicable here.

Overvalued real estate was at the epicenter of the financial crisis. In North Dakota, we can consider ourselves fortunate that we have been largely isolated from devaluations in the residential and commercial real estate markets. The health and performance of ND based REITS is not representative marketplace realities. We cannot build a wall around this state – our investor constituents participate in, are exposed to, are affected by, a national and global securities industry and marketplace. The protections afforded the rest of the country should apply here too.

If this bill becomes law, and we are unsuccessful in replacing with a rule the statutory authority that this bill eliminates, the North Dakota Securities Commissioner will be the only state securities regulator in the country that cannot enforce suitability standards in the sale of Real Estate Investment Trusts. If a North Dakota resident files a complaint with the Department claiming to have been victimized by an unsuitable sale, we will have to refer them off to FINRA in Washington DC.

On to Section 1 of the bill. As I said earlier, the legislature created broad statutory authority for the Commissioner in the area of the regulation of capital formation back in 1959. The legislature saw the wisdom of a regulatory structure set in statue that preserved to a degree the Commissioner's discretion and flexibility. The AG confirmed this authority for house ibl, and unfortunately the response by the committee was to introduce an amendment to eliminate that discretionary authority.

I must emphasize this point – through an amendment adopted in committee, with no public hearing, no input from this department and no floor debate in the House, regulatory policy that has been in place for over 50 years could be radically altered. As a result of this amendment, the Commissioner will need to write into administrative rule, all the policies and guidelines that are applied to the regulation of capital formation, and this will need to be done by Jan 1, 2012.

Examples of policies and guidelines that will need to be changed into rules (not an exhaustive list):

Statement of Policy Regarding Real Estate Investment Trusts
Statement of Policy Regarding Real Estate Investment Programs
Registration of Oil and Gas Programs
Mortgage Program Registration Guidelines
Equipment Program Registration Guidelines
Commodity Pool Program Registration Guidelines
Asset Backed Securities Registration Guidelines

Statement of Policy Regarding Church Extension Fund Securities

Statement of Policy Regarding Church Bonds

Statement of Policy Regarding Debt Securities

Statement of Policy Regarding Options and Warrants

Statement of Policy Regarding Preferred Stock

Statement of Policy Regarding Impoundment of Proceeds

Statement of Policy Regarding Loans and Other Material Transactions

Statement of Policy Regarding Unsound Financial Condition

Statement of Policy Regarding Promoters' Equity Investment

Statement of Policy Regarding Underwriting Expenses

To get a better understanding of the extensiveness of such a rulemaking undertaking, it is important to examine more closely the content of the policies. Looking at the Policy on Real Estate Investment Trusts as an example:

Definitions Section

Requirements of REIT sponsors, advisors, trustees and affiliates

Suitability Requirements

Fees, Compensation, Expenses

Conflicts of Interest and Investment Restrictions

Rights of Shareholders

Disclosure and Marketing

We do not have the human or monetary resources to apply to this undertaking. Our enforcement caseload is extensive - we currently are running investigations on cases involving over 170 victims who have collectively over $30,000,000 at risk. We will have to contract out for the rule writing, and estimate conservatively the cost associated with the process will run approximately half a million dollars. While we are a revenue generating agency, we are not self funding. Our general fund appropriation will not support this expense.

In addition to the fiscal impact of the bill, it is important to consider the impact this policy change will have on North Dakota small businesses and their access to capital. This bill moves the regulation of capital formation away from system that affords discretion and some flexibility, toward a prescriptive, rigid rules based system, the effect of which will be to potentially impair access to capital and create unnecessary regulatory hurdles for small businesses.

The discretionary authority of the Commissioner is the single most effective tool we have to facilitate access to capital for North Dakota businesses. It is the most important mechanism we deploy to foster legitimate capital formation in the state.

Contemplate our mandate in this area and the balance we must attempt to achieve -- we must provide necessary and appropriate protections for investors, but avoid unnecessary regulatory burdens for businesses that are issuing securities to raise capital.

Remember, our regulatory structure and authority reaches beyond our borders and applies to issuers selling into the state as well as those domiciled here. This legislature has long recognized that a prescriptive, on-size fits all approach to the regulation of capital formation would work to the detriment of the small North Dakota company seeking to raise capital.

This principles based system that has been in effect since the 1950's allows the commissioner to work with the business community and make adjustments to registration requirements, within a well structured framework, that serve to facilitate capital formation without compromising investor protection.

Our system for regulating capital formation has worked well through the terms of 13 Commissioners for over 50 years. The Department has never received a complaint from a North Dakota business, the Commissioner has never been accused of abusing the authority vested in the office, and the policies and guidelines we apply to the regulation of capital formation under our statutory authority have never been subject to a legal challenge by an issuer of securities.

As I said earlier, this Section of the bill reaches well beyond the regulation of capital formation – it creates a new section of the Act that covers the entire Act and affects everything we do. We are very concerned about how counsel for the defense will use this language in defending against an enforcement action. It wasn't there before – so what was the legislature's intent? What arguments will defense counsel use for that interpretation? Securities litigation is exceedingly technical. If this legislation passes, in addition to rewriting all our policies and guidelines into administrative rules, we will also have to conduct extensive analysis of every section of existing code and every existing administrative rule to identify potential weaknesses that would allow defense to argue, based on this new language, that the Commissioner's authority for the action taken, given the circumstances under which it was taken, isn't clearly established.

Before I close my remarks, I just want to mention that I am providing you with copies of letters from officers at two North Dakota based Real Estate Investment Trusts. In their letters they retract their previous support for this bill, state their opposition to the bill, and state the importance of retaining the current system of regulating capital formation in the state.

In conclusion, HB 1140 eliminates the commissioner's statutory authority to provide certain protections for North Dakota investors, protections that are available to investors across the

rest of country. It creates a more rigid system of regulation for North Dakota companies seeking to raise capital in the state. And it creates a significant and unnecessary resource burden that the Department is not equipped to support.

I ask you to vote do not pass on Engrossed House Bill 1140.

INREIT

REAL ESTATE INVESTMENT TRUST

To: Committee Members of House Bill 1140

Fr: Roger W. Domres INREIT Real Estate Investment Trust

Re: House Bill 1140

Committee Members:

After careful consideration regarding the passage of House Bill 1140 we have concluded that this Bill would negatively impact INREIT Real Estate Investment Trust,, the REIT Industry of North Dakota and the citizens of this great State Of North Dakota. We believe this Bill could have an impact on the ability of the ND Securities Commissioner Office to continue with a common sense approach and ultimately would create more rigid rules and regulations for our industry and other securities offerings in the State. Ultimately this could diminish Economic Development in the State of North Dakota and will hamper the Securities Commissioners ability to use flexibility in the decisions they make regarding securities matters. We also believe that this could potentially cost the citizens of this State substantial tax dollars in creating our own set of Rules and Regulations.

While I may not be in agreement with all of NASAA guidelines, we have come to the conclusion that our State is much better off working within the confines of the Securities Commissioner Office to address our concerns and formulate a practical decision then to have stringent rules and regulations put in to place that would hamper the Offices ability to use common sense when making decisions on whether to utilize the guidelines or find some other compromise that maybe more appropriate for the situation. We have the utmost respect for the ND Securities Commissioner Office and the job they have done for this State and realize today that NASAA rules and regulations are merely guidelines for the State.

INREIT Real Estate Investment Trust would like to withdraw our support of House Bill 1140.

Sincerely,

Roger W. Domres

216 South Broadway, Suite 202 • Minot, North Dakota 58701 • Office (701) 837-1031 • Toll Free 1-877-269-1031 • Fax (701) 837-9444

The Dakota REIT
Real Estate Investment Trust

3003 32nd Ave. SW, Suite 280
Fargo, ND 58103
701-239-6879 • Fax 701-293-1257

North Dakota Senate
Industry, Business and Labor Committee
Mr. Jerry Klein, Chairman
North Dakota State Capital
600 East Boulevard
Bismarck, ND 58505

March 6, 2011

REF: House Bill 1140

Dear Senator Klein:

House Bill 1140 directly affects our business in North Dakota and Dakota REIT particularly. This bill as originally conceived and subsequently formulated provides relief for income and asset restrictions of potential investors in our company. The thought was that individual investment advisors, those that are authorized to sell our shares, were in a better position to determine an individual investor's ability and understanding of the risk involved in the investment. Originally, I supported the idea when it was presented to a house committee during the last legislative session. I have since changed my position.

I have meet with staff from the commissioner's office and now in greater detail understand the "ramifications" of this bill. I am afraid that if this bill were to pass, we would only harm ourselves and future investors. Currently, staff has the prerogative to evaluate a company and set standards for investors as staff sees the risks associated with investing in a company. If staff were required to adopt set standards as a rule, and lose that flexibility, I would be concerned that the one size fits all rule would stifle development within the state of North Dakota.

Dakota REIT has grown steadily during the last ten years within the current income and asset restriction for investors. Originally, I thought it would be helpful to eliminate those restrictions, but have now come to the conclusion that sensible restrictions are necessary. The commissioner's office has not hindered Dakota REIT's growth and has, in fact, helped us. They looked at restrictions recommended nationally and determined they were too restrictive for North Dakota. By placing sensible restrictions on investors in our company, and other REIT's in North Dakota, we were able to grow and develop a sound investment for many North Dakotans. I am now afraid this bill would prevent that from happening.

Thank you for your consideration and presenting this letter to your committee.

Sincerely,

Jim Knutson
Executive Vice President

OneVoice 2011 Financial Services Institute Broker-Dealer Conference
Phoenix, Arizona
February 1, 2011

Remarks of James Shorris, FINRA Executive Vice President and Executive Director of Enforcement

"We've got quite a few focus areas this year, as we do most years, and I think, looking at this group, and trying to focus on those areas that'll be of interest to this group, I think one of the principal areas, and you've heard about this, but it's not an area that's going away, is the Reg D private placement market. That is a major, major initiative across FINRA. It's not only Enforcement, but it expands over to Member Regulation, to our Risk Oversight and Operational Regulation, Advertising, it goes all across the entity.

And what we're seeing is really failures in the areas of "reasonable basis" suitability, which is to say that we're seeing a number of firms that have engaged in sales of these kinds of securities without having done the due diligence that they really need to be doing to understand these offerings because frankly, and I know a number of you have probably seen this, several of these offerings – Provident to name one – MedCap – these have been very problematic and in some cases out-and-out Ponzi schemes that were sold to investors. It's not to say that we're alleging that the broker-dealers selling them were part of that conspiring or participating in the fraud directly, but that they failed to do the kind of due diligence and follow up on red flags that they should have that might have alerted them to the – and then caused them not to offer them to their customers. So that's a big one.

Related to that is sort of a "close cousin" is the non-traded REIT. That's a big issue for us. I think really while it's about due diligence, "reasonable basis" suitability is an issue there. I think "customer specific" suitability is even more of an issue and what I mean by that is we get a steady stream of complaints from customers saying that they bought a non-traded REIT and it's a Ponzi scheme. And we'll say "Well, why is it a Ponzi scheme?" and they'll say "Well because the broker

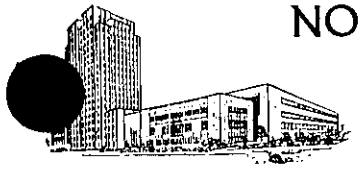
sold it to me and two years later I wanted to get my money back and the issuer says I can't get it back." And what it turns out is, if the customer had read the documents, the disclosure documents, carefully, they would have seen that obviously there were limitations on the ability to withdraw funds, but what it really kind of tells us is that these may not have been sold properly by the rep to the customer. In other words they didn't emphasize the lack of liquidity that is associated with these securities. So that's something we're looking at very closely.

Another couple, and this is really a broader issue, is the sort of migration toward chasing yields. And some of this came out I think with the speaker at the general session this morning when she talked about how interest rates are at these historic lows and so forth, well what's happening is elderly folks, folks who are retired, who need that yield and can't find it, are buying increasingly risky products that are associated with higher yields and often-times richer payouts to a broker and what you have is a mismatch there really in terms of again, suitability, liquidity in some cases, and just a basic understanding of the product. So that's also what we're looking at.

A more general category we're looking at is really sort of what we would call, maybe call exotic products or more unusual products, structured products, things like reverse convertibles. You may have seen some cases that we announced was a couple firms last year that focused on suitability, particularly with elderly folks. But also, principal protected notes, leveraged ETFs, floating rate funds and so forth, again we're looking at suitability and disclosure."

(2)

NORTH DAKOTA HOUSE OF REPRESENTATIVES



STATE CAPITOL
600 EAST BOULEVARD
BISMARCK, ND 58505-0360

Representative Lawrence R. Klemin
District 47
1709 Montego Drive
Bismarck, ND 58503-0856
Residence: 701-222-2577
Facsimile: 701-258-8486
lklemin@nd.gov

COMMITTEES:
Judiciary, Vice Chairman
Political Subdivisions

MEMORANDUM

TO: Sen. Jerry Klein, Chairman
Senate IBL Committee

FROM: Rep. Lawrence R. Klemin
District 47, Bismarck

SUBJECT: HB 1140 Securities Commissioner Rules

DATE: March 14, 2011

I know you have ready access to the administrative rules, but I think its interesting to see the number of rules that are currently in effect in the office of the Securities Commissioner. They are attached. The latest rule in that office was adopted in 1998, which is 13 years ago, but most of them are older. The Securities Commissioner hasn't had much need for rulemaking during her tenure in office.

Encl Securities Commissioner Rules
North Dakota Administrative Code, Title 73

cc Sen. George L. Nodland, Vice Chairman
Sen. John M. Andrist
Sen. Lonnie J. Laffen
Sen. Oley Larsen
Sen. Philip M. Murphy
Sen. Mac Schneider
IBL Committee Clerk
IBL Committee Intern

NORTH DAKOTA ADMINISTRATIVE CODE

TITLE 73 SECURITIES COMMISSIONER

ARTICLE 2 SECURITIES ACT OF 1951

CHAPTER 1 REGISTRATION OF SECURITIES

73-02-01-01 Small corporate offering registration.

Small corporate offering registration (SCOR) filings may be used for registration applications and exemption applications for corporations that issue securities exempt from federal registration under rule 504 of regulation D of the securities and exchange commission rules. Form U-7, as adopted by the North American securities administrators association, inc., on April 29, 1989, is adopted for this purpose.

CHAPTER 5 UNLAWFUL REPRESENTATIONS CONCERNING REGISTRATION OR EXEMPTION

73-02-05-01 Required statement.

1. Unless otherwise specifically provided in this section or otherwise waived by the commissioner, the following statement shall be set forth in capital letters printed in boldface type on the outside front cover of any prospectus intended for use or delivery in North Dakota:

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES COMMISSIONER OF THE STATE OF NORTH DAKOTA NOR HAS THE COMMISSIONER PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

2. The statement prescribed under subsection 1 shall not be required on a prospectus which conforms to the requirements established under the Securities Act of 1933 or any rules or regulations promulgated thereunder.

CHAPTER 6 REGISTRATION OF DEALERS, SALESMEN, AND INVESTMENT ADVISERS

73-02-06-01 Dealer accounts and records.

1. Segregated accounts. Dealers shall at all times keep their customers' securities and funds in trust and segregated from their own securities and funds.

2. Multiple businesses - separate records - commingling assets - division of income and expenses. Dealers engaged in more than one business:

a. Shall maintain separate accounts, books, and records relating to their securities business and their other businesses.

b. Shall not commingle assets of their securities business with assets of their other businesses.

c. Shall maintain a clearly defined division with respect to income and expenses between their securities business and their other businesses.

73-02-06-02 Examination of investment advisers and their representatives.

1. Examination. An applicant for registration as an investment adviser, including each partner, officer, director, or person occupying a similar position or performing similar functions if the applicant is a form of business association, and each person representing an investment adviser in this state shall take and pass a written examination covering the securities business, the Securities Act of 1951 and the rules and regulations adopted thereunder, and such other subject matter areas as the commissioner may prescribe.

2. Exemption - exception - waiver.

a. Except as otherwise provided hereinafter, those persons who are registered as investment advisers on the effective date of this section shall be exempt from the examination requirement imposed hereunder.

b. The commissioner may require any registered investment adviser or any person representing a registered investment adviser in this state to take and pass the written examination prescribed hereunder.

c. The commissioner may waive that part of the written examination relating to the securities business upon receipt of evidence that a person has passed a comparable examination administered by the securities and exchange commission, the national association of securities dealers, incorporated, or the New York stock exchange, incorporated, or has otherwise demonstrated to the satisfaction of the commissioner that the person is qualified to transact business in this state as an investment adviser on the basis of knowledge, training, and experience.

CHAPTER 7 RECORDS

73-02-07-01 Recordkeeping requirements.

1. All dealers, salesmen, investment advisers, and investment adviser representatives shall keep and maintain all books and records required to be kept by the securities and exchange commission and the national association of securities dealers.

2. All dealers, salesmen, investment advisers, and investment adviser representatives shall keep and maintain at their branch offices and offices of supervisory jurisdiction, open to inspection by the commissioner, the following items relating to the operations of such offices:

a. A complaint file containing a separate file of all written customer or client complaints and any action taken by the dealer, salesman, investment adviser, investment adviser representative, branch office, and office of supervisory jurisdiction with respect to those complaints.

b. A litigation file documenting any criminal or civil actions filed in any state or federal court against the dealer, salesman, investment adviser, investment adviser representative, branch office, and office of supervisory jurisdiction or against any personnel with respect to a securities or an investment advisory transaction and the disposition of any suchlitigation.

c. A correspondence file containing any and all correspondence disseminated to or received from the public in connection with the business of the dealer, salesman, investment adviser, and investment adviser representative.

d. In the case of dealers and salesmen:

(1) Commission runs showing the amount of commissions earned by each agent of the branch office and office of supervisory jurisdiction; and

(2) Confirmations of purchase and sale sent to each customer.

CHAPTER 8 FEES AND CHARGES

73-02-08-02 Fees for investigations.

The maximum fee to be charged for any investigation, examination, or audit must be the actual amount of the salary or other compensation paid to the persons making the investigation, examination, or audit plus the actual amount of expenses, including meals, lodging, transportation, and overhead, reasonably incurred in the performance of the work.

CHAPTER 9 FRAUDULENT AND UNETHICAL SALES PRACTICES AND MANIPULATIVE CONDUCT

73-02-09-01 Fraudulent practices.

A person who engages in one or more of the following practices has engaged in an "act, practice, or course of business which operates or would operate as a fraud" under North Dakota Century Code section 10-04-15 but acts or practices not described in this rule may also be fraudulent.

1. Entering into a transaction with a customer in any security at an excessive price or at a price not reasonably related to the current market price of the security or receiving an excessive commission or profit under the rules of the national association of securities dealers.

2. Contradicting or negating the importance of any information contained in a prospectus or other offering materials with intent to deceive or mislead or using any advertising or sales presentation in a deceptive or misleading manner.

3. For any person, in connection with the offer, sale, or purchase of a security, or the recommendation of an offer, sale, or purchase of a security, to lead a customer to believe that the person is in possession of material, nonpublic information which would impact on the value of the security.

4. In connection with the solicitation of a sale or purchase of a security, engaging in a pattern or practice of making contradictory recommendations to different investors who have similar investment objectives for some investors to sell and others to purchase the same security at approximately the same time, when not justified by the particular circumstance of each investor.

5. Failing to make a bona fide public offering of all the securities allotted to a broker-dealer for distribution by:

a. Transferring securities to a customer, another broker-dealer, or a fictitious account with the understanding that those securities will be returned to the broker-dealer or its nominees;

b. Parking, hiding, delaying, or withholding securities from trading; or

c. Engaging in any unreasonable delay in delivery of securities purchased by any customers or in the payment upon request of free credit balances.

6. Although nothing in this section precludes application of the general antifraud provisions against anyone

for practices similar in nature to the practices discussed in this subsection, the following subsections specifically apply only in connection with the solicitation of a purchase or sale of over the counter equity securities that are not listed on the national association of securities dealers automated quotation system (NASDAQ):

a. Failing to disclose the firm's present bid and ask price of a particular security at the time of solicitation and confirmation.

b. Failing to advise the customer, both at the time of solicitation and on the confirmation, of any and all compensation related to a specific securities transaction to be paid to the agent including commissions, sales charges, or concessions.

c. In connection with a principal transaction, failing to disclose, both at the time of solicitation and confirmation, a short inventory position in the firm's account of more than five percent of the issued and outstanding shares of the class of securities of the issuer if the firm is a market maker at the time of the solicitation.

d. Conducting sales contests in a particular security.

e. After a solicited purchase by a customer, failing or refusing, in connection with a principal transaction, to promptly execute sell orders.

f. Soliciting a secondary market transaction when there has not been a bona fide distribution in the primary market.

g. Engaging in a pattern of compensating an agent in different amounts for effecting sales and purchases in the same security.

7. Effecting any transaction in, or inducing the purchase or sale of any security by means of any manipulative, deceptive, or other fraudulent scheme or course of actions including, but not limited to, the use of boilerroom tactics or use of fictitious or nominee accounts.

8. Failure to deliver a prospectus as required by federal law.

73-02-09-02 Unethical practices of dealers.

The purpose of this section is to identify practices in the securities business which are dishonest or unethical. The following must be deemed "dishonest or unethical practices" by any person other than a sales agent, as used in North Dakota Century Code section 10-04-11. This section is not intended to be all inclusive, and thus, acts or practices not enumerated herein may also be deemed dishonest or unethical.

1. Engaging in any unreasonable and unjustifiable delay in the delivery of securities purchased by any of its customers or in the payment upon request of free credit balances reflecting completed transactions of any of its customers.

2. Inducing trading in a customer's account which is excessive in size or frequency in view of the financial resources and character of the account.

3. Recommending to a customer the purchase, sale, or exchange of any securities without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the dealer.

4. Executing a transaction on behalf of a customer without authorization to do so.

5. Exercising any discretionary power in effecting a transaction for a customer's account without first obtaining written discretionary authority from the customer, unless the discretionary power relates solely to the time or price for the execution of orders.

6. Executing any transaction in a margin account without securing from the customer a properly executed written margin agreement prior to the initial transaction in the account.

7. Failing to segregate customers' free securities or securities held in safekeeping.

8. Hypothecating a customer's securities without having a lien thereon unless the dealer secures from the customer a properly executed written consent promptly after the initial transaction, except as permitted by rules of the securities and exchange commission.

9. Entering into a transaction with or for a customer at a price not reasonably related to the current market price of the security or receiving an unreasonable commission or profit.

10. Failing to furnish to a customer purchasing securities in an offering registered pursuant to North Dakota Century Code section 10-04-07 or 10-04-08, no later than the date of confirmation of the transaction, either a final prospectus or a preliminary prospectus and an additional document, which together include all information set forth in the final prospectus; if the offering is not registered pursuant to section 10-04-07 or 10-04-08, the dealer shall furnish disclosure documents customarily available.

11. Charging unreasonable and inequitable fees for services performed, including miscellaneous services such as collection of moneys due for principal, dividends, or interest; exchange or transfer of securities; appraisals, safekeeping, or custody of securities, and other services related to its securities business.

12. Offering to buy from or sell to any person any security at a stated price unless such dealer is prepared to purchase or sell, as the case may be, at such price and under such conditions as are stated at the time of such offer to buy or sell.

13. Representing that a security is being offered to a customer at the market or a price relevant to the market price unless such dealer knows or has reasonable grounds to believe that a market for such security exists other than that made, created, or controlled by such dealer, or by any person for whom it is acting or with whom it is associated in such distribution, or any person controlled by, controlling, or under common control with such dealer.

14. Effecting any transaction in, or inducing the purchase or sale of, any security by means of any manipulative, deceptive, or fraudulent device, practice, plan, program, design, or contrivance, which may include, but not be limited to:

a. Effecting any transaction in a security which involves no change in the beneficial ownership thereof;

b. Entering an order or orders for the purchase or sale of any security with the knowledge that an order or orders of substantially the same size, at substantially the same time and substantially the same price, for the sale of any such security, has been or will be entered by or for the same or different parties for the purpose of creating a false or misleading appearance of active trading in the security or a false or misleading appearance with respect to the market for the security; provided, however, nothing in this subsection shall prohibit a dealer from entering bona fide agency cross transactions for its customers; or

c. Effecting, alone or with one or more other persons, a series of transactions in any security creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

15. Guaranteeing a customer against loss in any securities account of such customer carried by the dealer or in any securities transaction effected by the dealer with or for such customer.

16. Publishing or circulating, or causing to be published or circulated, any notice, circular, advertisement, newspaper article, investment service, or communication of any kind which purports to report any transaction as a purchase or sale of any security unless such dealer believes that such transaction was a bona fide purchase or sale of such security; or which purports to quote the bid price or asked price for any security, unless such dealer believes that such quotation represents a bona fide bid for, or offer of, such security.

17. Using any advertising or sales presentation in such a fashion as to be deceptive or misleading. An example of such practice would be a distribution of any nonfactual data, material, or presentation based on conjecture, unfounded or unrealistic claims or assertions in any brochure, flyer, or display by words, pictures, graphs, or otherwise designed to supplement, detract from, supersede, or defeat the purpose or effect of any prospectus or disclosure.

18. Failing to disclose that the dealer is controlled by, controlling, affiliated with, or under common control with the issuer of any security before entering into any contract with or for a customer for the purchase or sale of such security, the existence of such control to such customer; and if such disclosure is not made in writing, it must be supplemented by the giving of written disclosure at or before the completion of the transaction.

19. Failing to make a bona fide public offering of all of the securities allotted to a dealer for distribution, whether acquired as an underwriter, a selling group member, or from a member participating in the distribution as an underwriter or selling group member.

20. Failing or refusing to furnish a customer, upon reasonable request, information to which the customer is entitled, or to respond to a formal written request or complaint.

21. Failing or refusing to provide, within fourteen days or such lesser time as prescribed by the securities commissioner, information requested by the commissioner or the commissioner's representatives pursuant to the commissioner's investigative authority.

22. Extending credit to a customer in violation of the Securities Exchange Act of 1934 or the regulations of the federal reserve board.

23. Engaging in acts or practices enumerated in section 73-02-09-01.

24. Failing to promptly provide the most current prospectus, the most recently filed periodic report filed under section 13 of the Securities Exchange Act or other research reports when requested to do so by a customer in the solicitation of a sale or purchaser of an over the counter non-national association of securities dealers automated quotation system security.

25. Marking any order tickets or confirmations as unsolicited when in fact the transaction is solicited.

26. Failing to provide each customer with a statement of account which, with respect to all over the counter non-national association of securities dealers automated quotation system equity securities in the account, contains a value for each security based on the closing market bid on a date certain for any month in which activity has occurred in a customer's account, but in no event less than every three months; provided that, this subsection shall apply only if the firm has been a market maker in such security at any time during the period for which the monthly or quarterly statement is issued.

27. Engaging or aiding in boilerroom operations or high pressure tactics in connection with the promotion of speculative offerings or hot issues by means of an intensive telephone campaign, whereby the prospective purchaser is encouraged to make a hasty decision to buy irrespective of the purchaser's investment needs and objectives.

28. Engaging in other conduct such as forgery, embezzlement, nondisclosure, incomplete disclosure or misstatement of material facts, or manipulative or deceptive practices.

29. Failing to comply with any applicable provision of the Rules of Fair Practice of the national association of securities dealers or any applicable fair practice or ethical standard promulgated by the securities and exchange commission or by a self-regulatory organization approved by the securities and exchange commission.

73-02-09-03 Unethical practices of sales agents.

Statute text

The purpose of this section is to identify practices in the securities industry which are dishonest or unethical. The following must be deemed "dishonest or unethical practices" by an agent, as used in North Dakota Century Code section 10-04-11. This section is not intended to be all inclusive, and thus, act or practices not enumerated herein may also be deemed dishonest or unethical.

1. Engaging in the practice of lending or borrowing money or securities from a customer, or acting as a custodian for money, securities, or an executed stock power of a customer unless the customer is a member of the agent's family and the act or practice is approved in advance by supervisory personnel.

2. Effecting securities transactions not recorded on the regular books or records of the dealer which the agent represents, unless the transactions are authorized in writing by the dealer prior to execution of the transactions.

3. Establishing or maintaining an account containing fictitious information in order to execute transactions which would otherwise be prohibited.

4. Sharing directly or indirectly in profits or losses in the account of any customer without the written authorization of the customer and the dealer which the agent represents.

5. Dividing or otherwise splitting the agent's commissions, profits, or other compensation from the purchase or sale of securities with any person not also registered as an agent for the same dealer, or for a dealer under direct or indirect common control.

6. Engaging in acts or practices specified in subsections 2, 3, 4, 5, 6, 9, 10, 14, 15, 16, 17, 21, 23, 24, 25, 26, 27, 28, and 29 of section 73-02-09-02.

ARTICLE 3 FRANCHISE INVESTMENT LAW

CHAPTER 1 GENERAL PROVISIONS

73-03-01-01 Exemptions.

Any offer to sell or sale of a franchise organized and existing under the laws of any state as a nonprofit corporation for the exclusive use and benefit of its own members which satisfies the following conditions is exempt from the registration requirements imposed by North Dakota Century Code section 51-19-03, provided the governing board of the corporation certifies to the securities commissioner by resolution that such conditions are being met:

1. Control and ownership of each member is substantially equal;

2. Membership is limited to those who avail themselves of the services furnished by the organization;

3. Transfer of ownership interest is prohibited or limited;

4. Capital investment receives no return;

5. Members are not personally liable for obligations of the corporation in the absence of a direct undertaking or authorization by them;

6. Services provided to the membership are furnished primarily for the use of the members;

7. Each member and prospective member is provided with the most recent audited financial statements, bylaws, articles of incorporation, rules and regulations, and agreement; and

8. The corporation has had at least twenty-five franchises conducting business at all times during the five-year period immediately preceding the proposed offer or sale of a franchise, or has conducted business which is the subject of the franchise continuously for not less than five years preceding the proposed offer or sale of a franchise.

Any entity which has certified to the securities commissioner that the conditions listed in this section have been met, and which subsequently modifies its structure resulting in one or more of the conditions becoming nonapplicable, shall immediately notify the commissioner of such modification.

This rule does not exempt any individual or entity from the antifraud provisions contained in North Dakota Century Code section 51-19-11.