STATE OF CALIFORNIA – BUSINESS, TRANSPORTATION AND HOUSING AGENCY

GRAY DAVIS, *Governo*

DEPARTMENT OF CORPORATIONS
SACRAMENTO, CALIFORNIA

IN REPLY REFER TO:
FILE NO: OP 6757

COMMISSIONER'S OPINION 99/2C

THIS INTERPRETIVE OPINION IS ISSUED BY THE COMMISSIONER OF CORPORATIONS PURSUANT TO SECTION 25618 OF THE CORPORATE SECURITIES LAW OF 1968. IT IS APPLICABLE ONLY TO THE TRANSACTION IDENTIFIED IN THE REQUEST THEREFOR, AND MAY NOT BE RELIED UPON IN CONNECTION WITH ANY OTHER TRANSACTION.

Mr. Willie R. Barnes
Musick, Peeler & Garrett LLP
One Wilshire Boulevard
Los Angeles, CA 90017-3383

Dear Mr. Barnes:

The request for an interpretive opinion contained in your letter dated June 15, 1999, as supplemented by your letter of October 6, 1999, has been considered by the Commissioner of Corporations ("Commissioner").

Your letters ask the Commissioner to consider whether the placement of orders to purchase and sell American depository receipts of foreign issuers ("ADRs") by Mercury Asset Management Advisors ("Mercury") in the secondary market pursuant to specified investment advisory programs, under the circumstances described by you, will occur "in this state" as defined in Corporations Code Section 25008 for purposes of the qualification requirement of Corporations Code Section 25130. In our opinion, and based on the representations and assumptions stated below, this question must be answered in the negative.

Given the representations contained in your letters, we understand the relevant facts to be as follows:

Merrill Lynch, Pierce, Fenner & Smith ("Merrill Lynch") is a Delaware corporation and a registered broker-dealer under the Securities Exchange Act of 1934, with offices in California. Merrill Lynch proposes to engage in two investment advisory programs (the "Programs"). To carry out the Programs, agents of Merrill Lynch will refer their California-resident clients ("clients") to Merrill Lynch's affiliate, Mercury. Mercury is a division of Merrill Lynch Asset Management L.P., a Delaware limited partnership and a registered investment adviser under the Investment Advisers Act of 1940. Other than these referrals to Mercury, agents of Merrill Lynch will make no other recommendations or advice to their clients in connection with ADRs offered or sold under the Programs. As compensation for referrals to Mercury, agents will receive a specified portion of a wrap fee (i.e., a single fee that covers both portfolio management and brokerage commissions) charged by Mercury in accordance with an investment advisory agreement as described below.

Under the Programs, the client will enter into an investment advisory agreement with Mercury. Pursuant to this agreement, Mercury will conduct investment management services for the client from its office in Princeton, New Jersey rather than any office in California. In performing these services, Mercury will maintain a separate advisory account for the client at Merrill Lynch's principal office located in New York City. Each advisory account will require a minimum investment by the client (i.e., a minimum investment of $100,000 for one program, and $250,000 for the other program). The client will grant Mercury "full discretion" to manage the client's account under the Programs; thus, Mercury will buy and sell ADRs without any prior consultation or approval from the client. However, clients will receive periodic portfolio valuations and reports on investment strategy from Mercury. For these services, Mercury will charge a specified wrap fee pursuant to its agreement with the client.

In addition, clients will have no involvement in the ADR transactions conducted under the Programs, since offers and sales pursuant to the orders placed by Mercury will occur entirely in the states of New Jersey and New York. Orders for the purchase and sale of ADRs by Mercury from its office in Princeton, New Jersey will be executed by Merrill Lynch at its principal office in New York City. There, Merrill Lynch will act as custodian of the client's ADRs, utilizing the book-entry facilities of The Depository Trust Company. Moreover, the delivery of, and payment for, the ADRs will occur in New York City. Clients will receive confirmations of trades and periodic account statements from the New York City office of Merrill Lynch.

Finally, at all times during the Programs, Merrill Lynch and its agents, as well as Mercury, will comply with the appropriate licensing and notification requirements of the Corporate Securities Law of 1968. That is, Merrill Lynch will be licensed as a broker-dealer in California under Corporations Code Section 25211(b); its agents will be "approved" pursuant to Commissioner's Rule 260.210 (Title 10, California Code of Regulations, Section 260.210); and Mercury will comply with the notice filing requirement for certain investment advisers in accordance with Corporations Code Section 25230.1(b).

Corporations Code Section 25130 of the Corporate Securities Law of 1968 imposes a qualification requirement on persons offering and selling securities in this state in any nonissuer transaction, as defined, unless an exemption is available or the security or transaction is not subject to qualification. Corporations Code Section 25008(a) provides that an offer or sale of a security is made in this state when an offer to sell is made in this state or an offer to buy is accepted in this state or (if both the seller and the purchaser are domiciled in this state) the security is delivered to the purchaser in this state.

Assuming that the limited communications described by you with any client in California will relate solely to the Programs and will not involve any offer to sell (or any acceptance of an offer to buy) ADRs; and assuming further that those offers or acceptances (together with payment, delivery and custody of ADRs) will occur entirely outside California pursuant to a discretionary advisory account as described by you, we conclude that the offer and sale of ADRs by Mercury under the Programs will not occur "in this state" for purposes of the qualification requirement of Corporations Code Section 25130. (E.g., see Comm. Op. No. 69/25 where the Commissioner concluded that the offer and sale of securities must factually occur in this state to apply the qualification requirement of the Corporate Securities Law of 1968.)

Dated: November 22, 1999
Sacramento, California

WILLIAM KENEFICK
Acting Commissioner of Corporations
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June 15, 1999

VIA FEDERAL EXPRESS

Mr. William Kenefick
Assistant Commissioner
Department of Corporations
980 9th Street, Suite 500
Sacramento, California 95814-2724

RECEIVED
DEPT OF CORPORATIONS
OFFICE OF POLICY
99 JUN 16 AM 10: 50

Re: Merrill Lynch, Pierce, Fenner & Smith Incorporated

Dear Mr. Kenefick:

Following our meeting with you and Timothy LeBas on May 19, 1999, we are writing, pursuant to Section 25618 of the California Corporate Securities Law of 1968 ("CSL") and Rule 250.12 thereunder, to obtain a formal interpretive opinion from the Commissioner of Corporations based upon the facts set forth below.

FACTS:

A California resident either has or establishes a brokerage account with Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S"), a Delaware corporation and a registered broker-dealer under the Securities Exchange Act of 1934 ("Exchange Act"). MLPF&S has offices in California and elsewhere. The person's broker or financial consultant ("FC"), who is also located in California, refers the client to Mercury Asset Management Advisors ("MAMA"), a division of Merrill Lynch Asset Management, L.P. ("MLAM"), a Delaware limited partnership and a registered investment adviser under the Investment Advisers Act of 1940 ("Advisers Act"). MLAM is an affiliate of MLPF&S.[1/] MAMA has its

1/ MLPF&S and MLAM are separate entities within a financial services holding company the ultimate parent of which is Merrill Lynch & Co., Inc. ("Merrill Lynch"), a Delaware corporation. The employees of MLPF&S and MLAM are entirely different, and the

(continued...)

office in Princeton, New Jersey, where MLAM has its principal place of business. MLAM also has offices in other locations, including California, none of which would be involved in the advisory programs described herein.

Under the proposed arrangement, MAMA would provide investment management services to clients whose objective is long-term capital appreciation through investment in equity securities, including American depositary receipts ("ADRs"), of issuers located outside the United States. These services would be provided under a "wrap-fee" arrangement (whereby the client pays a single fee which covers both portfolio management and brokerage commissions) giving MAMA full discretion to manage some portion of the client's assets. Pursuant to the agreement, MAMA buys and sells securities for the client's advisory account without any prior consultation with, or approval from, the client with respect to individual security transactions. The FC maintains a liaison with the client regarding the advisory account but does not make any recommendations or otherwise offer any advice with respect to the securities in that advisory account.

The trades are executed by MLPF&S, where MAMA maintains a separate account for the client, from its principal office in New York City. MLPF&S acts as custodian of the client's portfolio and utilizes the book-entry facilities of The Depository Trust Company in New York City.

The client receives confirmations of the trades and periodic account statements from MLPF&S and quarterly individual portfolio valuations and reports on investment strategy from MAMA. The client is billed separately by MAMA (which fee may be paid directly by the client or deducted from the client's portfolio).

Certain of the ADRs purchased for the advisory account would not be qualified under the CSL or be exempted therefrom

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1/(...continued)

operations of each are separate from one another. MAMA is a United States affiliate of Mercury Asset Management International Ltd. ("MAMI"), an English company based in London. MAMI is a subsidiary of Mercury Asset Management Group Ltd., which in turn is a wholly-owned subsidiary of Merrill Lynch. As of March 31, 1999, the Mercury Asset Management group managed approximately $251 billion on behalf of investors around the world.

because they represent securities of foreign issuers which (i) do not have any securities listed on a national securities exchange or (ii) are not filing reports under the Exchange Act or (iii) do not meet (or MLPF&S does not know whether the issuer meets) certain financial tests.[2/] All of the securities purchased for the advisory account would be outstanding securities in the secondary market and none would represent initial issuances. The FC, MLPF&S and MAMA, as a division of MLAM, are all duly approved, licensed or noticed in California.

Two advisory programs would be involved, one where the client has a direct relationship with MAMA and the other where the client participates in the Merrill Lynch Consults Service ("Consults"). In either case, the investment adviser has full discretion to manage the client's assets allocable to the program. Consults requires a minimum account size of $100,000; MAMA, as a stand-alone investment advisory service, has a minimum investment size of $250,000. Consults is a service offered by MLPF&S in which the client completes a questionnaire to determine his or her overall investment profile, and the client is offered the opportunity to select from a number of affiliated and unaffiliated advisers to MLPF&S.

If the client selects MAMA as an adviser under the Consults program, the client would enter into a three-way agreement among the client, MLPF&S and MAMA. The client would receive ongoing performance profiles from Consults comparing the performance of MAMA against other advisers in the program and against certain industry performance indexes. If the client selects MAMA as a stand-alone investment advisory service, the investment advisory agreement is a two-way agreement between MAMA and the client, and the client would receive his or her performance reports from MAMA without MLPF&S involvement.

2/ We have assumed for purposes of this letter that Rule 260.105.11, which exempts from the provisions of Section 25130 of the CSL securities of certain foreign issuers, would not necessarily be available to all of the transactions described herein. It is expected that most of the ADRs will be securities invested in by Mercury International Fund, a portfolio of a "master/feeder" fund advised by MAMI and registered under the Investment Company Act of 1940, in which the average market capitalization of the portfolio companies currently is over $30 billion.

As compensation for referring the client to MAMA, the FC will receive a "production credit" equal to approximately two-thirds of the amount of the wrap fee charged on the advisory account. A portion of the production credit (generally one-third to one-half) is paid to the FC in cash. The standard wrap fee equals three percent per year of assets under management. For example, the standard wrap fee on a $100,000 account would be $3,000. The FC's production credit would be $2,000. The hard dollar payout to the FC would be within the range of $666 to $1,000. Since the compensation is asset-based and not transaction-based, the FC's compensation will depend upon the success of portfolio management and not on the amount of trading in the advisory account.

ISSUE:

Would the transactions, pursuant to which the affiliated investment adviser buys and sells securities on behalf of the client, a resident of California, which transactions are executed by the broker-dealer outside of California, be deemed to occur outside of California, so that the securities bought and sold for the client's advisory account would not have to be qualified under California law or be exempted therefrom?

CONCLUSION:

Based upon our review of the applicable law, our answer to this question is in the affirmative. Where the transactions for a California resident, who is a client of a broker-dealer with offices in California, are executed outside of California by the broker-dealer pursuant to orders placed by that broker-dealer's affiliated investment adviser, which is located outside of California and which is acting pursuant to an advisory agreement under a wrap-fee arrangement (whereby the client pays a single fee which covers both portfolio management and brokerage commissions) giving the investment adviser full discretion to manage certain of the client's assets, the transactions occur outside of California. Therefore, any securities bought and sold for the client's advisory account are not subject to the CSL.

DISCUSSION:

The CSL regulates the activities of persons conducting a securities business in California by requiring, among other things, the licensing of broker-dealers and investment advisers as well as other professionals. Thus, for example, in the case of broker-dealers, Section 25210(a) of the CSL provides as follows:

> Unless exempted under the provisions of Chapter 1 (commencing with Section 25200) of this part, no broker-dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any security in this state unless such broker-dealer has first applied for and secured from the commissioner a certificate, then in effect, authorizing that person to act in that capacity.

While MLPF&S is not effecting any specific transaction in securities in California under the scenarios that we have outlined, it is our view that MLPF&S is generally inducing or attempting to induce the purchase or sale of securities in California by referring certain of its brokerage clients to its investment adviser affiliate, MAMA. Consequently, we believe that any broker-dealer offering a program such as the ones described in this letter to California residents must be appropriately licensed in California. In our case, MLPF&S is a broker-dealer licensed pursuant to Section 25211(b) of the CSL.

In the case of agents, Section 25210(b) of the CSL provides as follows:

> No person shall, on behalf of a broker-dealer licensed pursuant to Section 25211, or on behalf of an issuer, effect any transaction in, or induce or attempt to induce the purchase or sale of, any security in this state unless that broker-dealer and agent have complied with any rules as the commissioner may adopt for the qualification and employment of those agents.

In this regard, Rule 260.210(b) under the CSL requires prior approval of the Commissioner before an agent may represent a broker-dealer.

Similarly, the FC may be said to be inducing or attempting to induce the purchase or sale of securities in California by referring certain of his or her clients to MAMA. In our case, the FC would be an agent approved pursuant to Rule 260.210 under the CSL.

In the case of investment advisers, Section 25230(a) of the CSL provides as follows:

> It is unlawful for any investment adviser to conduct business as an investment adviser in this state unless the investment adviser has first applied for and secured from the commissioner a certificate, then in effect, authorizing the investment adviser to do so or unless the investment adviser is exempted by the provisions of Chapter 1 (commencing with Section 25200) of this part or unless the investment adviser is subject to Section 25230.1.

In the case of an investment adviser that is registered with the Securities and Exchange Commission under the Advisers Act, Section 25230.1(a) of the CSL provides as follows:

> A person that is registered under Section 203 of the Investment Advisers Act of 1940 as an investment adviser is not subject to the requirement of obtaining a certificate under Section 25230, but may not conduct business in this state unless the person has fewer than six (6) clients as specified in Section 25202 or unless the person first complies with [the notice filing provision of] subdivision (b). . . .

By entering into a contract with the client to perform investment advisory services, MAMA, as a division of MLAM, may be said to be conducting business as an investment adviser in California. In our case, MAMA is included within the notice filing made by MLAM pursuant to Section 25230.1(b) of the CSL.

The CSL also regulates transactions in securities in California by requiring, among other things, the qualification of securities offered and sold in California unless an exemption from qualification is available. Thus, for example, in the case of secondary market transactions, Section 25130 of the CSL provides as follows:

> It is unlawful for any person to offer or sell any security in this state in any nonissuer transaction unless it is qualified for such sale under this chapter or under Section 25111 or 25113 of Chapter 2 (commencing with Section 25110) of this part (and no order under Section 25140 or subdivision (a) of Section 25143 is in effect with respect to such qualification) or unless such security or transaction is exempted or not subject to qualification under Chapter 1 (commencing with Section 25100) of this part.

As to what activities constitute the offer or sale of a security in California, Section 25008 of the CSL provides as follows:

> (a) An offer or sale of a security is made in this state when an offer to sell is made in this state, or an offer to buy is accepted in this state, or (if both the seller and the purchaser are domiciled in this state) the security is delivered to the purchaser in this state. An offer to buy or a purchase of a security is made in this state when an offer to buy is made in this state, or an offer to sell is accepted in this state, or (if both the seller and the purchaser are domiciled in this state) the security is delivered to the purchaser in this state.
>
> (b) An offer to sell or to buy is made in this state when the offer either originates from this state or is directed by the offeror to this state and received at the place to which it is directed. An offer to buy or to sell is accepted in this state when acceptance is communicated to the offeror in this state; and acceptance is communicated to the offeror in this state when the offeree directs it to the offeror in this state reasonably believing the offeror to be in this state and it is received at the place to which it is directed. A security is delivered to the purchaser in this state when the certificate or other evidence of the security is directed to the purchaser in this state and received at the place to which it is directed.
>
> . . .

Marsh and Volk, in their treatise on the CSL, state:

> The general result of these provisions is that the qualification provisions of the statute apply to the following:
>
> (1) offers made from California to persons outside the state;
>
> (2) offers made from outside the state to persons inside the state;
>
> (3) contracts of sale formed by an acceptance directed to a person in this state (whether from inside or outside the state and whether the offer was made inside or outside the state; and
>
> (4) transactions where the certificate representing the security is directed to the purchaser inside this state provided both the purchaser and the seller are domiciliaries of California (regardless of where the offer or contract of sale was made).

1 Harold Marsh, Jr. & Robert H. Volk, Practice Under the California Securities Laws § 3.08[1] (rev. ed. 1998) (footnotes omitted).

In our case, while the FC, MLPF&S and MAMA are conducting business in California and need to be licensed or noticed therein, the transactions in the client's portfolio will take place between MAMA and MLPF&S outside of California and, therefore, those transactions are not subject to the CSL. Thus, Marsh and Volk also state:

> If the transaction is entirely carried out by offer, acceptance and delivery of the security outside the boundaries of California, then the qualification provisions of the statute have no application, regardless of the domicile of any of the parties or the state of incorporation of the corporation issuing the securities.

1 Marsh & Volk, *supra*, § 3.08[2] (footnote omitted).

We believe that a conclusion that qualification of the securities in the circumstances that we have described is not

required would be consistent with several Commissioner's Interpretive Opinions regarding California issuers of securities. For example, in Interpretive Opinion No. 69/25, dated April 3, 1969, the Commissioner was asked to rule on whether the issuance of debentures of a Delaware corporation, then being organized and to have its principal place of business in California, which debentures were guaranteed by the issuer's parent (itself a California corporation with its principal place of business in California) and convertible into common shares of the parent, to certain overseas purchasers represented by a London, England, firm, where all offers to sell and all offers to purchase the debentures would be made overseas, the closing of the sale of the debentures held in London and the delivery of the debentures made there, will take place "in this state" within the meaning of Section 25008 and Section 25100 of the CSL.

In ruling that the sale of the issuer's debentures, including the right to convert them into the common shares of the parent, as well as the guarantee of the debentures by the parent, will not take place in California, the Commissioner stated that it was the intent of the committee which drafted the CSL, and the intent of the legislature which adopted the draft prepared by the committee with no amendments insofar as Section 25008 was concerned, "to apply the qualification requirements of the law equally to all issuers of securities, whether or not incorporated or situated in California, *only if the offer or sale takes place in this state."* (Emphasis added.)

To the same effect is Interpretive Opinion No. 69/30, dated April 17, 1969, in which the sales of shares in several transactions of a California corporation whose principal place of business was in California and affiliated corporations were deemed not to occur "in this state" for purposes of Section 25008, where the transactions related to the sale of the shares were negotiated by the corporation's president in Arizona, all agreements related to such sales were prepared and executed in that state and all securities would be delivered outside of California.

Therefore, in our opinion, while the initial solicitation by MLPF&S of the client's interest in a discretionary investment advisory program by MAMA, and the subsequent execution by the client of an agreement with MAMA, occurred in California (thus requiring proper licensing or notification of the broker-dealer and the investment adviser), the offer and sale of the securities, including the execution by MLPF&S in New York of the orders placed

by MAMA from New Jersey for such client's account, the delivery against payment of the securities in New York, and the custody of the securities maintained by MLPF&S in New York all occur outside of California. Therefore, we conclude that any ADRs or other securities purchased for the client's portfolio are not subject to the CSL.

We trust that you will be able to render a favorable opinion based upon the facts presented herein. If you have any questions or need additional information, please do not hesitate to contact the undersigned.

Very truly yours,

Willie R. Barnes
for MUSICK, PEELER & GARRETT LLP

WRB:vm

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October 6, 1999

VIA FEDERAL EXPRESS

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Senior Corporations Counsel
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RECEIVED
OCT 07 1999
DEPT OF CORPORATIONS
OFFICE OF POLICY

Re: Merrill Lynch, Pierce, Fenner & Smith Incorporated

Dear Mr. LaBas:

This letter responds to the questions you raised in our telephone conversations of September 28 and 30, 1999 and constitutes a supplement to our letter dated June 15, 1999 requesting an interpretive opinion that the transactions in the client's portfolio, as described in that letter, do not take place in California, and, therefore, such transactions are not subject to the Corporate Securities Law of 1968, as amended ("CSL").

In response to your question requesting a description of the California resident who, as a client of Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S"), may participate in the two advisory programs,[1/] please be advised that the client, in addition to having a brokerage account with MLPF&S, must satisfy a minimum investment requirement. The Consults Program requires a minimum account size of $100,000; the stand-alone investment advisory service with Mercury Asset Management Advisors ("MAMA") requires a minimum investment size of $250,000.

With respect to your inquiry concerning the duties or responsibilities of the client's broker or financial consultant ("FC"), please be advised that the FC does not give advice to the

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1/ Page 3 of our letter dated June 15, 1999 describes the two investment advisory programs.

client on sales or purchases of securities made or effected through the investment advisory agreement with MAMA or any other affiliated or non-affiliated investment advisor. MAMA, or in the case of the Consults Program, MAMA or any other investment advisor in the Program, buys or sells securities for the client's advisory account, without any prior consultation with or approval from the client or the client's FC with respect to individual security transactions. Of course, the client's FC may handle other normal brokerage transactions for the client, and, where appropriate, provide general advice to his or her client. It is possible, for example, as part of the general services provided to the client, the FC may review the performance of the separate advisory account and may even advise his client to terminate the advisory program. As noted on page 1 of our letter dated June 15, 1999, the FC, who is located in California, refers the client to MAMA. In such case, the client enters into an investment advisory agreement with MAMA and in the case of the Consults Program the client would enter into a three-way agreement among the client, MLPF&S and MAMA. Please refer to the last paragraph on page 3 of our letter dated June 15, 1999. While the FC may perform standard brokerage services for the client with respect to other transactions, the FC has no involvement, directly or indirectly, in the investment advisory contracts between MAMA and the client.

You also asked us to comment, in light of Commissioner's Opinion No. 72/58C, on whether the proposed advisory agreements are separate securities and, thus, required to be qualified in California unless an exemption from qualification is required. As we discussed in our telephone conversations, it is our opinion that neither the investment advisory agreement between MAMA and the client nor the three-way investment advisory agreement among the client, MLPF&S and MAMA is a separate security subject to the qualification requirements of the CSL. We have reviewed Commissioner's Opinion No. 72/58C. In that case, the Commissioner concluded that an agreement between a company and a California resident whereby the company agreed to assist the resident in the investment of between $30,000 and $50,000 in oil and gas investments was an "investment contract" and, therefore, was a "security" within the meaning of Section 25019. While not specifically stated in the opinion, it is apparent that the particular company was not licensed as an investment advisor. It obtained funds from individuals, invested those funds in oil, gas and mineral properties, ventures and operations in the United States and Canada, had control of the management of the investments of those funds in what appears to be "working interests" in oil and gas properties. It also had unrestricted authority to perform all acts necessary in its sole discretion to accomplish the purposes of

the agreement and, in addition to other so-called fees, participated in the net profits received by the client. The facts in that case are inapposite to the facts in this case or the facts in the typical investment advisory contract.

Moreover, the Commissioner has ruled that a discretionary account maintained by a customer with an investment advisor is not a security. Commissioner's Opinion No. 71/42C. The relevant facts in this opinion show that (i) a corporation ("A") was certified as an investment advisor and through salesmen of certified broker-dealers, solicited investment accounts having a minimum size of $10,000, (ii) the person procuring an account for "A" was paid a percentage of the money he or she brought in, (iii) "A" managed those accounts and was paid a yearly fee, and (iv) all orders in these accounts were executed through broker-dealers. In concluding that the accounts managed by "A" for its clients are not investment contracts, the Commissioner stated:

> When agreeing to have "A" manage its funds the clients are employing "A" as their agent to invest their funds in securities of other entities and by means of such securities, in the respective businesses of these other entities, and not in the business of "A." Any profits received by the clients will be derived from the efforts of the personnel responsible for the operation of the various entities in which their funds are invested through the agency of "A." Accordingly, it is our opinion that under the circumstances described . . . the accounts managed by "A" for its clients are not "securities" within the meaning of Section 25019.

As we discussed on page 8 of our June 15, 1999 letter, the transactions in the client's portfolio will take place between MAMA and MLPF&S outside of California. <u>The only California contact with these transactions is the residence of the client</u>. Therefore, those transactions are not subject to the CSL. As previously discussed, Corporations Code Section 25008 provides that California jurisdiction will attach if any one of the three following elements takes place in the State of California:[2/]

2/ As noted in our letter dated June 15, 1999, all of the securities purchased for the advisory account would be outstanding securities in the secondary market and none would represent initial issuances.

1. The offer to sell is made in California.

In the proposed transaction, any offer to sell securities will not be made in California since such offer will involve only MAMA and MLPF&S, both of which will be acting outside California. The client residing in California will have no involvement in the transaction since he/she has delegated to the investment advisor the authority to act on his/her behalf.

2. An offer to buy is accepted in California.

In the proposed transaction, any offer to buy securities will not be accepted in California since such offer will involve only MAMA and MLPF&S, both of which will be acting outside California. The client residing in California will have no involvement in the transaction since he/she has delegated to the investment advisor the authority to act on his/her behalf. While the client will receive, from time to time, confirmations of the trades and periodic account statements from MLPF&S and quarterly individual portfolio valuations and reports on investment strategy from MAMA, such communications cannot be deemed the acceptance of an offer to buy or sell resulting in a contract of sale.

3. The security is delivered to the purchaser in California if both the seller and the purchaser are domiciled in this state.

In the proposed transaction, no security will be delivered to any purchaser in California since any certificates evidencing securities purchased will be delivered and custody thereof will be maintained outside of California, where both MAMA and MLPF&S will be acting. The client, a resident of California, will have no involvement in this transaction because, as noted in item 1 above, he/she has delegated to the investment advisor the authority to act on his/her behalf.

In summary, the offer to sell and the offer to buy securities in the client's portfolio will take place outside of California; and any certificate evidencing securities purchased will be delivered and maintained outside of California. Therefore, irrespective of the domicile of the client, transactions in the client's portfolio as described above do not take place in California and, accordingly, such transactions are not subject to the qualification provisions of the CSL.

Marsh & Volk, in their treatise on the CSL, state:

> "If the transaction is entirely carried out by offer, acceptance and delivery of the security outside the boundaries of California, then the qualification provisions of the statute have no application, regardless of the domicile of any of the parties or the state of incorporation of the corporation issuing the securities."

1 Harold Marsh Jr. & Robert H. Volk, Practice Under the California Securities Laws, § 3.08[2] (rev.ed. 1998).

If you have any further questions, please call me at your earliest convenience.

Very truly yours,

Willie R. Barnes
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WRB:vm
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