Securities Act of 1933

The Securities Act of 1933 has two basic objectives:

- require that investors receive financial and other significant information concerning securities being offered for public sale; and
- prohibit deceit, misrepresentations, and other fraud in the sale of securities.

These requirements include the disclosure of important financial information through the registration of securities. This information is intended to enable investors, not the government, to make informed judgments about whether to purchase a company's securities.

As a general rule, securities sold in the U.S. must be registered. The registration forms companies file provide essential facts while minimizing the burden and expense of complying with the law. In general, registration forms call for:

- a description of the company's properties and business;
- a description of the security to be offered for sale;
- information about the management of the company; and
- financial statements certified by independent accountants.

Not all offerings of securities must be registered with the Commission. Some exemptions from the registration requirement include:

- private offerings to a limited number of persons or institutions;
- offerings of limited size;
- intrastate offerings; and
- securities of municipal, state, and federal governments.

Exemptions: By exempting many small offerings from the registration process, the SEC seeks to foster capital formation by lowering the cost of offering securities to the public.

A company's securities offering may qualify for one of several exemptions from the registration requirements. However, all securities transactions, even exempt transactions, are subject to the antifraud provisions of the federal securities laws. Make sure you check with the appropriate state securities administrator before proceeding with your offering.

Section 3(a)(11) of the Securities Act is generally known as the **"intrastate offering exemption."** To qualify for the intrastate offering exemption, your company must:

- be incorporated in the state where it is offering the securities;
- carry out a significant amount of its business in that state; and
- make offers and sales only to residents of that state.

Your company must determine the residence of each purchaser. If any of the securities are offered or sold to even one out-of-state person, the exemption may be lost.

Section 4(2) of the Securities Act exempts from registration **"transactions by an issuer not involving any public offering."** To qualify for this exemption, the purchasers of the securities must:

- have enough knowledge and experience in finance and business matters to evaluate the risks and merits of the investment (the "sophisticated investor"), or be able to bear the investment's economic risk;
- have access to the type of information normally provided in a prospectus; and
- agree not to resell or distribute the securities to the public.

In addition, <u>you may not use any form of public solicitation</u> or general advertising in connection with the offering.

Section 3(b) of the Securities Act **authorizes the SEC to exempt** from registration small securities offerings. By this authority, we created Regulation A, an exemption for public offerings not exceeding $5 million in any 12-month period. If you choose to rely on this exemption, your company must file an offering statement, consisting of a notification, offering circular, and exhibits, with the SEC for review.

Regulation A offerings share many characteristics with registered offerings. The principal advantages of Regulation A offerings, as opposed to full registration, are:

- The financial statements are simpler and don't need to be audited;
- There are no Exchange Act reporting obligations after the offering unless the company has more than $10 million in total assets and more than 500 shareholders;
- Companies may choose among three formats to prepare the offering circular, one of which is a simplified question-and-answer document; and
- You may "test the waters" to determine if there is adequate interest in your securities before going through the expense of filing with the SEC.

- **Rule 504** provides an exemption for the offer and sale of up to $1,000,000 of securities in a 12-month period. Your company may use this exemption so long as it is not a blank check company and is not subject to Exchange Act reporting requirements. Like the other Regulation D exemptions, in general <u>you may not use public solicitation or advertising to market the securities</u> and purchasers receive "restricted" securities, meaning that they may not sell the securities without registration or an applicable exemption.

Rule 505 provides an exemption for offers and sales of securities totaling up to $5 million in any 12-month period. Under this exemption, you may sell to an unlimited number of "accredited investors" and up to 35 other persons who do not need to satisfy the sophistication or wealth standards associated with other exemptions. Purchasers must buy for investment only, and not for resale. The issued securities are "restricted." Consequently, you must inform investors that they may not sell for at least a year without registering the transaction. You may not use general solicitation or advertising to sell the securities.

An "accredited investor" is:

- a bank, insurance company, registered investment company, business development company, or small business investment company;
- an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million;
- a charitable organization, corporation or partnership with assets exceeding $5 million;
- a director, executive officer, or general partner of the company selling the securities;
- a business in which all the equity owners are accredited investors;
- a natural person with a net worth of at least $1 million;
- a natural person with income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; or
- a trust with assets of at least $5 million, not formed to acquire the securities offered, and whose purchases are directed by a sophisticated person.

Rule 506 is a "safe harbor" for the private offering exemption. If your company satisfies the following standards, you can be assured that you are within the Section 4(2) exemption:

- You can raise an unlimited amount of capital;
- You cannot use general solicitation or advertising to market the securities;
- You can sell securities to an unlimited number of accredited investors (the same group we identified in the Rule 505 discussion) and up to 35 other purchasers. Unlike Rule 505, all non-accredited investors, either alone or with a purchaser representative, must be sophisticated - that is, they must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment;
- It is up to you to decide what information you give to accredited investors, so long as it does not violate the antifraud prohibitions. But you must give non-accredited investors disclosure documents that generally are the same as those used in registered offerings. If you provide information to accredited investors, you must make this information available to the non-accredited investors as well;
- You must be available to answer questions by prospective purchasers;
- Financial statement requirements are the same as for Rule 505; and
- Purchasers receive "restricted" securities. Consequently, purchasers may not freely trade the securities in the secondary market after the offering.

For additional information, please visit the following website:
http://www.sec.gov/

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