FINAL STATEMENT OF REASONS
FOR RULE CHANGES UNDER THE
CORPORATE SECURITIES LAW OF 1968

As required by Section 11346.2 of the Government Code, the Commissioner of Corporations ("Commissioner") sets forth below the reasons for the proposed adoption of Section 260.402 of the California Code of Regulations (10 C.C.R. Sec. 260.402).

In late October of 2000, the Securities and Exchange Commission (the "SEC") adopted a new regulation, Rule 10b5-1, which, among other things, provides for an "affirmative defense" to allegations of insider trading under the federal securities laws.

Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") provides, in relevant part:

> It shall be unlawful for any person, […] (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive devise or contrivance in contravention of such rules and regulations as the SEC may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Pursuant to this section of the Exchange Act, the SEC subsequently adopted Rule 10b-5, which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

This rule has subsequently been interpreted to prohibit a corporate insider from trading on the basis of material, nonpublic information.

The SEC's new regulation, Rule 10b5-1, sets forth an "affirmative defense" to allegations of "insider trading," i.e., a corporate insider trading on the basis of material, nonpublic information.

Generally, the SEC rule provides that a purchase or sale of a security is not "on the basis" of material, non-public information if the person making the purchase or sale demonstrates that before becoming aware of the information, the person had (1) entered into a binding contract to purchase or sell a security, (2) instructed another person to purchase or sell the security for his or her accounts, or (3) adopted a written plan for trading securities. The contract, instruction or plan is subject to further conditions, as set forth in the rule.

California's Corporate Securities Law of 1968 (the "CSL") also prohibits insider trading. Section 25402 provides as follows:

> It is unlawful for an issuer or any person who is an officer, director or controlling person of an issuer or any other person whose relationship to the issuer gives him access, directly or indirectly, to material information about the issuer not generally available to the public, to purchase or sell any security of the issuer in this state at a time when he knows material information about the issuer gained from such relationship which would significantly affect the market price of that security and which is not generally available to the public, and which he knows is not intended to be so available, unless he has reason to believe that the person selling to or buying from him is also in possession of the information.

Thus, the CSL prohibits insider trading when the following elements are present:

1. a relationship (e.g., an officer, director, or control person) with the issuer provides access to knowledge of facts that are material,

2. knowledge of facts which are material at the time of the transaction (whether the person knows that the facts are material or not),

3. the material information is such that it would significantly affect the market price of the issuer's securities, and

4. knowledge that the information is not available to the public.

Neither the CSL nor the rules adopted thereunder address the point in time at which the nonpublic information becomes disqualifying for purposes of materiality. As a result, the business community has been unable to rely upon the federal rule 10b5-1, which provides an "affirmative defense" to the federal prohibition on insider trading, because of the uncertainty in the interpretation of California's statute.

The proposed rule 260.402 seeks to define when an issuer or corporate insider is purchasing or selling a security at a time when he or she knows material information about the issuer. The rule provides that purchases or sales made in accordance with an instruction, contract or plan meeting the requirements and conditions of Rule 10b5-1(c) are not at a time when the issuer or insider knows material information about the issuer.

The Department of Corporations is adopting this regulation to clarify that an issuer or "insider" (as described in Section 25402) does not have knowledge of material information when purchasing or selling a security in accordance with SEC Rule 10b5-1(c) [17 CFR 240.10b5-1(c)]. Essentially, the clarification provides that an issuer or insider shall not be deemed to have knowledge of material information about the issuer at a time when the insider purchased or sold the issuer's security, if the issuer or the insider demonstrates that the purchase or sale of the issuer's security was in accordance with the requirements and conditions of the SEC rule. In other words, the purchase or sale of the issuer's securities by an issuer or insider is in accordance with an instruction, contract or plan meeting the requirements and conditions of Rule 10b5-1(c).

ALTERNATIVES CONSIDERED

No alternative considered by the Department or that has otherwise been identified and brought to the attention of the Department would be more effective in carrying out the purpose for which the regulation is proposed, would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses.

FISCAL IMPACT

Cost to local agencies and school districts required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code: None.

No other nondiscretionary cost or savings are imposed on local agencies.

DETERMINATIONS

The Commissioner has determined that the proposed regulatory action does not impose a mandate on local agencies or school districts, which require reimbursement pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

Facts evidence, documents, testimony, or other evidence upon which the agency relies to support a finding that the action will not have a significant adverse economic impact on business

ADENDUM REGARDING PUBLIC COMMENTS

No request for hearing was received during the 45-day public comment period which ended on June 18, 2001. No public hearing was scheduled or heard.

COMMENTS RECEIVED DURING THE 45-DAY COMMENT PERIOD

Five comment letters were received during the public comment period. These comment letters are summarized below.

COMMENTOR 1: . Morris Young, President, CEO, American Xtal Technology Inc., letter dated March 13, 2001.

COMMENTS. The comment contained in this letter supports the adoption of the rule as proposed.

COMMENTOR 2: Cary Klafter, Director of Corporate Affairs in the Legal Department of Intel

Corporation, e-mail dated March 16, 2001.

COMMENTS. The comment contained in this letter supports the adoption of the rule as proposed.

COMMENTOR 3: Frank Lin, President and CEO of Trident MricoSystems, Inc., letter dated March 23, 2001.

COMMENTS. The comment contained in this letter supports the adoption of the rule as proposed.

COMMENTOR 4: Rick D. Kent, CFO & COO, CIDCO, letter dated March 26, 2001.

COMMENTS. The comment contained in this letter supports the adoption of the rule as proposed.

COMMENTOR 5: Keith Paul Bishop of Irell & Manella LLP, letter dated May 10, 2001.

COMMENTS. The comment contained in this letter supports the adoption of the rule as proposed.

RESPONSE TO COMMENTS

Since all comments supported the adoption of the rule, no changes were necessary to the proposed rule.

No other comments were received.