

**NORTH CAROLINA GENERAL ASSEMBLY  
LEGISLATIVE FISCAL NOTE  
(INCARCERATION NOTE G.S. 120-36.7)**

**BILL NUMBER:** SB 1455 3rd Edition  
**SHORT TITLE:** Strengthen Securities Fraud Enforcement Laws  
**SPONSOR(S):** Senators Rand and Dalton

		<b>FISCAL IMPACT</b>				
		<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
		<u><b>FY 2002-03</b></u>	<u><b>FY 2003-04</b></u>	<u><b>FY 2004-05</b></u>	<u><b>FY 2005-06</b></u>	<u><b>FY 2006-07</b></u>
<b>GENERAL FUND</b>						
<b>REVENUE</b>						
<b>Recurring</b>		\$223,350	\$223,350	\$223,350	\$223,350	\$223,350
<b>EXPENDITURES</b>						
<b>Correction</b>	Exact amount cannot be determined; some impact anticipated					
<b>Judicial</b>	Exact amount cannot be determined; impact anticipated					
<b>Secretary of State</b>						
<b>Recurring</b>		\$ 226,692	\$ 233,862	\$ 241,349	\$ 248,581	\$ 256,038
<b>Nonrecurring</b>		\$ 15,990				
<b>ADDITIONAL PRISON BEDS*</b>	Exact amount cannot be determined; some impact anticipated					
<b>POSITIONS:</b>	3 positions in Secretary of State; unknown number in Correction					
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b>	Department of Correction; Judicial Branch; Department of the Secretary of State					
<b>EFFECTIVE DATE:</b>	Sections 4, 9, and 10 become effective on December 1, 2002. Sections 5, 6, 7, and 11 become effective on July 1, 2002. The remainder of the act becomes effective when it becomes a law.					
<i>*This fiscal analysis is independent of the impact of other criminal penalty bills being considered by the General Assembly, which could also increase the projected prison population and thus the availability of prison beds in future years. The Fiscal Research Division is tracking the cumulative effect of all criminal penalty bills on the prison system as well as the Judicial Department.</i>						

**BILL SUMMARY:** Securities fraud committed in North Carolina by any person or any company is subject to both criminal and civil actions, whether or not the company is chartered in North Carolina, and whether or not the security is registered in North Carolina. Criminal violations of the securities fraud laws are punished as Class H felonies, regardless of the amount involved. In civil actions, the statute of limitations for securities fraud is two years and punitive damages are not allowed to be imposed. The Proposed Committee Substitute for Senate Bill 1455 would strengthen various laws prohibiting fraud in securities transactions and dealings by increasing criminal punishment for large-scale securities fraud, expanding civil remedies to recover damages arising from securities fraud, strengthening administrative and criminal powers of securities administrators, and authorizing additional securities investigators.

Section 1 of the bill clarifies that the issuance of false or misleading securities analyses, reports or financial statements constitutes a deceptive or fraudulent manipulation of the market.

Sections 2, 3 and 17 correct an incorrect reference to GAAP (generally accepted accounting principles) accounting standards and allows the Securities Administrator to require audited financial statements.

Sections 4, 5 and 18 amend the civil damages remedies sections to authorize the recovery of punitive damages in addition to actual damages arising from securities fraud.

Section 6 extends the civil statute of limitations under the securities law from two years to five years after the date of the sale of the securities.

Sections 7, 19 and 20 increase the punishment for criminal violations of the Securities Act, the Investment Act and the Commodities Act for losses of \$100,000 or more from a Class H felony to a Class C felony. This change makes the punishment for these types of white-collar crimes consistent with the punishment for other similar white-collar crimes including embezzlement and obtaining property by false pretenses.

Section 8 and the new G.S. 78C-39(a3) in Section 19 make it a Class H felony to willfully interfere with an investigation by the Securities Administrator, including the destruction of records. This statute is similar to the statute that makes it a crime to willfully interfere with an audit by the State Auditor that is punished as a Class 2 misdemeanor. (G.S. 147-64.7A).

Sections 9, 10, and 11 increase renewal fees charged for certain securities registrations from \$100 to \$200, and for amendments to certain filings from \$50 to \$100. These fees have not been increased since at least 1983.

Sections 12 and 16 amend the securities dealers and investment advisors registration laws to prevent the withdrawal of an application after investigation has begun by the Securities Administrator of a person's qualifications for registration.

Sections 13, 14 and 15 recodify an exception for registration as an investment advisor of a person registered under federal law.

Section 21 adds investigations by the Securities Administrator to the list of circumstances when a governmental authority can get access to a customer's financial records held by a financial institution.

Section 22 amends a limited provision of the Administrative Procedures Act to authorize the Secretary of State to adopt temporary rules governing the conduct of administrative hearings.

Section 23 appropriates \$226, 692 for recurring expenses and \$15, 990 for nonrecurring expenses for three additional unsworn securities investigators in the Secretary of State's Securities Division. The increase revenue arising from increases in the fees in Sections 9, 10 and 11 approximates the amount of this appropriation.

Provisions that change the classes of offenses are effective Dec. 1, 2002, and apply to acts committed on or after that date. Provisions relating to fees and the appropriation are effective July 1, 2002. Remainder of the act is effective when it becomes law. (Summary provided by the Research Division of the NC General Assembly)

## **ASSUMPTIONS AND METHODOLOGY:**

### **Secretary of State**

**General Fund Revenue.** Sections 5, 6 and 7 of this bill would increase certain fees that are now charged by the Securities Division of the Secretary of State. The estimated additional revenue is \$223,350 annually.

Specifically, Section 5 would amend G.S. 78A-28(b) to increase the public offerings registration/carryover fee from \$100 to \$200. This fee has only been charged once in the last five to six years because the occurrence of registration statements relating to redeemable securities to be offered for a period in excess of one year is rare. Thus, this increase is not expected to generate any significant additional revenue.

Section 6 would amend G.S. 78A-28(j) to increase the public offering amendment filing fee from \$50 to \$100. For fiscal year 2000-2001, the revenue from this fee was \$50. The proposed increase would generate an additional \$50 annually.

Section 7 would amend G.S. 78A-31(a)(4) to increase the investment company notice filing renewal fee from \$100 to \$200. For fiscal year 2000-2001, the revenue from this fee was \$218,650. Doubling the fee to \$200 is expected to generate an additional \$218,650 annually.

Section 7 would also amend G.S. 78A-31(a)(5) to increase the investment company notice filing amendment fee from \$50 to \$100. For fiscal year 2000-2001, the revenue from this fee was \$4,650. Doubling the fee to \$100 is expected to generate an additional \$4,650 annually.

**General Fund Operating Budget.** The Department estimates that the Securities Division would need three additional unsworn securities investigators at a pay grade of 71 to investigate complaints and to significantly enhance the enforcement of the securities fraud provisions. The cost per investigator is as follows:

<b>Cost per Securities Investigator (Unsworn)</b>			
<b>Recurring</b>		<b>Nonrecurring</b>	
Salary	\$33,284	Furniture/Equipment	\$2,130
Benefits	\$7,145	Computers	\$3,200
Travel	\$28,635		
Communication	\$1,300		
Education/Other Expenses	\$5,200		
<b>Total Recurring</b>	<b>\$75,564</b>	<b>Total Nonrecurring</b>	<b>\$5,330</b>

The total recurring cost for the three investigators is expected to be \$226,692. The nonrecurring cost is expected to be \$15,990. For the front page box, recurring costs are adjusted for annual inflation as determined by *Economy.com*.

**Correction**

To project the impact of a bill on the prison population, the Sentencing Commission uses data based on offense codes from the Administrative Office of the Courts (AOC).<sup>1</sup> Offenses that are infrequently charged or infrequently result in convictions are not assigned offense codes. Most violations of the statutes amended in this bill [G.S. 78A-8 through G.S. 78A-14, G.S. 78C-8(a)(1), G.S. 78C-8(a)(2), and G.S. 78C-8(b)] are not assigned offense codes. This is an indication that violations or convictions are relatively rare. Without offense codes and prior conviction rates, the Sentencing Commission cannot project the impact of this bill.

*Sections 7 and 19* of the proposed legislation would increase the penalty for securities fraud (in the above statutes) from a Class H felony to a Class C felony in instances where the value of the consideration or losses was \$100,000 or more. If, for example, there was one conviction reclassified from Class H to Class C, there would be the need for one additional prison bed in the first year and two additional prison beds in the second year, due to active sentences and probation revocations.

These sections would also increase the punishment for violation of G.S. 78A-9 or G.S. 78C-9 from a Class I felony to a Class H felony. If, for example, there were five convictions reclassified from Class I to Class H, there would be the need for one additional prison bed in the first year and one additional prison bed in the second year.

---

<sup>1</sup> The Sentencing and Policy Advisory Commission prepares inmate population projections annually. The projections used for incarceration fiscal notes are based on December 2001 projections. These projections are based on historical information on incarceration and release rates under Structured Sentencing, crime rate forecasts by a technical advisory board, probation and revocation rates, and the decline (parole and maxouts) of the stock prison population sentenced under previous sentencing acts.

Finally, these sections create a Class 2 misdemeanor for other violations of G.S. 78A-9 and G.S. 78C-9. The Sentencing Commission does not have any historical data from which to estimate the potential impact of this proposal on the prison population. It is not known how many offenders might be sentenced for this offense. In FY 2000-01, 11.8 percent of Class 2 misdemeanor convictions resulted in active sentences. The average estimated time served was 19.1 days. Offenders serving active sentences of 90 days or less are housed in county jails; the Department of Correction (DOC) reimburses county jails for the cost of housing offenders serving active sentences of 30 to 90 days. Therefore, Class 2 misdemeanor convictions that result from the broadening of this statute are not expected to have a significant impact on the prison population.

*Sections 8 and 19* create a new Class H felony offense. Sentencing Commission does not have any historical data from which to estimate the potential impact of this proposal on the prison population. If, for example, there were three Class H felony convictions for these offenses per year, this bill would result in the need for one additional prison bed the first year and two additional prison beds the second year due to active sentences and probation revocations.

*Section 10* of the bill amends G.S. 78D-24 to punish (upon conviction) any person who willfully violates any provision of Chapter 78D (Commodities Act) as a Class H felon if the actual losses caused by the violation are less than \$100,000 and as a Class C felon if the actual losses caused by the violation are \$100,000 or more. Under current law, such a person is punished as a Class I felon. Every five convictions reclassified from Class I to Class H would result in the need for one additional prison bed in the first year and one additional prison bed in the second year. If, for example, there was one conviction reclassified from Class I to Class C, there would be the need for one additional prison bed in the first year and two additional prison beds in the second year.

The chart below describes the impact of each new or amended criminal penalty on the prison system in the first year (2003-04). Please note that due to active sentences and probation revocations, convictions of Class C felonies that lead to one new prison bed in 2003-04 will result in the need for two new prison beds in 2004-05. **If, for example, there was one violation of each of the statutes listed (with losses at least \$100,000) – and each violation resulted in a conviction - there would be the need for 9 new prison beds in the first year and 17 new prison beds in the second year.** Each prison bed costs, on average, \$23,831 to operate annually.

**Increase in Number of Prison Beds in 2003-04 For Every Conviction**

Section/Statute violated	<i>Current Law</i> All losses	<i>Bed increase under SB 1455</i>	
		Losses less than \$100,000	Losses at least \$100,000
<b>Section 7</b>			
G.S. 78A-8	0.33	no change	+1 bed
G.S. 78A-11	0.33	no change	+1 bed
G.S. 78A-12	0.33	no change	+1 bed
G.S. 78A-13	0.33	no change	+1 bed
G.S. 78A-14	0.33	no change	+1 bed
G.S. 78A-9 (false/misleading statements)	0.13	+ 0.20 beds	
G.S. 78A-9 (other)	-	+ jail time	
<b>Section 8</b>			
G.S. 78A-58	-	+ 0.33 beds	
<b>Section 19</b>			
G.S. 78C-8(a)(1)	0.33	no change	+1 bed
G.S. 78C-8(b)	0.33	no change	+1 bed
G.S. 78C-9 (false/misleading statements)	0.13	+ 0.20 beds	
G.S. 78C-9 (other)	-	+ jail time	
<b>Section 20</b>			
G.S. 78D-24(a)	0.13	+ 0.20 beds	+1 bed

**It is impossible to estimate the impact of the proposed legislation on the prison system, and available data indicate a range of possible results.** Based on data from the AOC and the Securities Division of the Secretary of State’s office, there is the potential for an increase in prison beds needed under SB 1455. AOC data indicates that as many as 55 convictions in calendar year 2000 might have been affected by the proposed legislation; AOC cannot determine the total number of convictions for these offenses or the proportion of convictions that would have been eligible for the higher felony class under this bill. Securities Division data indicates that only six individuals were charged – and might have been affected by the provisions in SB 1455 – in 2001. In the event that there are no convictions under the affected statutes, there would be no impact on prison beds.

Based on the most recent population projections and estimated available prison bed capacity, there are no surplus prison beds available for the five year Fiscal Note horizon and beyond. This means that any increase in Class C felony convictions will impact the need for new prison beds. Due to the December 2002 effective date and time it would take for an offender to be convicted and begin serving a prison sentence, the prisons would not see a significant impact from this bill until FY 2003-04. For each additional prison bed needed in that year, the average statewide operating cost is estimated to be \$71.34/day.

Only operating costs of new prison beds, not construction costs, will be included in the fiscal estimate under the following circumstances: (1) when a bill increases the inmate population in the first two years of the fiscal note horizon, FY 2003 and 2004; this is based on the assumption that Correction cannot build prisons quickly enough to house additional offenders before 2004-05 and, (2) if the number of beds is anticipated to be less than 400 beds total since it is not practical to assume DOC would construct a general population prison with fewer than 400 beds.

In practice under these circumstances, DOC will have to take all or one of several actions: purchase additional beds out of state or in county jails; pay counties to increase jail backlog; or, establish temporary beds in the State system. For these circumstances, the Fiscal Research Division (FRD) will use the DOC statewide average operating cost, plus 3% annually, to calculate the prison bed cost.

### **Judicial Branch**

For most criminal penalty bills, the Administrative Office of the Courts (AOC) provides Fiscal Research with an analysis of the fiscal impact of the specific bill. For these bills, fiscal impact is typically based on the assumption that court time will increase due to an expected increase in trials and a corresponding increase in the hours of work for judges, clerks and prosecutors. This increased court time is also expected to result in greater expenditures for jury fees and indigent defense. The AOC relies on offense code data to project the court costs of a bill; the lack of data for these offenses prevents the AOC from estimating the court impact. However, the AOC does expect SB 1455 to have an impact on the court system. Extending the length of time for filing a civil lawsuit would result in more such lawsuits being filed and the availability of punitive damages would increase the complexity, and thus workload, of existing and new cases.

The AOC anticipates that many sections of the bill could have a substantial fiscal impact on the courts because they create new offenses not currently charged and elevate offense classes for existing offenses. Sections 8 and 19 of the bill create new Class H felony offenses for obstructing investigations under Chapter 78A (N.C. Securities Act) and 78C (Investment Advisers). Sections 7 and 19 enhance the punishment from a Class H felony to a Class C felony for any person who willfully engages in certain fraudulent practices if the total value of the consideration involved or actual losses caused in the violation or violations is \$100,000 or more. Similarly, Section 20 enhances punishment from a Class I felony to a Class C felony if the actual losses caused in the violation or violations is \$100,000 or more, and to a Class H felony if the actual losses caused in the violation or violations is less than \$100,000. Sections 7 and 19 also make it a Class H felony for any person to willfully violate G.S. 78A-9 or G.S. 78C-9 by knowingly making false or misleading statements in any material respect, or a Class 2 misdemeanor for any other willful violation of G.S. 78A-9 or G.S. 78C-9, instead of a Class I felony under current law.

As a result of the enhanced penalties under the bill, some defendants charged with Class H or Class I felonies under current law would be charged with Class C or Class H felonies. Moreover, defendants charged with Class C felonies would serve active sentences under the bill. The Securities Division staff of the Department of the Secretary of State notes that defendants convicted of the Class H or Class I felonies now do not typically have the requisite number of prior record level points to ensure that they serve active sentences. With upgrades in the offenses charged (particularly the more significant upgrades from Class H or Class I felonies to Class C

felonies), all defendants would face active sentences (all sentences in Class C are active). More vigorous defense and prosecution, and more time and cost disposing of cases would accompany such enhancement. Trials and pleas would demand more court time and preparation time as a result of the stiffer penalties under the bill.

In addition, the bill expands the definition of “Investment advisers” (Section 13 of the bill) to include persons exempt from registration under federal law Section 203(b)(3) of the Investment Advisers Act of 1940. Section 203(b)(3) exempts certain investment advisers from registering in order to use mails or any other means of interstate commerce in connection with his or its business as and investment adviser. Sections 14 and 15 of the bill further clarify that investment advisers exempt from registration under Section 203(b)(3) (or a representative of such a person) are allowed to transact business in the State as investment advisers or investment adviser representatives respectively. While it is possible that more investment advisers and their representatives could transact business in the State under the bill than before, conversations with Securities Division staff indicate that any such increase would be insignificant and impossible to quantify. According to the Securities Division staff, these changes would only move a small number of private investment advisers within the scope of the antifraud provisions in the State.

While the AOC expects these changes to affect the courts, it is unable to provide an estimate. Regarding the impact of the civil liability changes, the AOC expects increased complexity of civil cases and more civil lawsuits as a result of the inclusion of punitive damages and extension of the filing period. No securities cases have been assigned to the Business Court, which could suggest that the civil cases to date have not been so complex that assignment of those cases was warranted.

Regarding the criminal cases, the AOC also does not have offense codes for most of the offenses to which the bill would apply. Calendar year 2001 data, for the one offense for which there is presently an offense code (G.S. 78A-8), reveal no defendants charged with that particular offense. Available data for calendar year 2000 reveal 55 convictions under G.S. 78A-8. (These data come from a review of what the clerks entered into what is often referred to as “free text” fields. Since the clerks may enter anything, or nothing, into that field, the data reveal at best an order of magnitude. The 55 convictions are a significant number for this field.) AOC data do not reveal how many of those cases involved securities in excess of \$100,000. If the crimes selected for prosecution often involve substantial securities, the \$100,000 threshold may be crossed in the majority of cases. Enhancement from Class H to Class C felonies would translate into a substantial fiscal impact. These data, moreover, reflect convictions, not charges, and it may be assumed that the number of charges for this or similar offenses (to which G.S. 78A-8 could have been a plea) was significantly greater.

The Securities Division estimates that approximately 1,700 to 2,100 complaints are filed and investigated by their office each year. During calendar year 2001, only six arrests resulted from these investigated complaints. The Securities Division also estimates that 98 percent of the arrests resulting in criminal cases would be elevated to Class C felonies under the bill. According to the Securities Division, not many cases have arisen in the past because the cases are most often referred to individual district attorney’s offices that may not have the necessary expertise or resources to prosecute these types of cases. As such, the Securities Division staff indicates that it is not unlikely for a district attorney to work out a plea agreement with a defendant before the



defendant is charged or indicted. However, Section 11 of the bill does appropriate funds to provide the necessary resources (three additional unsworn securities investigators) to the Department of the Secretary of State to investigate complaints. Therefore, there may be significant enforcement of the provisions of the bill and substantial increases in the workload of the courts. While all these data collectively suggest a significant number of cases, the AOC is unable to estimate a specific number.

**SOURCES OF DATA:** Department of Correction; Judicial Branch; North Carolina Sentencing and Policy Advisory Commission; Department of the Secretary of State.

**TECHNICAL CONSIDERATIONS:** None

**FISCAL RESEARCH DIVISION:** (919) 733-4910

**PREPARED BY:** Marilyn Chism  
and Chloe Gossage

**APPROVED BY:** James D. Johnson

**DATE:** July 16, 2002



**Signed Copy Located in the NCGA Principal Clerk's Offices**