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A Report  
to the  
Commissioner of Economic Development  
on  
The Status of Technology Intensive Industries  
in Minnesota

**minnesota**  
DEPARTMENT OF ECONOMIC DEVELOPMENT

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Minnesota Department of Economic Development

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Respectfully Submitted by  
The Task Force on Technology Intensive Industries

January 9, 1981

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## EXECUTIVE SUMMARY

The special task force on Technology Intensive Industries is one of five committees created by the Commissioner of the Minnesota Department of Economic Development to identify opportunities for economic growth in the state. Its members, who are leaders of the business and education communities, have examined the role of the technology intensive industries in Minnesota's past economic development and considered what part the industries can play in the state's future.

In order to create a framework for their discussions, the task force defined technology intensive industries as those in which engineers, scientists, and technicians play an important role in industry growth. An examination of statistics revealed that industries meeting this definition are concentrated in the U.S. Department of Commerce Standard Industrial Classification codes (SIC's) 28 (Chemicals), 35 (Machinery, except Electrical), 36 (Electric and Electronic Machinery), and 38 (Instruments).

Industries that fall within the categories above provide about one-third of the jobs in Minnesota's manufacturing sector, produce about forty percent of the total state manufacturing output, and contribute significantly to state tax revenues. In the past 30 years, the technology intensive industries have grown more than twice as fast as the state's manufacturing section as a whole.

Technology intensive industry has the potential to contribute to Minnesota's economic vitality in the future just as it has in the past. As an environmentally clean, low energy consumption industrial sector, it can provide high quality jobs in both urban and rural areas, increase the productivity of the state's workers (including those previously considered unemployable due to physical impairments), and meet the stiff competition for investment that Minnesota will face from other areas of the nation.

The committee identified nine conditions that will be necessary for the growth of technology intensive industries. While Minnesota already provides most of these conditions, improvements will be necessary if further growth in these industries is to be enjoyed by the state, since other areas of the nation (such as New England and the Sunbelt states) are actively seeking to attract technology intensive industries. The committee recommends that five actions be taken to meet that competition. Those actions include the following:

1. Improvement of Technology Development and Transfer
2. Improvement of State Securities Policies
3. Improvement of the State Education System
4. Modification of State Tax Structure and Policy
5. Improvement of Public Understanding of Business and Industry's Role in Society

While these recommendations could be carried out separately, they are interactive in nature and will have the desired effect only if they are implemented together under the leadership of both the public and private sectors of the state economy.

## I. INTRODUCTION AND STATEMENT OF PURPOSE

This report contains an overview of technology intensive industries in Minnesota, their role in the past economic development of the state, and their potential role in Minnesota's future. It also contains recommendations for actions that can be taken by the business community, state and local government, the legislature, the media, educators, and the general public to promote future growth in this important sector of Minnesota's economy.

This report is a product of the Minnesota Department of Economic Development's special task force on Technology Intensive Industries. This task force is one of five task forces created by the Commissioner of the Minnesota Department of Economic Development to identify opportunities for continued economic growth and diversification in Minnesota. The complementary task forces are in the following industries: Agribusiness, Forest Products, Tourism and Minerals.

The task force was comprised of members of the business and education community having an interest in the future of technology intensive industries. The members were:

Bill Drake, Chairman, Data Card  
Lee Berlin, 3M Company  
Wil Viitala, Honeywell  
Bob Zicarelli, Northwest Growth Fund  
Margaret Lulic, Institute of Technology, U of M  
George Heenan, Control Data  
Bob Stone, Stone, Howard, Nowill & Kouwehnoven

The task forces were established based upon the belief that Minnesota must actively "create" its economic future rather than passively observe its evolution if it is to maintain its economic health and competitive position. Other areas of the country have permitted their economies to stagnate or to decline due, at least in part, to neglect. Our own economy is not exempt from a similar fate and has in some cases shown signs of slower growth or even decline.

The five task forces have been charged with the responsibility to examine their respective industries, note potential problems, and offer solutions. By merging these solutions into our state's policy structure, the Department of Economic Development hopes to enhance the economic environment for these key sectors.

## II. DEFINITION OF TECHNOLOGY INTENSIVE INDUSTRIES

*TECHNOLOGY INTENSIVE INDUSTRIES: Those businesses that employ engineers, scientists and technicians in activities that are significant to the businesses' growth.*

In recent years there has been increasing interest in "high technology" industries and their role in job and income creation. Along with increasing attention and interest has come a great deal of confusion about what is or is not a technology intensive industry. This confusion has frequently led to misunderstanding and misinterpretation of statistics and commentaries on these industries.

To avoid further confusion and to create a framework for continued discussion, the task force developed a definition for technology intensive industries. The purpose of this definition was not to merely outline the boundaries of the industry group, but also to define it in such a way that it would be possible to collect and analyze statistics on the industry with relative ease. With these dual purposes in mind the above definition was selected.

With this definition it became possible to examine Minnesota industries to determine where concentrations of engineers, scientists, and technicians are employed. This elementary analysis yielded a list of four basic industries having a high concentration of those employees. Those industries were identified using U.S. Department of Commerce Standard Industrial Classification codes (SIC's). They are as follows:

<u>SIC</u>	<u>Industry</u>
28	Chemicals and Allied Products
35	Machinery, except Electrical
36	Electrical and Electronic Machinery
38	Instruments and Related Products

Clearly this definition excludes some industries or industry segments that have a significant technology intensity or are becoming more and more technology oriented as the industry matures. For example, the construction and building design industries employ architects and engineers extensively in the design and construction of energy efficient structures. The definition also includes some industries that are not highly technology intensive, such as fertilizer mixing. Despite this limitation, the task force deemed its definition adequate for this study.

Some major industry components in each of the four SIC's selected are listed below as examples of the content of each group.

### Components of Technology Intensive Industries

SIC 28 - Chemicals and Allied Products-- pharmaceuticals, paints, organic chemicals, fertilizers, adhesives, explosives.

SIC 35 - Machinery, except Electrical--turbines and generator sets, internal combustion engines, electronic computing equipment.

SIC 36 - Electric and Electronic Equipment--transformers, industrial controls, radio and T.V. sets, semiconductors, electro-medical apparatus.

SIC 38 - Instruments and Related Products--environmental controls, optical instruments, testing equipment.

Table 1 displays the national distribution of engineers, scientists and technicians by major industry code. This data was used to identify technology intensive industries for Minnesota.

Table 1

Percent Distribution of Engineers,  
Scientists and Technicians  
by 2 Digit SIC  
U.S.A.

<u>SIC</u>	<u>Classification</u>	<u>Engineers</u>	<u>Scientists</u>	<u>Technicians</u>
20	Food & Kindred Products	.74	5.13	2.64
21	Tobacco Manufacturing	.12	.09	.36
22	Textile Mill Products	.82	1.50	1.26
23	Apparel, Other Textiles	.54	.32	.40
24	Lumber & Wood Products	.31	.95	.67
25	Furniture & Fixtures	.43	.24	.65
26	Paper & Allied Products	1.34	2.13	1.18
27	Printing & Publishing	.29	2.13	1.10
28	Chemicals & Allied Prod.	7.50	39.83	10.18
29	Petroleum & Coal Products	2.04	5.02	1.72
30	Rubber & Misc. Products	1.71	2.05	2.35
31	Leather & Leather Products	.10	.24	.08
32	Stone, Clay, & Glass Prod.	1.38	1.74	1.91
33	Primary Metal Industries	4.00	3.23	4.06
34	Fabricated Metal Products	5.69	2.84	6.73
35	Machinery, Except Electrical	18.85	8.12	23.87
36	Electric & Electronic Equip.	24.55	9.94	20.83
37	Transportation Equipment	22.04	9.23	11.52
38	Instruments & Related Prod.	6.98	3.78	7.54
39	Misc. Manufacturing Inds.	.60	.55	.91

SOURCE: National Science Foundation

NOTE: Totals do not add to 100 due to rounding. SIC 37, "Transportation Equipment", consists primarily of snowmobile assembly in Minnesota. It was thus deemed inappropriate for inclusion as a technology intensive industry for the purposes of this study.



### III. THE FUTURE OF OUR ECONOMY

The future holds bold challenges for the state's economy. We must be prepared to:

- provide jobs for a labor force that is expected to increase by 130,000 during the next 10 years alone.
- provide jobs for individuals that were previously considered unemployable due to physical impairments.
- continue our economic expansion and health despite a decrease in the supply and an increase in the cost of energy.
- increase productivity despite diminishing natural resources in the state and nation.
- maintain our economic vitality under increasing environmental constraints.
- retrain our work force to meet changing demands.
- reduce our state's seasonal employment problems in rural areas by increasing investment and job creation outside the metropolitan area.
- decrease underemployment of our labor force.
- meet the stiff competition posed by foreign and domestic producers of goods and services.

Technology intensive industry is unique in its ability to meet these demands. Generally speaking, it is an environmentally clean, low energy consumption industrial sector that creates high-quality full time jobs and yields an attractive return on investment. The overall outcome of increased activity in this sector is a more stable and productive economy. Minnesota is by no means the only state to recognize this fact. We currently face stiff competition for investment in new technology intensive businesses and expansion of existing ones from areas such as "Silicon Valley" in California and "Route 128" in Massachusetts--areas which already have established bases of technology intensive firms. In addition, states which have not been centers for technology intensive firms in the past, such as Colorado and Idaho, are now making efforts to attract such firms. Add to this increasing foreign competition with domestic technology intensive industries, and it becomes clear that positive action is required if Minnesota is to expand its share of employment and investment in the world's technology intensive industries.

To be sure, high technology industry is not a panacea for our economic ills or the only way to meet future challenges--but it does have many attributes that enable it to contribute significantly to the well-being of our economic system. It can make that contribution only if we realize that the industry is not an outside force acting on our economic system, but is in fact an integral part of that system. As such, it can only achieve its potential if it is working in harmony with the other parts of

the economic system--parts that include state government, educational institutions, tax policies, the public, regulatory policies, business leaders, labor leaders, and many more. Our economy is a complex, multifaceted system that occasionally needs adjustment when we find that different parts of it are working at cross-purposes. The recommendations which conclude this report embody the adjustments that the committee feels need to be made if the technology intensive industries are to make their maximum contribution to our economy's growth.

#### IV. AN OVERVIEW OF THE ROLE OF TECHNOLOGY INTENSIVE INDUSTRIES IN MINNESOTA'S ECONOMY

Technology intensive industries have played an increasingly important role in Minnesota's economy since the mid -1950's. Their growing importance is evidenced by the significant gains in employment, corporate income, personal income, and contributions to tax revenues attributable to the industry.

For example, in 1979 the technology intensive industries in Minnesota employed approximately 148,000 people. Compared to about 46,000 in 1950, that represents a gain of more than 100,000 jobs for Minnesotans. As Table 2 on the following page illustrates, employment in the technology intensive industries has increased since 1950 almost 2½ times more than in the manufacturing sector as a whole. As a result, more than one-third of the jobs in Minnesota's manufacturing sector are in technology intensive industries.

While the headquarters of our largest technology intensive firms are located in the Twin Cities metropolitan area, many of the jobs in technology intensive industries are in outstate areas. Table 3 shows the dispersion of technology intensive firms throughout the state. Expansion of these firms could help meet Minnesota's need to increase rural employment by creating stable and well paying jobs in outstate areas. (It should be noted once more that this table shows all firms in SIC's 28, 35, 36 and 38. It thus includes some firms inappropriately and excludes others that would, judged on an individual basis, be considered technology intensive).

By 1977 the total value of shipments by technology intensive industries had reached \$6.4 billion--about 40 percent of Minnesota's total manufacturing output and 10 percent of the gross state product. Personal income (wages, salaries, and dividends) attributable to Minnesota's technology intensive industries was \$2.7 billion in 1979. About 11 percent of the state's total wages and salaries are generated in the technology intensive industries, going to 9 percent of the state's wage and salary workers--a comparison which not only demonstrates that these industries employ a large proportion of Minnesota's workers, but also that those workers enjoy relatively high wages and salaries. Looked at another way, the technology intensive industries provide about 32 percent of the state's total manufacturing wage and salary employment.

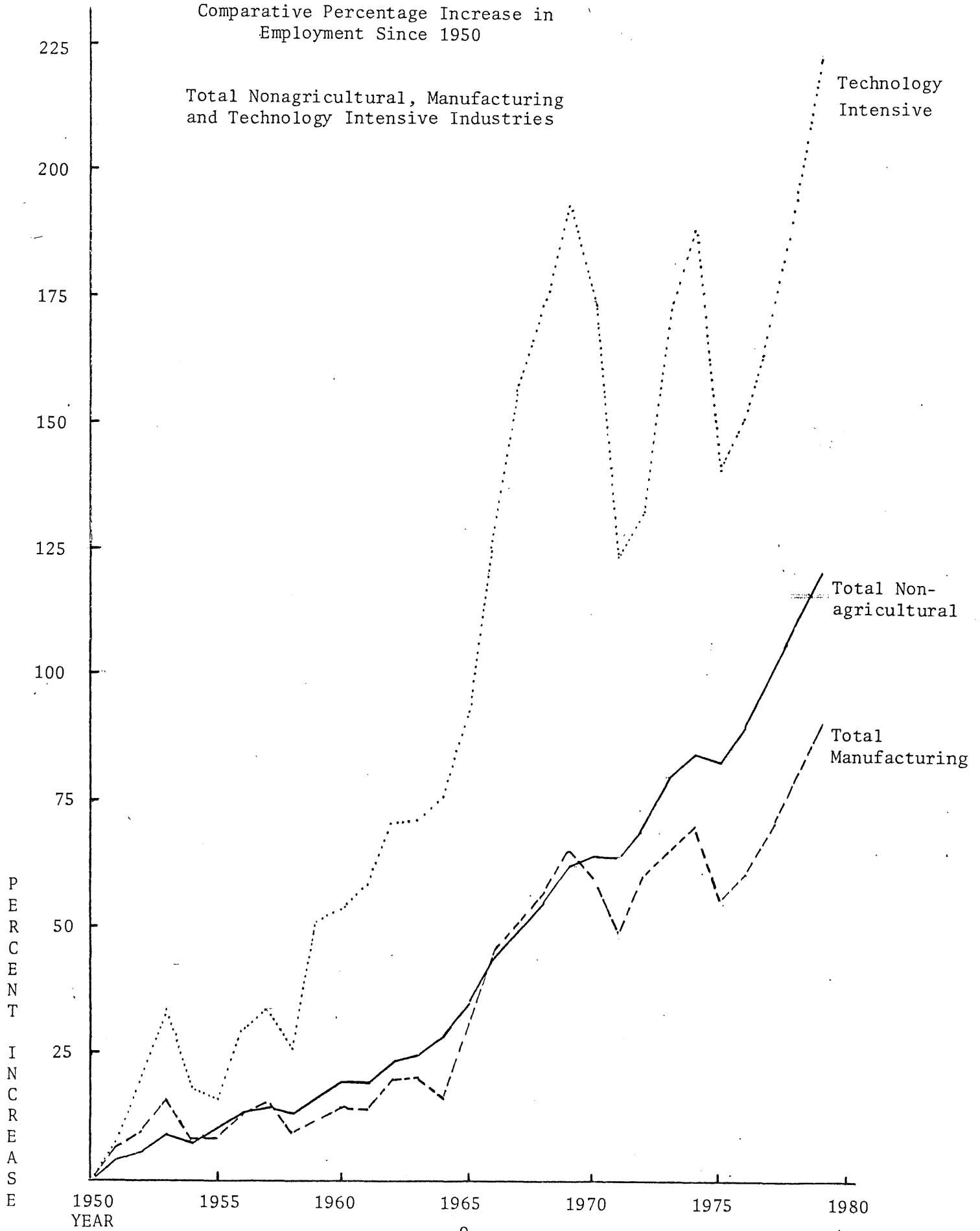
Of course, the technology based industries and the people they employ all pay taxes. In 1978, it is estimated that the technology intensive industries in Minnesota paid \$31 million in state corporate income taxes, \$124 million in property taxes, and \$24 million in sales and use taxes. In addition, their employees paid about \$111 million in state personal income taxes. Thus the total state tax contribution attributable to the technology intensive industries was approximately \$290 million.

The foregoing figures demonstrate the significance of the technology intensive industries in Minnesota's economy. This significance is particularly dramatic in light of the fact that these industries have developed into a major force in our economy from a relatively minor role in only 30 years. Many have progressed from embryonic ideas into large corporations in a matter of just a few years. Minnesota has proven to be

Table 2.

Comparative Percentage Increase in  
Employment Since 1950

Total Nonagricultural, Manufacturing  
and Technology Intensive Industries





a fertile environment for the growth of the technology intensive industries, and the state has reaped the benefits of that growth.

The U.S. Department of Commerce recently published its projections for industrial growth through the year 1984. The technology intensive industries rated high on these projections. "Electronic computing equipment", for example, is ranked first, with an expected annual compounded real growth rate of 11.7 percent. Minnesota has one of the highest concentrations of employment and value added in this industry in the nation. Other industries with high concentrations in Minnesota and their growth rates are "Process Control Instruments" (7.0 percent), "X-ray and Electro-Medical Equipment" (7.0 percent), and "Engineering and Scientific Instruments and Equipment" (6.0 percent). By virtue of its already established position in these industries, Minnesota is in an excellent position to experience even higher growth rates in these sectors than the nation as a whole will. Other technology intensive industries will also be potential sources of economic growth in the state.

V. NECESSARY CONDITIONS FOR CONTINUED GROWTH OF MINNESOTA'S TECHNOLOGY INTENSIVE INDUSTRIES

As shown in the previous section, growth in the technology intensive industries has generally been superior to that experienced in other Minnesota industries. Just as this past growth was the result of an economic and social environment favorable to the development of technology intensive industries, so will continued growth result if, and only if, Minnesota continues to provide conditions favorable to these industries. With this fact in mind, the committee has identified the following key conditions which are crucial to creating an environment conducive to the growth of technology intensive industries:

1) An Existing Base of Technology Oriented Firms.

Personnel of existing firms are most frequently the sources of ideas which lead to expansion of those firms or to the spinning-off of new firms.

2) Established Methods of Transferring Technology and Ideas.

The existence of new ideas cannot in itself assure the development of those ideas. Firms with past records of successful spin-offs or corporations formed specifically to foster early-stage development of new technologies can play important roles in turning ideas into reality.

3) Excellent Universities and Schools of Technology and Business

Technology intensive industries must have sources of highly trained personnel, both technical and managerial. Schools of technology are particularly important, as they provide leadership in ideas and research as well as vital trained scientists. Schools of business provide necessary managerial personnel.

4) Vocational-Technical Schools and Experienced Labor Force

In addition to the university system as a source of personnel, technology intensive industries need an adequate stream of new technicians graduating from vocational-technical schools if they are to expand and develop. These graduates supplement the existing pool of experienced technicians that exist in an area with a base of technology intensive industries.

5) Enlightened Regulatory Policy

Industry's perception of a state's regulatory policy is a very important factor in making decisions about locating new firms or expanding existing firms. Regulatory policy includes not only laws and regulations, but also the attitudes of government, the public, and business. Enlightened attitudes will result in regulatory policy that is understandable, predictable, stable, and fair.

6) Availability of Venture Capital

Entrepreneurs starting new firms will be particularly concerned about the availability of the venture capital they will require. State or industry-sponsored organizations which could provide funds even before the venture capital stage (e.g. for investigation of engineering feasibility or patentability of ideas) could also be a major factor in encouraging the establishment of new firms.

7) Balanced Securities Regulations

New, innovative technology intensive firms generally rely on the issuance of stock to obtain venture capital. This fact makes securities regulations which facilitate stock offers (while, of course, protecting the public as they are intended to) just as important as the general availability of venture capital.

8) Balanced Tax Structure

Whether a firm is new or is an established firm seeking to expand, state tax structures will play a major role in decisions made about location. Firms expect, of course, to pay income, property, sales, and capital gains taxes, but they will seek areas where taxes are minimized or balanced by factors favorable to their business. Capital gains taxes will be considered particularly significant by new or rapidly expanding firms, since these taxes have a great impact on the availability of the outside capital they require to finance growth.

9) High Quality of Life

Since technology intensive firms rely more on an area's human resources than on specific natural resources, quality of life becomes an important factor in determining where they will locate. A high quality of life enables these firms to attract and retain the personnel that they depend on.

Minnesota's record as a national leader in the growth of its technology intensive industries provides an indication that it has been at least adequate in the conditions for growth listed above. As it enters the decade of the eighties, however, it cannot afford to complacently assume that it will maintain that leadership position. Both Chicago and Philadelphia were leading technology centers in the U.S. at one time, but they saw their shares of the industry gradually decline as firms in other areas (such as the Twin Cities) came into the forefront of innovation and development. These precedents serve to remind us that we must actively seek to maintain the vitality of the technology intensive industries in our state by fostering the conditions listed above. This is particularly true during the current period of increasingly competitive foreign technology. Other areas of the U.S. (notably New England and the "Sunbelt" states) have also perceived the technology intensive



industries to be among the most desirable to attract and are seeking to promote their growth. These facts make it imperative that Minnesota should be not only adequate, but superior in providing the conditions necessary for continued growth of our technology intensive industries. The economic environment that such superior conditions can create will enable us to continue to enjoy the benefits of having a large and growing number of technology based firms in our state.

## VI. RECOMMENDATIONS FOR CHANGE AND IMPROVEMENT

Minnesota already rates high in some of the growth factors listed in the previous section. It has, for example, the necessary base of existing technology intensive firms and a high quality of life. It also has an excellent university system which includes a fine Institute of Technology--though this is a factor which the state should constantly strive to improve. On the other hand, Minnesota could be given a low rating in comparison to other states on some factors. Current securities regulations, for example, are considered by the committee to be unduly restrictive. But while these nine factors may be evaluated individually, their effect on industry does not consist of nine different influences. These factors reinforce each other to synergistically produce an economic environment, and any attempt to alter that environment must take into account the interactive nature of its elements if it is to be effective. It is with this fact in mind that the committee has arrived at the following recommendations--recommendations that, taken individually, represent only small changes, but which would have a major impact on future technology intensive industrial development if enacted in concert.

### 1. Improved Technology Development and Transfer

Minnesota's technology intensive industries depend on continued innovations in both process and product technologies for their survival and growth. It is the opinion of the committee that additional incentives are needed within the state for the development of such innovations. Furthermore, the committee believes that firms in Minnesota have frequently performed inadequately in transferring new technologies to business entities that can develop them into new products and services. Therefore, the following three actions are recommended.

#### A. Improvement of Technology Transfer Mechanisms

Minnesota already has a few organizations intended to help small business develop technological innovations. The Minnesota Cooperation Office provides management help to entrepreneurs and the Minnesota Seed Capital Corporation provides funds prior to the venture capital stage of a new business. The committee feels that these organizations need to be encouraged and supported. Additionally, mechanisms, including tax incentives, need to be established for the transfer of new technologies which established companies have developed (but decided not to implement) to entrepreneurial ventures which can further develop the ideas to the product stage. Some local firms might wish to emulate the General Electric Company, which encourages the sale or licensing of such developments. A state-sponsored corporation for such development is another possibility, as is a non-profit corporation which could be supported by private and/or state funds. Government and business leaders need to work together toward increasing awareness of the need for such a mechanism in order that the appropriate solution may be found and implemented.

## B. Development of Minnesota Science and Technology Center (MINTECH)

The Institute of Technology of the University of Minnesota has effectively served the state in the past in an ad hoc manner. The increasing technical needs of the state, especially in the areas of energy, the environment, industrial growth, and productivity, have led leaders of the Institute of Technology to propose creation of a Minnesota Science and Technology Center (MINTECH) to provide more effective organization to meet those needs. MINTECH would also substantially improve the transfer of technology in Minnesota.

The committee enthusiastically supports the creation of MINTECH. It could increase the effectiveness of the Institute of Technology in transferring existing knowledge to those who can use it and in responding to the needs of the community through its traditional research role. Its formal organization would aid the Institute of Technology in obtaining federal and industry funds to supplement state funds in undertaking projects directly related to major industries, such as electronics, computers, transportation, energy development, primary metals, power generation, etc.

An additional function of MINTECH would be to link the technical and non-technical segments of the community by offering assistance to public organizations through conferences and workshops. Another important contribution to technological development could be made by providing entrepreneurs and inventors access to inexpensive facilities and consulting services. In short, the creation of MINTECH would provide increased access to state resources that are currently underutilized.

## C. Tax Credit for Research and Development

The value of the investment tax credit for the purchase of new capital equipment has been demonstrated through its effect in creating new jobs and increasing productivity. Expenditures for research and development have a similar effect. The committee, therefore, recommends adoption of the draft bill attached as Appendix A, which would provide a 10 percent tax credit for increases in research and development expenditures, or adoption of a bill providing a similar tax credit.

## 2. Improved State Security Policies

The committee believes that appropriate modification of regulations regarding the issuance of securities by firms in this state could greatly enhance the ability of firms to obtain adequate financing and reduce the time and expense required to secure funds. Furthermore, the committee believes that some relaxation of those regulations is quite possible without increasing the risk to the public. Specifically, the committee recommends that the proposed rules submitted by the Commissioner of Securities to reduce the restrictions on issuance of securities in the state of Minnesota be adopted. A copy of these proposed rules is attached as Appendix B.

### 3. Improvement of State Education System

The University of Minnesota is an invaluable resource for our state. It is also invaluable to the technology intensive industries as a source of scientific and managerial personnel, as well as for its contribution to technological development. It is not the function of the present committee, certainly, to recommend educational policy, but rather to point out the value of our educational resources and to emphasize the need for their growing contribution to our economy, especially to the technology intensive sector of the economy.

The committee wishes to point out the need for coordination between business and educational institutions. This coordination is vital to the fulfillment of the need for relevancy in education for the sake of the students and business alike and needs to be carried out in our vocational, business, and secondary schools as well as in our university system.

The Institute of Technology and the College of Business Administration of the University of Minnesota are particularly vital to the growth of Minnesota's technology intensive industries. Both of these schools are already overloaded. Still more graduates will be needed in the future if demands of expanding technology intensive industries are to be met. Given the current level of resources available to the schools, it seems doubtful that these schools can expand their enrollments and continue to provide the high quality of education required of personnel in the technology intensive industries. The committee thus concludes that additional resources for these schools will be required, including equipment, facilities, and faculty. The recognition of these needs by Minnesota businesses has been made evident by past support of the University, but even greater support from both public and private sources will be needed in the future.

### 4. Tax Structure and Policy

It is the opinion of the committee (as well as many other business and government leaders) that some alterations of the current corporate income and capital gains tax structures would eliminate present inhibitions to capital formation and retention and to new capital investment. As the alterations of tax policy (along with the other changes recommended) take effect and industry expands in the state, there will be a long-term increase in corporate income tax revenues. Expansion of business will help to provide increased employment, allowing the state to divert its expenditures away from income maintenance programs and toward more productive purposes.

The committee considered a wide range of options before adopting these recommendations. Those options are briefly described and their estimated impacts on state revenues for fiscal year 1981 shown in Table 4.

#### A. Alignment with Federal Capital Gains Exclusion.

Due to the nature of the risks inherent in any new innovative venture (such as new high technology firms), such ventures tend overwhelmingly to be financed through equity (issuance of stock)

rather than debt (issuance of bonds). Minnesota currently allows an exclusion of only 50 percent of capital gains from taxation, compared with a 60 percent federal exclusion. Since gains on equity are in fact capital gains, the effect of this discrepancy is to discourage equity financing of new innovative firms in Minnesota. For this reason, the committee recommends that Minnesota exclude 60 percent of capital gains from taxation to align its tax structure with federal structure. Any future decreases in federal capital gains taxation should also be followed by Minnesota.

B. Adoption of a Bi-Level Corporate Income Tax

Minnesota currently taxes corporate income at a flat 12 percent rate. Firms with sales delivered outside of Minnesota are, basically, allowed to exclude income derived from those sales from the corporate income tax. The committee feels that this tax structure tends to be detrimental to small firms (including many young, innovative technology intensive firms with growth potential) in two ways. First, these firms need their incomes to finance growth to a greater degree than larger firms. Second, small firms are likely to have a greater proportion of their sales inside Minnesota than are larger firms. Given the protection from taxation of the profits from out-of-state sales by the larger firms, the smaller firms often have their incomes taxed at a higher effective rate than larger firms' incomes.

The committee recommends that this situation be remedied by instituting a bi-level corporate income tax in which the first \$25,000 of any corporation's annual income would be taxed at a reduced rate of 6 percent, with the remainder of income to be taxed at the normal 12 percent rate. This change would direct tax relief at the firms that most need it (in 1978, 11,236 firms had incomes of \$500 to \$25,000, while 9,856 had incomes in excess of \$25,000) without incurring an unreasonable cost in lost revenues (an estimated \$22.1 million in fiscal year 1981 - see Table 4 for comparison with other alternatives).

C. Increased Loss Carryforward Period

Minnesota businesses are currently allowed to deduct present losses from income up to five years into the future (referred to as a loss carryforward). Since many new businesses in the technology intensive industries go through a time consuming process of developing innovative new products and services, they do not generate sufficient income soon enough to utilize their early losses as tax deductions. In a definitive article for Harvard Business Review (May-June 1979), Ralph Biggadike points out that "new ventures need, on the average, eight years before they reach profitability." Furthermore, "ten to twelve years elapse before the return on investment of ventures equals that of mature businesses." The committee feels that extension of the loss carryforward period to ten years would ensure that such firms could utilize their early losses when they begin to generate sufficient income. Furthermore, they would do so at a time when they were

TABLE 4

## REVENUE COSTS OF TAX PROPOSALS

	Revenue Cost <u>FY 81</u>
1. 60% Capital Gains Exclusion (Alignment of Minnesota with U.S.)	\$13.8 million
2. Corporate Tax Rate Changes to:	
11%	\$35.1 million
10%	70.3
6% on first \$20,000	18.9
6% on first \$25,000	22.1
6% on first \$50,000	34.4
6% on first \$100,000	47.8
Under \$25,000 @ 6%            )	
\$25,000 - \$50,000 @ 9%    )	
Over \$50,000 @ 12%         )	28.3
Under \$50,000 @ 6%           )	
\$50,000 - \$100,000 @ 9%    )	
Over \$100,000 @ 12%         )	41.2
Under \$25,000 @ 6%           )	
Over \$25,000 @ 11%         )	53.6
Under \$25,000 @ 6%           )	
Over \$25,000 @ 10%         )	85.0

experiencing their fastest growth and had the greatest need to retain revenues. This change in policy would provide a means for the state to target an effective tax reduction where it would result in the greatest growth.

D. Personal Income Tax Reduction

The committee believes that Minnesota's current personal income tax rate is too high relative to that in other states and acts to discourage needed qualified personnel from locating in Minnesota. This is particularly significant in light of the need of expanding Minnesota technology intensive firms to compete with firms in other states for personnel. The committee notes approvingly the recent reduction of the maximum rate from 17 percent to 16 percent and advocates continued gradual reduction. Adoption of such a reduction as a long-term policy could, when implemented in concert with corporate tax policy modifications, result in a general shift toward an expanded business sector and away from personal income as a source of revenues necessary for the state to meet its social responsibilities. The committee believes that such a shift would be a desirable long-term goal.

5. Improving Understanding of Business and Industry's Role in Society

While the citizens of this country enjoy the widest variety of products and services in the world as a result of our advanced technology and business, they unfortunately are too often ignorant of the roles of business, technology, and capital formation in our society. This observation does not apply to only the general public--leaders of business, government, labor, and education are often so involved in their specialized interests that their awareness of the complex interdependencies of our economy and society is diminished. The committee firmly believes that increasing the general level of awareness of these interdependencies is vital if efforts to enhance Minnesota's business climate are to be truly effective.

While the committee recognizes the need for increased understanding of the role business plays in society, it also recognizes the difficulty of meeting that need. Certainly, no single program can enlighten an entire population in this regard. But the committee is optimistic about the potential for the following steps to begin to accomplish this task.

- A. Organizations such as the Minnesota Business Partnership and the Minnesota Association of Commerce and Industry need to increase their activities in informative and educational programs.
- B. Innovative approaches need to be taken toward opening better lines of communication with the media. The Minnesota Department of Economic Development might be able to coordinate its own resources with the business community's in order to create programs which would draw media interest and coverage. A theme such as "A Preview of Minnesota's Economy in the 80's" has been suggested.

- C. Courses are needed in our school system which would help promote understanding of business. Organizations of business leaders could encourage and cooperate with the Department of Education to implement such courses.
  
- D. The committee feels that it would be appropriate for the Institute of Technology and the College of Business Administration of the University of Minnesota to jointly coordinate a group formed to study the questions raised by this section of the recommendations. The goal of such a group, which could draw on the business and educational communities for members, would be to formulate long-term policies and actions intended to foster the understanding of business, technology, and capital formation referred to in this section. The committee suggests that a first step for such a group could be to specifically identify subjects that all members of the work force should have a general understanding of. A list of such subjects could then be used as a basis for suggesting positive actions to business and education leaders.

#### Conclusion

The interactive nature of the foregoing recommendations cannot be over-emphasized. Economic incentives for technological development will not suffice by themselves--they must be combined with an awareness of the need for such development among leaders and the general public alike. Conversely, awareness of the need for development cannot advance such development in the absence of economic incentives. The committee has conceived these recommendations as a synergistic set of actions which, while each could be undertaken separately, will have its maximum desired effect only when implemented as an overall strategy under the continuing leadership of members of both the private and the public sectors of our state economy.



Appendix A

Draft bill to provide a tax credit for increases in research and development expenditures by private businesses.

STATE OF MINNESOTA

A bill for an act to encourage expansion of research and experimental activities in Minnesota by providing an income tax credit for the increase in such expenditures paid or incurred in Minnesota over base period expenditures; amending Minnesota Statutes 1976, Section 290.06 by adding a subdivision

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA

Section 1. Minnesota Statutes 1976, Section 290.06, is amended by adding a subdivision to read:

Subd. 12. Credit for research and experimental expenditures.

(a) A credit for 10% of the amount of expenditures incurred in Minnesota during the taxable year for research and experimental purposes, as set out in Section 290.09 Subd. 18 and as further defined in paragraph (b), in the development of new products or services or for the improvement of existing products or services may be deducted from the tax due under this chapter in the year in which such expenditures are paid or incurred, subject to the following limitations:

(1) Such credit shall not exceed twenty per cent of the liability for tax for the taxable year, which liability shall be determined

for purposes of this credit as the tax imposed under this chapter less all credits allowable under Sec. 290.06 other than the credit allowed under paragraph (a).

- (2) If the credit determined under paragraph (a) for any taxable year exceeds the limitation provided by subparagraph (1), such unused credit, to the extent of such excess, shall be
- (a) a credit carryback to each of the three preceeding taxable years and
  - (b) a credit carryover to each of the seven succeeding taxable years.
  - (c) The entire amount of the excess unused credit for any taxable year shall be carried first to the earliest of the ten taxable years as set out in clauses (a) and (b) and then in order to each of the other nine taxable years to the extent that, due to the limitation provided by subparagraph (1), such excess unused credit may not be added for a prior taxable year to which such excess unused credit may be carried.
  - (d) The aggregate amount of the excess unused credits which may be added

under clauses (a), (b), and (c) for any preceeding or succeeding taxable year, when added to the first-allowable credit for such taxable year, may not exceed the limitation set out in subparagraph (1) for such taxable year.

(b) The amount of research and experimental expenditures incurred in Minnesota as set out in paragraph (a) shall be the excess of such expenditures paid or incurred during such taxable year over:

(1) the average of the three taxable years research and experimental expenditures incurred in Minnesota preceding the taxable year in which the credit is to be allowed. In the event that there are not three prior taxable years in which the trade or business was conducted in Minnesota, an average of the expenditures incurred shall be determined by dividing such expenditures for such lesser number of prior years by the number of prior years. In the event there are no prior years of trade or business conducted in Minnesota, the average referred to in this clause shall be zero.

(c) In the case of an electing small business corporation as defined in Section 290.971,

- (1) the credit allowed by paragraph (a) shall be pro rated among the persons who are shareholders of such corporation on the last day of such taxable year, and
- (2) any person to whom any such credit has been apportioned under clause (1) shall be treated for purposes of this subdivision as the taxpayer with respect to such credit.

Section 2. The amendment made by this Act shall be effective for taxable years beginning after December 31, 1978.

APPENDIX B

Pursuant to Minn. Laws of 1980, § 15.0412, subd. 4h, an agency may propose to adopt, amend, suspend or repeal rules without first holding a public hearing, as long as the agency determines that the rules will be noncontroversial in nature. The agency must first publish a notice of intent to adopt rules without a public hearing, together with the proposed rules, in the *State Register*. The notice must advise the public:

1. that they have 30 days in which to submit comment on the proposed rules;
  2. that no public hearing will be held unless seven or more persons make a written request for a hearing within the 30-day comment period;
  3. of the manner in which persons shall request a hearing on the proposed rules;
- and
4. that the rule may be modified if modifications are supported by the data and views submitted.

If, during the 30-day comment period, seven or more persons submit to the agency a written request for a hearing of the proposed rules, the agency must proceed under the provisions of § 15.0412, subds. 4 through 4g, which state that if an agency decides to hold a public hearing, it must publish in the *State Register* a notice of its intent to do so. This notice must appear at least 30 days prior to the date set for the hearing, along with the full text of the proposed rules. (If the agency has followed the provisions of subd. 4h and has already published the proposed rules, a citation to the prior publication may be substituted for republication.)

Pursuant to Minn. Stat. § 15.0412, subd. 5, when a statute, federal law or court order to adopt, suspend or repeal a rule does not allow time for the usual rulemaking process, temporary rules may be proposed. Proposed temporary rules are published in the *State Register*, and for at least 30 days thereafter, interested persons may submit data and views in writing to the proposing agency.

Public Hearings on Agency Rules December 15-19, 1980		
Date	Agency and Rule Matter	Time & Place
Dec. 16	Energy Agency Establishment of the MN Energy Conservation Service Program Hearing Examiner: Allan Klein	9:30 a.m., Large Hearing Room 83 State Office Building, 435 Park Street, St. Paul, MN

## Department of Commerce Securities and Real Estate Division

### Proposed Rules and Forms Relating to the Minnesota Securities Act

#### Notice of Intent to Adopt, Amend and Repeal Rules Without a Public Hearing

Notice is hereby given that, pursuant to her authority under Minn. Stat. § 80A.25 (1978), the Commissioner of Securities and Real Estate intends to adopt, repeal and amend rules and forms relating to the Minnesota Securities Act (Minn. Stat. ch. 80A).

KEY: PROPOSED RULES SECTION — Underlining indicates additions to existing rule language. ~~Strike outs~~ indicate deletions from existing rule language. If a proposed rule is totally new, it is designated "all new material." ADOPTED RULES SECTION — Underlining indicates additions to proposed rule language. ~~Strike outs~~ indicate deletions from proposed rule language.

The commissioner desires that the proposed rules and forms be adopted, repealed and amended without a public hearing in accordance with Minn. Stat. § 15.0412 (1978), as amended by Laws of 1980, ch. 615, § 7.

A free copy of the proposed rules and material relating to the proposed forms may be obtained from the commissioner's office. Those interested in submitting comment pertaining to the proposed rules and forms may do so within 30 days of the publication of this notice in the *State Register*. Additionally, if during the 30-day comment period, seven or more persons make a written request for a hearing on the proposed rules and forms, the commissioner will hold a public hearing in accordance with Minn. Stat. § 15.0412, subd. 4 (1978), as amended by Laws of 1980, ch. 615, § 6. A request for a copy of the proposed rules and/or material relating to the proposed forms, all comments, any requests for a hearing and all questions regarding the proposed rules and forms, should be directed to:

Mr. Daniel W. Hardy  
Assistant to the Commissioner  
Securities and Real Estate Division  
Department of Commerce  
500 Metro Square Building  
Saint Paul, Minnesota 55101  
Telephone: (612) 296-5689

The proposed rules and forms may be modified by the commissioner if the modifications are supported by the data and views submitted during the 30-day comment period, provided the modifications do not result in substantial change.

The commissioner has prepared a Statement of Need and Reasonableness which contains a summary of the evidence justifying both the need for, and the reasonableness of, the proposed rules and forms. The Statement of Need and Reasonableness is available for inspection by the public, during regular business hours, at the above address.

If no hearing is required, the commissioner will submit to the Attorney General the proposed rules and forms and notice as published in the *State Register*, the rules and forms as proposed for adoption, any *written* comments received by the commissioner during the 30-day comment period, and the Statement of Need and Reasonableness for the rules and forms. On the same day these materials are submitted to the Attorney General, the commissioner will notify any person who has requested that the commissioner inform him or her of when these materials have been submitted to the Attorney General. Any person wishing to be so notified should contact Mr. Hardy, at the address listed above.

A copy of the existing Securities and Real Estate Division rules may be obtained from the Department of Administration, Documents Division, 117 University Avenue, Saint Paul, Minnesota 55155, (612) 296-2874.

Finally, Minn. Stat. ch. 10A (1978), as amended, requires each lobbyist to register with the State Ethical Practices Board within five days after he or she commences lobbying. A lobbyist is defined in Minn. Stat. § 10A.01, subd. 11 (1979 Supp.) as any individual:

(a) Engaged for pay or other consideration, or authorized by another individual or association to spend money, who spends more than five hours in any month or more than \$250, not including *his own* travel expenses and membership dues, in any year, for the purpose of attempting to influence legislative or administrative action by communicating or urging others to communicate with public officials; or

(b) Who spends more than \$250, not including *his own* traveling expenses and membership dues, in any year for the purpose of attempting to influence legislative or administrative action by communicating or urging others to communicate with public officials.

The statute provides certain exceptions. Questions should be directed to the Ethical Practices Board, 41 State Office Building, Saint Paul, Minnesota 55155, telephone: (612) 296-5615.

November 20, 1980

Mary Alice Brophy  
Commissioner of Securities and Real Estate

### Amendments as Proposed

SDiv 2006 (b) It shall constitute a "manipulative, deceptive or other fraudulent device or contrivance" within the meaning of ~~Section~~ Minn. Stat. § 80A.03 (1978), as amended, for a broker-dealer or agent to recommend the purchase or sale of any security or to furnish any quotation for a security or, directly or indirectly, to submit any such quotation for publication, in any quotation medium (as defined in this rule) unless:

(1) The issuer has filed a registration statement under ~~Sections~~ Minn. Stat. §§ 80A.09, 80A.10 or 80A.11 (1978), as amended, which became effective ~~not~~ less than 90 calendar days prior to the day on which such broker-dealer or agent publishes or submits the quotation to the quotation medium, provided that such registration statement has not thereafter been the subject of

a stop order which is still in effect when the quotation is published or submitted, and such broker-dealer has in his records a copy of the prospectus or offering circular used in connection with the registration, or

SDiv 2009 Upon termination of the activities of a licensed person, the broker-dealer or issuer shall, within five ten business days, notify the commissioner in writing of the termination stating the reason therefor and including the license.

SDiv 2010 "Successor" for the purpose of Minnesota Statutes 1973, Section Minn. Stat. § 80A.05, subd. 2 (1978), as amended, includes any person succeeding to the business of a licensed broker-dealer or investment adviser under the following circumstances:

(a) When a licensee is a partnership, and a change in the membership of the partnership occurs which, under the law of the jurisdiction in which such partnership is formed, results in the creation of a new legal entity. This paragraph shall not apply, however, if more than one-half of the members of the predecessor partnership are no longer partners after such change in partnership;

(b) When a partnership or individual incorporates or otherwise changes its form of legal organization;

(c) When an entity formed under the laws of the particular jurisdiction changes the jurisdiction in which it is incorporated, organized or formed;

(d) When a licensee changes its name; or

(e) Upon the consolidation or merger of a licensee, or in the case of the acquisition of substantially all of the assets of a licensee, unless the transactions are entered into for the purpose of evading the operation of the licensing requirement.

SDiv 2012 ~~(e)~~ If any person required to pass an examination under paragraphs (a) or (b) of this section shall fail such examination, he may reapply to take the examination a second time thirty days after the date on which he was first examined, and a third time ninety days after the date he was first examined. No person shall be permitted to take any examination more than three times except as the Commissioner may in his discretion permit for good cause shown.

~~(c)~~ ~~(d)~~ Any broker-dealer, agent or investment adviser whose most recent license has been terminated for a period of ~~one~~ year two years or more immediately preceding the filing of a new application and who has not been actively engaged as a broker-dealer or agent respectively during that period shall be required to satisfactorily complete an examination prescribed by the commissioner, or an examination for principals or agents respectively given by the New York Stock Exchange, the National Association of Securities Dealers Inc., or the Securities and Exchange Commission.

~~(e)~~ The time and place at which the examination may be taken shall be determined by the Commissioner.

SDiv 2013 (c) [The existing rule is proposed for repeal and the following language is proposed as a substitute.]

SDiv 2013 (c) The net capital requirements for broker-dealers, as set forth in this Rule, shall be calculated in conformance with 17 C.F.R. section 240-15c3-1, as amended.

SDiv 2014 (c) No investment adviser's license shall be issued or renewed unless the investment adviser shall have first posted with the Commissioner a surety bond in the amount of \$25,000, on such form as the Commissioner may prescribe. Any investment adviser who has custody of, or discretionary authority over, any assets of any client shall have first posted with the commissioner a surety bond in the amount of \$25,000, on such form as the commissioner may prescribe.

SDiv 2014 (d) Any appropriate deposit of cash or security shall be accepted in lieu of any bond required by this section. An appropriate deposit requires, in the case of deposited securities, that such securities have a market value equal to 120 percent of the amount of the bond which would otherwise be required, and represent an interest in, or debt of, any of the persons whose securities are exempt from registration under Minnesota Statutes, Section Minn. Stat. § 80A.15, subd. 1, Clauses (a), (b), (c), (d) or (e) (1978), as amended. At no time shall the market value of the securities on deposit be less than 105 percent of the amount of the required bond. Any deposit of cash, or securities under this clause shall be made with an escrow agent, and under such terms and conditions as the commissioner deems appropriate, and shall remain with the depository for a period of three years after the last securities transaction conducted by the licensee or the effective date of any bond acquired by the licensee, whichever first occurs. The commissioner may allow an irrevocable letter of credit in lieu thereof.

SDiv 2014 (e) The provisions of SDiv 2014 (a) and (b) do not apply to any agent employed by a broker-dealer who continuously

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maintains net capital of not less than \$100,000. SDiv. 2014 (e) does not apply to any investment adviser who continuously maintains net capital of not less than \$100,000.

SDiv 2015 (d) (1) Every broker-dealer shall keep and preserve any written, printed or other advertisement which is published in connection with the offer or sale of a security or which is reasonably intended to encourage individuals or others to engage the services of the broker-dealer or any of its agents.

(2) The practices deemed deceptive or misleading pursuant to SDiv 2123 (c) shall likewise be deemed deceptive or misleading when employed by or on behalf of a broker-dealer.

SDiv 2015 (e) (1) Every broker-dealer shall preserve all records, files, communications and other information required by this SDiv 2015 for a period of not less than three years, the first two years in an easily accessible place and form. After the first two years, a photograph on film may be substituted for the records for the balance of the required time.

SDiv 2016 (j) (1) Every investment adviser shall keep and preserve any written, printed or other advertisement which is published in connection with the offer or sale of a security or which is reasonably intended to encourage individuals or others to engage the services of the investment adviser.

(2) The practices deemed deceptive or misleading pursuant to SDiv. 2123 (c) shall likewise be deemed deceptive or misleading when employed by or on behalf of an investment adviser.

SDiv 2016 (k) Every investment adviser shall preserve all records, files, communications and other information required by this rule for a period of not less than three years, the first two years in an easily accessible place and form. After the first two years, a photograph on film may be substituted for the records for the balance of the required time.

SDiv 2017 (a) Every broker-dealer shall, within 90 days following the close of either its fiscal or accounting year, submit an annual report to the commissioner in such form, and containing such information as the commissioner shall prescribe. At a minimum, the report shall contain audited financial statements certified by an independent certified public accountant consisting of a balance sheet, income statement, and reconciliation of surplus prepared in accordance with generally accepted accounting principles.

SDiv 2018 [Proposed for repeal; number reserved for future use.]

SDiv 2019 (b) (1) "Offering circular" means an offering circular ~~complying in compliance with the requirements of Rule 256 and Form 4-A under~~ the Securities Act of 1933 and the rules and forms promulgated thereunder.

SDiv 2022 (a) (1) Where the offering of securities is not firmly underwritten, and in the opinion of the commissioner, the protection of public investors so requires, the commissioner may require as a condition of registration, unless reason for exception can be demonstrated, that all or a portion of the proceeds from the sale of the securities registered shall be impounded with an impoundment agent satisfactory to the commissioner. ~~In cases where the offering of the securities is not firmly underwritten, the commissioner shall require, unless reason for exception can be demonstrated, that the proceeds be impounded. The conditions of impoundment shall be determined by the commissioner in each case.~~

SDiv 2024 [The existing rule is proposed for repeal and the following language is proposed as a substitute.]

SDiv 2024 So long as a registration is effective, the issuer shall, if possible, notify the commissioner in writing prior to or simultaneously with the occurrence of any of the following events, but in no event later than 10 days following the occurrence thereof:

(a) A decision to file for bankruptcy, enter receivership or any other similar proceeding;

(b) The cessation of business activities;

(c) A default on any payment of principal, interest, sinking fund installment or other similar payment, for a period of over 30 days, with respect to any indebtedness of the registrant or any of its subsidiaries exceeding five percent of the total assets of the registrant and its consolidated subsidiaries; or

(d) Any other event, occurrence or transaction which may or will have a material adverse effect upon the financial stability of the issuer.

SDiv 2025 (a) ~~Except as provided in paragraph (c) of this section, within 30 days after the end of each six month period following the effective date of the registration statement under Minnesota Statutes, Section 80A.11, the issuer or other person for whose account the securities covered by such registration statement are offered or sold except for registered investment companies, shall file a report of sales in such form as the Commissioner shall prescribe. A final report containing the same~~



information required by such form shall be made upon completion or termination of the offering and may be made prior to the end of the six month period in which the last sale is made.

(b) Any registrant filing reports with the Securities and Exchange Commission which contains substantially the same information as is required by the form prescribed by the Commissioner and which are filed at substantially the same time as the report required by paragraph (a) of this section is required to be filed may file, in lieu of the report required by the Commissioner's form, the report filed with the Securities and Exchange Commission. Every issuer or its agent shall immediately notify the commissioner in the event of a sale of securities in excess of the amount registered. Under no circumstances shall the notice be more than 30 days after the date on which the oversale occurred.

S Div 2025 (b) ~~(c)~~ If, by the terms of the order for registration, the offering period or the term of any impoundment agreement entered into in connection with the registration is less than six months, the final report required by paragraph (a) of this section shall be filed within 10 days after the date the offering or impoundment agreement terminates pursuant to the order of registration.

S Div 2027 (a) So long as a registration statement is effective, the issuer shall file an annual report in such form, and containing such information as the commissioner prescribes. At a minimum, the annual report shall contain the following:

- (1) The date of the report and fiscal year covered by the report;
- (2) The exact name of the issuer;
- (3) The state or other jurisdiction of incorporation or organization;
- (4) The address of the issuer's principal executive offices;
- (5) The telephone number of the issuer;
- (6) A description of all sales of unregistered securities made within the fiscal year covered by the report including:
  - (aa) The type of securities sold;
  - (bb) The number and dollar amount of securities sold;
  - (cc) The persons or class of persons to whom such securities were sold;
  - (dd) The market price of the securities sold on the date of sale, if applicable;
  - (ee) The name of any broker-dealer or agent participating in such sale, and the amount of commissions or other remuneration paid, if applicable; and
  - (ff) The exemptions claimed for any such sales;
- (7) A description of all securities of the issuer repurchased or otherwise reacquired by the issuer within the fiscal year covered by the report;
- (8) The names and addresses of all officers and directors, or persons occupying similar status or performing similar functions;
- (9) A description of the business of the issuer, including its products and services, competitive conditions, sources of supply, the number and general function of employees, its market area, and any other factors which materially affect the business or operations of the issuer;
- (10) A summary of operations for the fiscal year covered by the report including, without limitation, gross revenues, cost of goods sold or services provided, net income, debt service and earnings per share of each class of equity security outstanding, together with a comparison of similar figures for the fiscal year preceding the fiscal year covered by the report. The comparison required by this paragraph may be presented in columnar form;
- (11) A brief description of the location and general character of plants, mines and other materially important physical properties of the issuer;
- (12) A description of any material legal proceedings pending against the company;
- (13) An explanation of any increase or decrease in the number of outstanding securities, in any class, of the issuer;
- (14) The approximate number of holders of record of each outstanding class of equity securities;

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(15) A list in tabular form of the name and address of each executive officer, and any person known to the issuer who beneficially owns 10 percent or more of any class of outstanding voting securities of the issuer, showing for each the title of the class owned, the type of ownership, the amount owned and the percent of class owned;

(16) A list in tabular form of the amount of remuneration received and the capacity in which such remuneration was received for each executive officer and director;

(17) A list and description of the number and exercise price of all options outstanding which are beneficially owned by any officer or director;

(18) A description of any transactions in the last fiscal year or any currently pending transaction to which the issuer or any of its subsidiaries was a party and in which any director, officer, ten percent shareholder or any affiliate had or will have a direct or indirect material interest, and a description of the nature of such interest; and

(19) Financial statements complying with the requirements of SDiv. 2132 of these regulations.

(b) (1) Any issuer filing annual reports under the Securities Exchange Act of 1934 ~~or the Investment Company Act of 1940~~ may file, in lieu of the report required by paragraph (a) of this section, a duplicate copy of the annual report filed with the Securities and Exchange Commission.

(2) Any issuer filing reports under the Investment Company Act of 1940 may file, in lieu of the report required by paragraph (a) of this section, a current updated prospectus as filed with the Securities and Exchange Commission or a copy of the annual report required to be filed with the Securities and Exchange Commission.

(c) The annual report or prospectus required by this section shall be filed on or prior to the 90th day (or 120th day in the case of issuers registered under the Investment Company Act of 1940) following the close of the issuer's fiscal year, except that if the information required by ~~item~~ SDiv 2027(a) (19) is not reasonably available at such time, such information may be filed on or before the 150th day following the close of the issuer's fiscal year.

**SDiv 2028 Application.**

Regulations under this section of the act are divided into separate subchapters based upon the type of security involved. However, SDiv 2029-2041 shall apply to all securities, and should be followed in all instances unless they are inconsistent with another regulation in the appropriate subchapter for the type of security proposed to be registered. In that instance, the subchapter requirements will apply. ~~Reg. SDiv 2028 to 2109 shall not apply to securities or transactions exempted by Minnesota Statutes, 1973 Supplement, Section Minn. Stat. § 80A.15, subds. 1 or 2 (1978), as amended,~~ nor shall they apply to securities registered by notification.

- Subchapter 1 Equity Securities Regulation SDiv 2029-2041
- Subchapter 2 Senior Securities Regulation SDiv 2042-2046
- Subchapter 3 Investment Companies Regulation SDiv 2047-2057
- Subchapter 4 Real Estate Limited Partnerships SDiv 2058-2066
- Subchapter 5 Oil and Gas Programs SDiv 2067-2080
- Subchapter 6 Cattle Feeding Programs SDiv 2081-2089
- Subchapter 7 Real Estate Investment Trusts SDiv 2090-2109
- Subchapter 8 Commodity Pool Guidelines 4 MCAR §§ 1.2140 to 1.2145.

SDiv 2029 [The existing rule is proposed for repeal and the following language is proposed as a substitute.]

**SDiv 2029 Minimum investment required.**

(a) Unless an issuer or its predecessors have demonstrated profitable operations for two of the three fiscal years prior to registration, determined in accordance with generally accepted accounting principles, after taxes and excluding extraordinary items, the "fair value of the equity investment" of such issuer shall be at least 10 percent of the first \$1 million and 5 percent thereafter of the "equity investment" which would result from the sale of all the securities proposed to be offered.

(b) "Fair value of the equity investment" shall mean the higher of:

(1) the total of all sums irrevocably conveyed to the issuer in cash, together with the reasonable value of all tangible assets irrevocably conveyed to the issuer, and together with an evaluation by a qualified independent appraiser of intangible assets including, but not limited to, patents, licenses, technologies, trademarks, and technical or professional services contributed by the promoters, as adjusted by the retained earnings of the issuer subsequent to the dates of such conveyances, payments or contributions, or

(2) the total shareholders' equity as set forth in a certified balance sheet prepared in accordance with SDiv 2132, less the value assigned to any intangible assets which have not been independently evaluated.

(c) "Equity investment" shall mean the sum of:

(1) the "fair value of the equity investment" plus

(2) an amount equal to the net proceeds which would be received by the issuer upon completion of the offering, assuming the maximum aggregate amount of securities registered are sold.

(d) An appraisal or other evaluation used for the purposes of complying with the minimum equity investment may not be reflected in any form, either in the prospectus or in the issuer's financial statements or any footnotes thereto, unless it conforms with generally accepted accounting principles.

#### SDiv 2030 Cheap stock.

(a) The quantity of cheap stock, expressed as a percentage of the total number of shares to be outstanding after the proposed offering, shall not exceed the following percentages, depending on the "fair value of the equity investments" as defined in SDiv 2029(b):

<u>Equity Investment</u>	<u>Cheap Stock</u>
15 percent	30 percent
20 percent	40 percent
30 percent	60 percent
40 percent	80 percent
45 percent	90 percent

In the case of a "minimum maximum" offering, the allowable ratio, of 1 to 2, between the fair value of the equity investment and stock shall not be exceeded at any time. The amount of "cheap stock" allowable, based upon the "fair value of the equity investment" as defined in SDiv 2029(b), shall not exceed three times the first 10 percent of equity investment and two times any further equity investment to a maximum number of shares of cheap stock allowable of 90 percent of the total number of shares to be outstanding after the proposed offering.

SDiv 2030 (c) Cheap stock does not include securities which have been outstanding more than three years at the time of the proposed registration, if the issuer had been in active, continuous business operation for more than three years immediately prior to the proposed registration. Cheap stock does not include:

(1) securities which have been outstanding more than three years at the time of the proposed registration, provided that the issuer of its predecessors have been in active, continuous business operation for more than three years immediately prior to the proposed registration;

(2) securities of an issuer which (a) had earnings during the fiscal year prior to registration or (b) had earnings during two of the three fiscal years prior to registration, as determined in accordance with generally accepted accounting principles, after taxes and excluding extraordinary income, if such earnings are in an amount equal to 4 percent of the proposed public offering price on all outstanding shares of the same class at the date of application for registration; or

(3) securities previously issued pursuant to a registration under Minn. Stat. ch. 80A.

SDiv 2031 [The existing rule is proposed for repeal and the following language is proposed as a substitute.]

#### SDiv 2031 Employee and Director Options and Other Forms of Compensation through Receipt of Securities.

(a) Outstanding options to all employees and directors shall not exceed 20 percent of the to be outstanding common shares of the issuer unless a majority of the shareholders, excluding officers, directors, employees, and their spouses have approved a larger percentage, provided further that:

(1) the exercise price shall be no less than 100 percent of the fair market value on the date of the grant; and

(2) no such options in excess of 10 percent of the to be outstanding shares are granted to any individual who, immediately

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before such option is granted, owns stock possessing more than 10 percent of the total combined voting power or value of all classes of stock of the issuer.

(b) No shares shall be issued to employees or directors unless they shall have paid fair market value therefor, in cash, other than pursuant to the provisions of paragraph (a) of this section, unless: they are issued under the same terms and conditions as shares are issued to all holders of the same class of securities of the issuer, or unless a majority of shareholders, excluding officers, directors, employees and their spouses, have approved the issuance.

**SDiv 2036 Interest of management and others in certain transactions.**

(a) The prospectus or offering circular should describe briefly any material interest, direct or indirect, of any of the following persons in any material transactions during the last three years, or in any material proposed transactions, to which the registrant or any of its subsidiaries was, or is to be, a party:

- (1) Any affiliate of the registrant.
- (2) Any associate or affiliate of any of the foregoing persons.

Official instructions and other applicable interpretations or rules promulgated by the United States Securities and Exchange Commission pursuant to Form S-4 will be deemed to apply to this regulation.

**SDiv 2039 Speculative issues.**

As a condition to permitting any offering involving securities which the commissioner shall deem speculative, the commissioner may require any one or more of the following:

- (a) that the prospectus or offering circular conspicuously state on its cover or the following two printed pages that the securities offered thereby are speculative or a brief description of the material risks involved in the purchase of the securities with a cross-reference to further discussion (in greater detail) in the body of the prospectus and/or that each investor receive a statement concerning the speculative nature of the securities, sign a copy thereof, and file same with the commissioner;
- (b) that the prospectus or offering circular conspicuously state on its cover or the following two printed pages that the offering involves substantial dilution of the book value of the common stock from the public offering price and further state within its body, in reasonable detail, the amount and nature of such dilution;

**SDiv 2050 Speculative activities.**

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

- (a) Borrowing money for investment in securities, excluding borrowing for temporary purposes.
- (b) Purchasing securities for short-term trading but excluding money market funds or other investment companies whose portfolio holdings consist substantially of debt instruments.
- (c) Purchasing restricted securities as herein defined.
- (d) Purchasing put or call options or combinations thereof.
- (e) Short selling of securities, excluding short selling against the box.

**SDiv 2051 [Proposed for repeal; number reserved for future use; relating to the maximum annual expenses paid or incurred by an investment company.]**

**SDiv 2052 Minimum capitalization.**

An investment company having net assets of less than \$1,000,000 or an affiliated investment adviser with less than an aggregate of \$100,000,000 under management may not qualify its securities for registration unless:

- (a) the securities are being offered pursuant to a firm underwriting commitment which will, upon expiration of the initial offering period, capitalize the fund at not less than \$1,000,000; or
- (b) all proceeds of the offering are deposited in an escrow account, subject to their return in full to the investors if the minimum capitalization of \$1,000,000 is not achieved within three months after the date of the offering.

**SDiv 2057 Closed end investment companies.**

(b) No closed-end fund shall be registered for public offering in this state unless such fund adheres to, and discloses in its prospectus, each of the following policies:

(1) The fund shall not at the time of purchase, as to 100% of its total assets:

(aa) invest more than 30% of its total assets in restricted debt securities; unless permitted by the commissioner upon proper justification;

(bb) invest more than 15% of its total assets in all forms of illiquid securities, including, but not limited to, commodities, real estate, general and limited partnership interests, oil and gas interests, options and warrants, puts, calls, straddles, spreads, and restricted securities, except as provided in (1) above;

(cc) invest in securities carrying more than 10% of the voting rights of any issuer;

(dd) invest in more than 10% of the equity securities of any one issuer;

(ee) invest more than 10% of its total assets in the securities of real estate investment trusts or other investment companies, provided that investments in excess of 10% may be permitted by the commissioner upon a showing that such investments involve no duplication to management or advisory services with those of the fund.

(2) The fund shall not at any time, as to 75% of its total assets, invest more than 5% of such assets in the securities of any one issuer, exclusive of government securities.

(3) The fund shall not effect any brokerage transactions in its portfolio securities with any broker-dealer affiliated directly or indirectly with its investment adviser or manager, unless such transactions (including the frequency thereof, the receipt of commissions payable in connection therewith, and the selection of the affiliated broker-dealer effecting such transactions) are not unfair or inequitable to the shareholders of the fund.

(c) Notwithstanding paragraph (b) above, because of the possible risk to the investor, no closed end fund which engages in any of the following or related speculative activities shall be registered for public offering in this state unless the appropriate disclosure is made in bold face type on the cover of both the preliminary and final prospectuses, or on a prospectus supplement satisfactory in form to the commissioner, as follows:

"These securities may involve a high degree of risk because the fund is authorized:

(1) to engage in short term trading resulting in portfolio turnover greater than 100 percent annually (see page \_\_\_\_).

(2) to leverage more than 10 percent of its total assets (see page \_\_\_\_).

(3) to invest more than 5 percent of assets in restricted securities exclusive of debt securities (see page \_\_\_\_).

(4) to engage in short sales, excluding short sales against the box (see page \_\_\_\_).

(5) to invest more than 5 percent of its total assets in foreign securities where the fund must pay an interest equalization tax.

(6) in relation to ~~85~~ 75 percent of its total assets, to invest more than 5 percent of such assets in any one issuer."

SDiv 2113 [Proposed for repeal; number reserved for future use.]

SDiv 2115 (c) For the purpose of determining the number of sales which have been made, or will have been made upon completion of a proposed distribution under Section 80A.15 Subdivision 2(a), only those sales which would be included within the scope subject to the registration provisions of Chapter 80A, as determined by ~~Section~~ Minn. Stat. § 80A.27, shall be included.

(d) For purposes of this rule, time shall be computed pursuant to Minn. Stat. § 645.15 (1978), as amended.

SDiv 2117 The terms "financial institution or institutional buyer" contained in ~~Section~~ Minn. Stat. § 80A.15, subd. 2(g) (1978), as amended, do not ordinarily include a Small Business Investment Company unless it can be demonstrated that it possesses adequate sophistication with respect to the specific offer and sale include but are not limited to: (1) any corporation with a class of equity securities registered under Section 12(g) of the Securities Exchange Act of 1934, as amended, (2) any single investor who purchases \$100,000 or more of an issue with respect to such sale, provided the purchase is for cash and payment is made at the time of the sale, and (3) a Small Business Investment Company.

SDiv 2118 (b) The limitation of 25 purchasers contained in § 80A.15, subd. 2(h) is waived in connection with any ~~limited~~ distribution resulting in sales to not more than 35 persons in this state in connection with any offering being made in compliance

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with Rule 146 promulgated by the Securities and Exchange Commission [17 C.F.R. Section 230.146 (~~1975~~)] if such offering complies in all respects with that Rule or rules promulgated under section 3(b) of the Securities Act of 1933, if such offering is in compliance with any such rules.

SDiv 2118 (c) The exemption contained in § 80A.15, subd. 2(h) is withdrawn for any security representing an interest in or formed for the purpose of investing in any oil and gas venture, or any partnership, joint venture, group or association formed principally for the purpose of exploring for oil and gas or developing oil and gas reserves unless said security is sold in compliance with Rule 146 promulgated by the Securities and Exchange Commission. [17 C.F.R. Section 230.146 (~~1975~~)].

SDiv 2118 (d) The exemption contained in Section 80A.15, Subdivision 2(h) is withdrawn for any security representing an interest in, or formed for the purpose of investing in, any animal breeding, animal feeding, animal leasing or similar venture, unless said security is sold in compliance with Rule 146 promulgated by the Securities and Exchange Commission. [17 C.F.R. Section 230.146 (~~1975~~)].

SDiv 2118 (g) (2) For purposes of this rule, "public distribution" means a public offering registered under the Securities Act of 1933 or exempted by Regulation A of Section 3(b) of that act, provided, however, that this rule shall not apply to a public distribution does not include exchange offers or offers the exercise of options pursuant to a plan approved, or proposed to be approved by shareholders.

SDiv 2118 (j) The requirement of Minn. Stat. § 80A.15, subd. 2(h)(1) is hereby waived in connection with any distribution of securities pursuant to any employer savings, stock purchase, pension, profit sharing or similar benefit plan, or self-employed person's retirement plan.

SDiv 2118 (k) The exemption contained in § 80A.15, subd. 2(h) is conditioned on the use of an offering circular or other documents offering full disclosure in connection with each offer or sale.

SDiv 2118 (1) For the purpose of this rule, time shall be computed pursuant to Minn. Stat. § 645.15 (1978), as amended.

SDiv 2119 Offers, but not sales of any industrial revenue bond for which a registration statement has been filed under Sections 80A.01 to 80A.31 Minn. Stat. ch. 80A, are hereby exempted from registration pursuant to Section Minn. Stat. § 80A.15, subd. 2(i) (1978), as amended, provided, however, that any such written offer may be made only by, or only if accompanied by, the most recent preliminary or the final prospectus on file with the commissioner.

SDiv 2122 (a) Any offer or sale by an affiliate of the issuer thereof is hereby exempted from registration pursuant to Section Minn. Stat. § 80A.15, subd. 2(o) (1978), as amended, if the following conditions are met prior to any such offer or sale:

(1) if the sale is subject to Rule 144 of the Securities and Exchange Commission:

(aa) a registration statement is in effect with respect to securities of the same class of such issuer and

(bb) the sale is made pursuant to Rule 144 promulgated by the Securities and Exchange Commission and

(cc) ~~a copy of Form 144 is transmitted to the Commissioner contemporaneous with its transmittal to the Securities and Exchange Commission and,~~

(cc) ~~(dd)~~ all annual, quarterly or other reports required by Section Minn. Stat. § 80A.12 (1978), as amended, or any rule thereunder have been filed or distributed during the twelve months preceding such sale (or for such shorter period for which the issuer was required to file such reports), or

(2) if the sale is not subject to Rule 144:

(aa) a registration statement is in effect with respect to securities of the same class of such issuer and

(bb) a statement of the facts called for by Form 144 has been furnished to the commissioner concurrent with the placing with a broker-dealer of an order to execute a sale (if a broker-dealer is used) or at the time of the offer (if a broker-dealer is not used) and,

(cc) all annual, quarterly, or other reports required by § 80A.12 or any rule thereunder have been filed or distributed during the twelve months preceding such sale (or for such shorter period for which the issuer was required to file such reports).

SDiv 2123 Advertising material. (a) Definition. "Advertisement" means any written or printed communication or any communication by means of recorded telephone messages or transmitted on radio, television, or similar communications media, including film strips or motion pictures, published in connection with the offer or sale of a security.

(b) Certain advertisements to be filed. All sales and advertising literature and promotional material including that material required to be preserved pursuant to SDiv 2015 (d) (1), other than that exempted by this rule, shall be governed by the following:

(1) The applicant shall file with the Commissioner, at least five days before its intended dissemination, one copy of each item of literature or material. Any such material shall, upon the written request of the commissioner, be filed with the commissioner prior to being disseminated.

S Div 2123 Advertising material.

(e) Violations. Any person, including any broker-dealer or agent thereof, investment advisor or issuer who knowingly prepares, distributes or causes to be issued or published any sales literature which is knowingly inaccurate, false, misleading or tending to mislead in any material respect or otherwise in violation of the provisions herein may be held responsible and accountable therefor in any administrative or civil proceeding arising under the act or these rules.

S Div 2124 Every registration statement and prospectus for a security which is not registered as required under chapter 80A, and is exempt from registration by § 3 (a) (11) of the Securities Act of 1933 as amended or exempted by section 3 thereof shall bear, on the front page of such registration statement or prospectus, the following language in capital letters and boldface type:

**THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE MINNESOTA SECURITIES AND REAL ESTATE DIVISION NOR HAS THE DIVISION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.**

S Div 2125 (b) (1) In recommending to a customer the purchase, sale or exchange of any security, a broker-dealer shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his financial situation and needs.

S Div 2125 (d) (1) No broker-dealer, investment adviser, agent or employee of any of the above shall effect with or for any customer's account in respect to which such broker-dealer or his agent or employee is vested with any discretionary power any transactions of purchase or sale which are excessive in size, amount or frequency in view of the financial resources and character of such account.

S Div 2125 (e) If a broker-dealer buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit.

S Div 2126 Any rescission offer described in Section Minn. Stat. § 80A.23, subd. 3 8 (1978), as amended, shall normally be accompanied by a document meeting the requirements of a prospectus for a registration by qualification. Said document shall, in addition, clearly disclose any material facts concerning the alternatives available to the offeree.

S Div 2135 Incorporation by reference.

Whenever a reference is made in S Div 2000 to ~~S Div. 2137~~ 4 MCAR § 2151 to a federal or state statute, rule, decision or opinion, such reference shall be deemed to refer to the version of the statute, rule, decision or opinion as of ~~April 15, 1974~~ April 15, 1974 ~~except that any such reference contained in S Divs. 2077, 2079, 2089, 2099, 2110, 2113-2119, 2122, 2126 and 2137 shall be to the version as of July 15, 1975~~ December 1, 1980.

### Amendments to the Minnesota Securities Act Forms as Proposed

Form 101, "APPLICATION FOR INVESTMENT ADVISER'S LICENSE." [Proposed for repeal.] The following form is proposed as a substitute:

Form ADV, "APPLICATION FOR REGISTRATION AS AN INVESTMENT ADVISER OR TO AMEND SUCH AN APPLICATION UNDER THE INVESTMENT ADVISERS ACT OF 1940", as referred to at 17 C.F.R. § 279.1 (1980), as amended.

Form, "Quarterly Report." [Proposed for repeal.]

Form BD, "APPLICATION FOR BROKER/DEALER'S LICENSE." [Proposed for repeal.] The following form is proposed as a substitute:

Form BD, "UNIFORM APPLICATION FOR REGISTRATION, LICENSE OR MEMBERSHIP AS A BROKER-DEALER OR TO AMEND SUCH AN APPLICATION UNDER THE SECURITIES EXCHANGE ACT OF 1934, OR UNDER THE

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LAWS OF THE JURISDICTIONS OR UNDER THE CONSTITUTIONS AND RULES OF THE SELF-REGULATORY ORGANIZATIONS ACCEPTING THIS FORM", as referred to at 17 C.F.R. § 249.501 (1980), as amended.

#### Rules as Proposed (all new material)

4 MCAR § 1.2127 Amendments "Requiring an order of the commissioner," pursuant to Minn. Stat. § 80A.28, subd. 3, (1978), as amended, shall mean any change in the language of the currently effective "order" of registration or licensing, including, by way of example:

- A. A change in the name of the registrant, whether an issuer, broker-dealer or investment adviser;
- B. A change in price, if equity securities are involved;
- C. A change in interest rate, if debt securities are involved;
- D. A change in type or class of security registered.

#### Subchapter 8: Commodity Pool Guidelines (4 MCAR §§ 1.2140-1.2145)

4 MCAR § 1.2140 Definitions. As used in these rules, the following terms shall mean:

- A. Commissioner. The Commissioner of Securities and Real Estate.
- B. Adviser. A person who for any consideration engages in the business of advising others, either directly or indirectly, as to the value, purchase, or sale of commodity futures contracts or commodity options.
- C. Capital contributions. The total investment in a program by a participant or by all participants, as the case may be.
- D. Clearing broker. Any person who engages in the business of effecting transactions in commodities futures contracts for the account of others or for his own account.
- E. Commodity futures contract. A contract providing for the delivery or receipt at a future date of a specified amount and grade of a traded commodity at a specified price and delivery point.
- F. Net assets. The total assets, less total liabilities, of the program determined on the basis of generally accepted accounting principles. Net assets shall include any unrealized profits or losses on open positions, and any other credit or debit accruing to the program but unpaid or not received by the program.
- G. Net asset value per unit. The net assets divided by the number of units outstanding.
- H. Net profits. The sum of:
  - 1. The net of any profits and losses realized on all trades closed out during the period.
  - 2. The net of any unrealized profits and losses on open positions as of the end of the period, minus,
  - 3. The net of any unrealized profits or losses on open positions as of the end of the preceding period,
  - 4. All expenses incurred or accrued during the period and
  - 5. Cumulative net realized losses, if any, carried forward from preceding periods.
- I. Organization and offering expenses. All expenses incurred by the program in connection with and in preparing a program for registration and subsequently offering and distributing it to the public, including, but not limited to, total underwriting and brokerage discounts and commissions (including fees of the underwriter's attorneys), expenses for printing, engraving and mailing, salaries of employees while engaged in sales activity, charges of transfer agents, registrars, trustees, escrow holders, depositories and experts; and expenses of qualification of the sale of securities under federal and state law, including taxes and fees and accountants' and attorneys' fees.
- J. Participant. The holder of a program interest.
- K. Person. A natural person, partnership, corporation, association or other legal entity.
- L. Program. The limited partnership, joint venture or incorporated organization formed and operated for the purpose of investing in commodity futures contracts.
- M. Program interest. A limited partnership or other form of ownership in a program.
- N. Pyramiding. A method of using all or a part of an unrealized profit in a commodity futures contract position to provide margin for additional commodity futures contracts of the same or related commodities.
- O. Sponsor. Any person directly or indirectly instrumental in organizing a program or any person who will be responsible for the management of a program. Sponsor shall include an adviser or a clearing broker who pays any portion of the organizational expenses of the program, a general partner, and any other person who regularly performs or selects the persons who perform



services for the program. Sponsor does not include wholly independent third parties such as attorneys, accountants, and underwriters whose only compensation is for professional services rendered in connection with the offering of the units. The term "sponsor" shall be deemed to include affiliates of any sponsor otherwise coming within this definition.

P. Valuation date. The date as of which the net assets of the fund are determined.

R. Valuation period. A regular period of time between valuation dates.

#### 4 MCAR § 1.2141 Requirements of sponsors, advisers, and clearing brokers.

A. Experience. Any person providing management, advisory, or clearing services to the program shall have at least three years of relevant experience in the area of trading commodity futures contracts. Such experience must include the trading of commodity futures contracts for others or must otherwise demonstrate sufficient knowledge of such person to perform the services proposed and to carry out the program policies and objectives.

B. Financial condition. The financial condition of a sponsor must be commensurate with any financial obligations assumed in the offering and in the management and operation of the program. At a minimum, the net worth shall be the greater of:

1. An amount equal to 5 percent of the participants' capital in all existing programs in which a sponsor or an affiliate has potential liability, plus 5 percent of the total subscriptions in the program being offered, or

2. Fifteen percent of the gross amount of the current offering with respect to offerings of less than \$2,500,000. If the offering exceeds \$2,500,000, the net worth must be at least 10 percent of the gross amount of the offering, up to \$1 million of net worth, but in no case less than \$50,000. Net worth of individual sponsors shall be determined exclusive of home, furnishings and automobiles. Audited balance sheets of sponsors shall be furnished except that in the event a sponsor is an individual, an unaudited balance sheet prepared by a certified public accountant and signed and sworn to by such individual sponsor may be accepted for the purpose of determining required net worth. Also, evaluation will be made of contingent liabilities to determine the appropriateness of their inclusion in the computation of net worth.

C. Investment in the program. A sponsor must make a permanent investment in the program equal to the lesser of 3 percent of the public investors' interest or \$50,000.

D. Tax ruling or opinion. A program organized in the form of a limited partnership must obtain a favorable tax ruling from the Internal Revenue Service or favorable opinion of qualified tax counsel in a form acceptable to the commissioner concerning the tax status as a limited partnership. A favorable tax ruling or opinion is one which concludes that the program will be treated as a partnership for tax purposes.

E. Liability and indemnification. The sponsor(s) shall not attempt to pass on to participants the liability imposed upon a sponsor by law except that the program agreement may provide for indemnification of the sponsor(s) under the following circumstances and in the manner and to the extent indicated:

1. In any threatened, pending or completed action, suit, or proceeding to which a sponsor was or is a party or is threatened to be made a party by reason of the fact that he is or was a sponsor of the program (other than an action by or in the right of the program), the program may indemnify such sponsor against expenses, including attorneys' fees, judgments and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if the sponsor acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the program, and provided that his conduct does not constitute gross negligence, wilful or wanton misconduct, or a breach of his fiduciary obligations to the participants. The termination of any action, suit or proceeding by judgment, order or settlement shall not, of itself, create a presumption that the sponsor did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the program;

2. In any threatened, pending or completed action or suit by or in the right of the program, to which a sponsor was or is a party or is threatened to be made a party, involving an alleged cause of action by a participant or participants for damages arising from the activities of a sponsor in the performance of management of the internal affairs of the program as prescribed by the program agreement or by the law of the state of organization, or both, the program may indemnify such sponsor against expenses, including attorneys' fees, actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the program as specified in this clause, except that no indemnification shall be made in respect of any claim, issue or matter as to which the sponsor shall have been adjudged to be liable for negligence, misconduct, or breach of fiduciary obligation in the

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performance of his duty to the program as specified in this clause, unless and only to the extent that the court in which such action or suit was brought shall determine upon application, that, despite the adjudication of liability but in view of all circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses as the court shall deem proper;

3. To the extent that a sponsor has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in E.1. or E.2., or in defense of any claim, issue or matter therein, the program shall indemnify him against the expenses, including attorneys' fees, actually and reasonably incurred by him in connection therewith; and

4. Any indemnification under E.1. or E.2., unless ordered by a court, shall be made by the program only as authorized in the specific case and only upon a determination by independent legal counsel in a written opinion that indemnification of the sponsor is proper in the circumstances because he has met the applicable standard of conduct set forth in E.1. and E.2.

F. Additional requirements. Any sponsor, adviser, or clearing broker must present evidence that it is or will be in compliance with applicable licensing or registration requirements under the Commodity Exchange Act, as amended.

#### 4 MCAR § 1.2142 Standards.

A. Disclosures. In view of the limited transferability, the relative lack of liquidity, and the high risk of loss of many commodity pool programs, suitability standards related to the risks to be undertaken will be required for the participants, and must be set forth in both the prospectus and a written instrument to be executed by each participant. The prospectus shall set forth the investment objectives of the program, a description of the type of participant who could benefit from the program and the suitability standards to be applied in marketing the program.

B. Sales to appropriate persons. A sponsor and each person selling program interests on behalf of a sponsor shall make every reasonable effort to assure that those persons being offered or sold the interests meet the suitability standards set forth in this section. The following shall be evidence thereof:

1. That the participant has the capacity of understanding the fundamental aspects of the program, which capacity may be evidenced by the following:
  - a. The nature of employment experience;
  - b. The education level achieved;
  - c. Access to advice from qualified sources, such as an attorney, accountant or tax adviser; and
  - d. Prior experience with investments of a similar nature;
2. That the participant has an apparent understanding:
  - a. Of the fundamental risks and possible financial hazards of the investment;
  - b. Of the lack of liquidity of the investment;
  - c. That the investment will be directed and managed by the sponsor; and
  - d. Of the tax consequences of the investment;
3. That the participant can bear the financial risks involved.

C. Maintenance of suitability records. A sponsor shall retain for at least three years all records necessary to substantiate the facts that program interests were sold only to participants for whom such securities were suitable. The commissioner may require a sponsor to obtain from the purchaser a letter justifying the suitability of such investment.

D. Minimum Investment. The minimum subscription shall not be less than \$2,500 and shall be paid in cash at the time of purchase. Assessments of any kind shall be prohibited.

#### 4 MCAR § 1.2143 Fees, compensation and expenses.

A. Organizational and offering expenses. All organizational and offering expenses, including commissions, incurred in order to sell program interests shall be reasonable. In no event shall these expenses exceed 15 percent of the gross proceeds of the offering.

##### B. Compensation.

1. Maximum expenses. The aggregate annual expenses of every character paid or incurred by a program, including management and advisory fees based on the net assets of the program but excluding commodity brokerage commissions, incentive fees, legal, audit and extraordinary expenses, calculated at least quarterly on a basis consistently applied, shall be reasonable but in no event shall exceed one-half of 1 percent of the program's net assets per month; provided a sponsor shall not receive a management fee if he receives any portion of the brokerage commissions under B.3.

The sponsor(s) shall reimburse the program quarterly for the amount by which such aggregate monthly expenses exceed the amounts herein provided, up to an amount not exceeding its management and advisory fees for the period for which reimbursement is made, prior to publication of the program's quarterly report and shall promptly notify the commissioner if the aggregate expense limitation is exceeded by reason of any extraordinary expenses.

2. Incentive fees. A sponsor or adviser will be entitled to an incentive fee. The total of the incentive fee shall not exceed 15 percent of the net profits of the program, calculated not more often than quarterly on the valuation date, over the highest previous valuation date. For purposes of this calculation, program losses shall be carried forward but shall not be carried back.

3. Brokerage commissions. The program shall seek the best price and services available in its commodity futures brokerage transactions. The program shall not effect any transactions in commodities futures contracts with any clearing broker affiliated directly or indirectly with a sponsor or with any adviser providing the sponsor with research information, recommendations, or other services which might be of value to any sponsor, unless such transactions are effected at competitive brokerage rates. In no event will the program be allowed to enter into any exclusive brokerage contract. If any person receives any portion of the brokerage commissions from program operations, the adviser may not be affiliated with such person. The commissioner may require the program to file periodic reports concerning all brokerage transactions.

4. Other income. Any interest or other income earned by any portion of the program assets shall accrue solely to the benefit of the program or the management fee shall be reduced by any amount which does not so accrue.

5. Expenses of the program. All expenses of the program shall be billed directly to and paid by the program. Reimbursements (other than for organizational and offering expenses) to any person or affiliate shall not be allowed, except for reimbursement of the actual direct costs to the sponsor or affiliate of legal and audit services used for or by the program. Expenses incurred in connection with administration of the program, including but not limited to salaries, rent, travel expenses and such other items generally falling under the category of overhead, shall not be charged to the program.

#### 4 MCAR § 1.2144 Rights and obligations of participants.

A. Meetings. Meetings of the participants may be called by a sponsor or by participants holding more than 10 percent of the then outstanding units for any matters for which the participants may vote as set forth in a program agreement. Such call for a meeting shall be deemed to have been made upon receipt by a sponsor of a written request from holders of the requisite percentage of units stating the purpose of the meeting. The sponsor shall deposit in the United States Mails within 15 days after receipt of said request, written notice to all participants of the meeting and the purpose of such meeting, which shall be held on a date not less than 30 nor more than 60 days after the date of mailing of said notice at a reasonable time and place.

B. Voting rights of participants. The program agreement must provide that holders of a majority of the then outstanding units may, without the necessity for concurrence by the sponsor(s), vote to:

1. Amend the program agreement,
2. Dissolve the program,
3. Remove a general partner and elect a new general partner,
4. Elect a new general partner if a general partner elects to withdraw from the program, and

5. Cancel any contract for services with any sponsor or an affiliate without penalty upon 60 days written notice. A general partner shall not withdraw from a partnership without 90 days prior written notice thereof to the participants.

#### C. Access to program records.

1. The program agreement shall require the maintenance of a list of the names and addresses and interests owned of all participants at the principal office of the program. Such list shall be made available for the review of any participant or his representative at reasonable times, and upon request, either in person or by mail. A participant or his representative shall be furnished a copy of such list upon payment of the cost of reproduction and mailing.

2. The participants and their representatives shall be permitted access to all records of the program, after adequate notice, at any reasonable time. Records shall be maintained and preserved for a period of not less than six years.

#### D. Annual and periodic reports.

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1. The program agreement shall provide for the transmittal to each participant of an annual report, within 120 days after the close of the fiscal year, containing at least the following information:

a. A balance sheet as of the end of its fiscal year and statements of income, participants' equity, and changes in financial position for the year then ended, all of which shall be prepared in accordance with generally accepted accounting principles and accompanied by an auditor's report containing an opinion (without material qualification) of an independent certified public accountant or independent public accountant.

b. A statement showing the total fees, compensation, brokerage commissions and expenses paid by the program, segregated as to type, and stated both in aggregate dollar terms and as a percentage of net assets.

2. Participants shall be furnished with quarterly reports, which may be unaudited, containing the same information required in D.1.a. and D.1.b. within 60 days after the end of the quarter.

3. All participants shall be provided all information necessary for the preparation of the participants' income tax returns by not later than March 15 of each year.

4. The net assets of the program shall be calculated daily and the net asset value per unit shall be made available upon the request of a participant.

#### 4 MCAR § 1.2145 Disclosure and marketing requirements.

A. Minimum program capital. The minimum amount of funds required to activate a program shall be sufficient to accomplish the objectives of the program, including diversification. Any minimum less than \$500,000, after deduction of any organizational and offering expenses, including commissions, will be presumed to be inadequate to diversify. Provision must be made for the return to participants of 100 percent of paid subscriptions in the event that the established minimum to activate the program is not reached. All funds received prior to activation of the program must be deposited with an independent custodian, trustee or escrow agent whose name and address shall be disclosed in the prospectus.

B. Sales literature. Sales literature, sales presentations (including prepared presentations to prospective participants at group meetings) and advertising used in the offer of sale of program interests shall conform in all applicable respects to the requirements of filing, disclosure and adequacy currently imposed by SDiv. 2125 on sales literature, sales presentations and advertising used in the sale of corporate securities.

#### C. Contents of the prospectus.

1. Information on the cover page. There should be set forth briefly on the cover page, or the following two printed pages of the prospectus, a summary which should include the following: the title and general nature of the program interests being offered; the minimum and maximum aggregate amount of the offering; the minimum and maximum amount of net proceeds; the subscription price; the period of the offering; the maximum amount of any sales or underwriting commissions to be paid (or if none, whether such commissions are to be paid by the sponsor(s)).

2. Sales to appropriate persons. There shall be set forth a description of the type of person who could benefit from the program and the suitability standards to be applied in marketing it.

3. Definitions. Technical terms used in the prospectus should be defined in a glossary.

4. Risk factors. A participant should be advised in a carefully organized series of short, concise paragraphs, under subcaptions where appropriate, of the risks to be considered before making an investment in a program. The paragraphs should include a cross reference to further information in the prospectus.

5. Business experience. The business experience of the principal officers of all sponsors shall be prominently disclosed in the prospectus. Such disclosure shall indicate their business experience for the past 5 years. Disclosure shall also be made regarding the experience of any commodity trading adviser and any clearing broker who is utilized by the program. The terms of any material contracts entered into by the program shall be summarized in the prospectus.

6. Compensation. All direct and indirect fees and compensation of every type and from every source which may be paid by the program to any person shall be summarized in tabular form in one location in the forepart of the prospectus. A sponsor shall not receive any compensation, direct or indirect, other than that disclosed in the compensation section.

7. Use of proceeds. The prospectus shall state the purposes for which the proceeds of the program are intended to be used and the approximate amount intended to be used for each such purpose.

8. Investment objectives and policies.

a. Describe the investment objectives and policies of the program, indicating which policies may be changed by the sponsor(s) without a vote of the participants.

b. Describe the plan for distribution of income of the program.

9. Prior performance.

- a. The previous relevant program experience of any sponsor or adviser shall be disclosed in the prospectus for all programs during the past three years which:
- (1) Involved a public offering registered under state or federal securities laws;
  - (2) Involved a private or limited offering.
- b. Information on previous programs shall include, but not be limited to, the following:
- (1) Identification of the program, including the name and location;
  - (2) The effective date of the offering, the date it commenced operations and the date of dissolution or termination or, if it is continuing, that fact;
  - (3) The total amount of units, the gross amount of capital raised by the program, the number of participants, and the dollar amount of investment of the sponsor, if applicable;
  - (4) Income credited and cash distributed to participants and to any sponsor, adviser, or clearing broker;
  - (5) Compensation and fees to any sponsor, segregated as to type;
  - (6) Compensation and fees paid to other relevant parties such as advisers and clearing brokers;
  - (7) The net asset value per unit as of the end of each valuation period previously used;
  - (8) Such additional or different disclosures of the success or failure of the programs as may be permitted or required by the commissioner.
- c. All of the foregoing information shall be set forth on a cumulative basis for each program in tabular form wherever possible and include a brief description of any material differences between a prior program and the program to be offered.
- d. The following caveat should be prominently featured in the presentation of the foregoing information: "It should not be assumed that participants in the offering covered by this prospectus will experience returns, if any, comparable to those experienced by participants in prior programs."
- e. The foregoing information shall be supported in the application for registration by an affidavit that the performance summary is a fair presentation of the information contained in the audited financial statement or the federal income tax returns of the program or in other reports or data.

10. Conflicts of interest and transactions with affiliates.

- a. Any conflicts of interest between the program and any sponsor, adviser, clearing broker or any affiliate thereof, must be fully disclosed. This would include, at a minimum the following:
- (1) Any conflicts arising out of involvement with previous programs;
  - (2) Any conflicts arising out of involvement in the area of activities not related to the management, advising or other services performed for commodity pools;
  - (3) Any other agreements, arrangement or transactions, proposed or contemplated, that may be a potential conflict of interest;
  - (4) The sponsor shall also be required to disclose the steps that will be taken to alleviate any real or potential conflict of interest;
  - (5) If the program pays higher than the minimum commission rates for commodity brokerage transactions, such fact shall be set forth along with a justification.
- b. Certain material conflicts of interest are presumed to be sufficient to render the proposed program incapable of accomplishing its stated objectives in the best interest of the participants and shall be controlled as follows:
- (1) No loans may be made by the program to any sponsor or any other person;
  - (2) The funds of a program shall not be commingled with the funds of any other person. Funds used to satisfy margin requirements will not be considered commingling;

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(3) No rebates or give ups may be received by any person nor may any person participate in any reciprocal business arrangements which could circumvent these guidelines. Furthermore, the prospectus and program agreement shall contain language prohibiting the above as well as language prohibiting reciprocal business arrangements which would circumvent the restrictions against dealing with affiliates or other interested parties;

(4) The program agreement shall prohibit the commodity trading adviser or any other person acting in such capacity from receiving an advisory fee if they share or participate, directly or indirectly, in any commodity brokerage commissions generated by the program;

(5) The maximum period covered by any contract of the program with any adviser, clearing broker, sponsor or affiliate thereof shall not exceed one year. Any contract must be terminable without penalty upon 60 days written notice by the program, which provisions shall be set forth in the program agreement;

(6) Any other agreement, arrangement or transactions, proposed or contemplated, may be restricted in the discretion of the commissioner if it would be considered unfair to the participants in the program.

11. Federal tax consequences. The prospectus shall disclose the following tax aspects:

- a. Tax treatment of the program;
- b. Tax treatment of the participants;
- c. Method of allocation of losses or profits and cash distributions;
- d. Any other pertinent information applicable to the tax aspects of the investment; and
- e. The possibility that the filing of state tax returns will be required in the states in which interests are held.

12. Commodities futures markets. At a minimum, the prospectus should disclose the following characteristics of the commodities markets:

- a. That the commodities markets are extremely volatile and the risk of loss is great;
- b. The procedures used in trading commodities futures contracts including, but not limited to, the margin requirements on the commodities to be invested in by the program, the exchanges or board of trade on which the program anticipates trading, and a description of the applicable exchange requirements.

13. Licensing and regulation. The prospectus shall disclose any licensing or registration requirements of the program, including those imposed by the Commodity Futures Trading Commission.

14. Prohibitions. The prospectus shall disclose that the program agreement specifically prohibits the following activities:

- a. A program shall not engage in pyramiding;
- b. A program shall not utilize borrowing;
- c. A program shall not enter into an open position during a delivery month;
- d. A program shall not permit the investment of its funds deemed "customer's funds" under the Commodity Exchange Act, as amended, in any securities other than as permitted by the Commodity Futures Trading Commission;
- e. A program shall not commit more than 15 percent of its equity in the trading account at any time for margin in any one commodity irrespective of the delivery month. For this purpose gold and silver bullion, coins and futures contracts shall be considered one commodity;
- f. A program's trading policy shall specifically exclude the purchasing, selling, writing or trading in commodity options or purchasing or selling securities, other than those mentioned in C.14.d.;
- g. A program shall not engage in cash commodity transactions unless the cash commodity is fully hedged;
- h. A sponsor shall not commit more than two-thirds of the net assets of a program as margin for commodity futures contracts and the balance of such assets shall be retained in cash or cash equivalent to apply as needed for additional margin or for redemption;
- i. A sponsor shall not permit the churning of the program's account so as to generate a commission for itself or for the benefit of any other person.

15. Notification. Each participant shall be notified within seven business days from the date of any decline in the net value per unit to less than 50 percent of the amount on the last valuation date. Included in the notification shall be a description of the participants' voting rights pursuant to 4 MCAR § 1.2143B.

16. Material changes. Any material changes in the program's basic investment or trading policies or structure shall require prior written approval by a majority of program interests held by participants. This shall include, specifically, any transfer or withdrawal of any sponsor's required interest in the program.

17. Summary of any limited partnership agreement or other program agreement.

18. Legal proceedings. Briefly describe any legal proceedings to which the program or any person is or was a party which is material to the program and any material legal proceedings between any sponsor and participants in any prior program of the sponsor.

19. Financial information required on application. A sponsor and the program shall provide as an exhibit to the application for registration or where indicated below shall provide as part of the prospectus, the following financial information and financial statements:

a. Balance sheet of the program. As part of the prospectus, a balance sheet of the program as of the end of its most recent fiscal year, prepared in accordance with generally accepted accounting principles and accompanied by an auditor's report without material qualification by an independent certified public accountant or an independent public accountant, and an unaudited balance sheet as of a date not more than 90 days prior to the date of filing:

b. Balance sheet of a sponsor.

(1) Corporate Sponsor. A balance sheet of a corporate sponsor as of the end of its most recent fiscal year, prepared in accordance with generally accepted accounting principles and accompanied by an auditor's report without material qualification by an independent certified public accountant or an independent public accountant and an unaudited balance sheet as of a date not more than 90 days prior to the date of filing. Such statements shall be included in a prospectus.

(2) Individual Sponsor. A balance sheet for each individual sponsor as of a time not more than 90 days prior to the date of filing an application; such balance sheet may be audited and should conform to generally accepted accounting principles and shall be signed and sworn to by such sponsor. A representation of the amount of such net worth must be included in the prospectus:

c. Statement of income for corporate sponsor. A statement of income for the last fiscal year of a corporate sponsor (or for the life of a corporate sponsor, if less) prepared in accordance with generally accepted accounting principles and accompanied by an auditor's report without material qualification by an independent certified public accountant or independent public accountant, and an unaudited statement for any interim period ending not more than 90 days prior to the date of filing an application.

#### 4 MCAR § 1.2146 Miscellaneous provisions.

A. Fiduciary duty. The program agreement shall provide that the sponsor(s) shall have fiduciary responsibility for the safekeeping and use of all funds and assets of the program, whether or not in its immediate possession or control, and that it shall not employ, or permit another to employ, such funds or assets in any manner except for the exclusive benefit of the program.

B. Redemptions. The program shall provide an opportunity at least quarterly for the redemption of program interests at the net asset value as of the valuation dates upon the written request of any participant. The participant must notify a sponsor of his intent to redeem at least 30 days prior to the redemption date. The prospectus and program agreement must indicate the valuation dates for redemption. Such requests must be honored within 30 days following the valuation date, unless the quantity of redemptions would be detrimental to the tax status of the program. In that case, redemptions may be selected by lot, and participants notified within 30 days whether or not their program interests were redeemed. The program agreement may provide for the suspension of redemptions if the effect of substantial redemptions would impair the ability of the program to operate in pursuit of its objectives.

#### 4 MCAR §§ 1.2147-1.2149 Reserved for future use.

#### 4 MCAR § 1.2150 Waiver.

A. The requirements of subchapters 4, 5, 6, 7, and 8 may be waived by the commissioner upon proof of substantial compliance with rules, statements of policy or guidelines of national or regional securities regulatory organizations composed of securities administrators of this and other states.

B. Any such waiver shall be based upon a determination by the commissioner that compliance with such rules, statements of policy or guidelines is:

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1. consistent with the purposes fairly intended by the policy and provisions of Minn. Stat. §§ 80A.01 to 80A.31 (1978), as amended.

2. appropriate for the protection of investors, and

3. promotive of uniformity of regulation.

4 MCAR § 1.2151 A diamond, ruby, emerald, or sapphire constitutes an "investment gem" pursuant to Minn. Stat. § 80A.14(j) (1978), as amended.