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**EARLY STAGE FINANCING:
OFFERINGS EXEMPT FROM REGISTRATION
REQUIREMENTS**

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I. THE REQUIREMENT FOR REGISTRATION OR EXEMPTION

Every offer and sale of a "security" must be registered or the issuing company must bear the burden of proving an exemption from the registration requirement is available under the federal Securities Act of 1933, §5, 15 U.S.C. §77(e), and under the Missouri Securities Act, Mo. Rev. State. §409.3-301. Prima facie case for plaintiff: that he was sold a security in a transaction which was not registered.

II. WHAT IS A SECURITY?

A. STATUTORY DEFINITION - §2(1) of the Securities Act of 1933 defines a "security" as:

Any note, stock, treasurer stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, . . . investment contract, ...fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege or any security, ...or, in general, any interest or instrument, commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Missouri definition virtually identical. Mo. Rev. Stat. §409.1-102(28).

B. STOCK - Traditional corporate stock is always plainly within the statutory definition. Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985).

C. INVESTMENT CONTRACT - An interest is an "investment contract", and thus a security, if the following elements are present: (1) an investment, (2) a common venture, (3) a reasonable expectation of profit and (4) profits are derived primarily from the entrepreneurial or managerial efforts of others. SEC v. W.J. Howey, 328 U.S. 293, 301 (1946). The following, as examples, have been held to be "investment contracts":

1. Leasehold rights on subdivided parts of land coupled with lessor's promise to drill test wells on the property.
2. Sale of citrus grove interests together with a contract whereby seller would cultivate the grove, market the produce and remit the buyer's share of profits.
3. Certain multi-level distributorships and other business opportunities offered through pyramid sales.
4. A vacation condominium offered with a rental management contract.

D. INTERESTS IN LIMITED PARTNERSHIPS AND LIMITED LIABILITY COMPANIES.

Are "securities". E.g., Mo.Rev.Stats. §409.1-102(28)(E).

III. FEDERAL EXEMPTIONS – The General Scheme

1933 Act, §3(b): authorized SEC to adopt rules/regulations exempting "small" offerings, i.e., not exceeding \$5,000,000. The most important are the "safe harbor" exemptions under Rule 504 and 505 of Regulation D. Less important, exemption under Regulation A.

1933 Act, §4(2): exempts "transactions not involving a public offering", i.e., "private offerings." Regulation D, Rule 506, is a "safe harbor" version of this exemption.

Note similarity of a "small" and "private". Regulation D attempts to rationally combine the concepts.

IV. REGULATION D:

A. REGULATION D: The Exemptions themselves

1. Rule 504 - Offerings the proceeds of which within 12 month period do not exceed \$1,000,000.

No requirements for issuer to establish the offerees' or purchasers' "suitability", i.e., investment sophistication and net worth.

No limit on number of purchasers (but the state exemptions used will generally set limits).

No requirement for a disclosure document for this federal exemption (though the state(s) concerned may require one).

2. Rule 505 - Offering not Exceeding \$5,000,000 in a 12-month period.

Limit of 35 purchasers, excluding "accredited investors."

"Bad-boy" provisions: Rule 505 unavailable to issuers which are, or have principals who are, or have been, involved in certain fraud or securities law violations.

No requirements for "suitability" (but Missouri coordinating exemption has suitability standards - see below).

Disclosure document must be provided to purchasers prior to sale (See Rule 502, below).

3. Rule 506 - Offerings without regard to dollar amount.

Limit of 35 non-accredited purchasers, but unlimited number of "accredited investors."

Suitability: Issuer must reasonably believe any non-accredited investor or his purchaser representative has such knowledge and experience that he is capable of evaluating risks of investment.

Disclosure document required. (See Rule 502, below)

B. REGULATION D: General Provisions

1. Rule 501 - Definitions - "Accredited Investor":

-specific institutions

-any director, executive officer, or general partner of this issuer

-natural persons, and married couples, with net worth exceeding \$1,000,000

-natural persons with annual income of \$200,000, and married couples with annual incomes of \$300,000 for the year of sale and the two prior years

-certain trusts with assets exceeding \$5,000,000.

2. Rule 502 – General Conditions

(a) Integration - i.e., combining offerings when calculating number of purchasers and dollar amount of offering.

Not integrated: offers and sales more than 6 months before beginning of or 6 months after last sale in the offering, if no "similar" offers or sales occur during those 6 month periods.

"Similar" - consider whether prior or later offers or sales are part of same plan of financing, at about same time, of similar class of security, as in the offering being examined.

(b) Disclosure Requirements

No "specified" disclosure required for Rule 504 offerings, or offerings under Rules 505 and 506 only to "accredited" investors. (But under Rules 505 and 506, must give opportunity to ask questions of and receive answers from the issuer.) And under Rules 505 and 506 must make below disclosures if offer made to any "non-accredited" investors.

(i) Disclosures required of "SEC reporting companies" (i.e., report under §13 or §15(d) - must furnish copies of recent SEC filings.

(ii) Disclosure required of non-reporting companies:

(A) In offerings up to \$1,000,000: Rule 504 No specific disclosure required (but state exemption used may require certain disclosures).

(B) In all other offerings, the non-financial information (re issuer's business, management compensation, etc.) required in part II (offering circular) of Form I-A under Regulation A, plus the following financial information:

(I) In offerings up to \$2,000,000: The financial statements required in Item 310 of Regulation S-B (the SEC form for registration of small businesses), except that only balance sheet must be audited, and need only be dated within 120 days of start of offering.

(II) In offerings up to \$7,500,000: Rules 505 and 506 - The financial statements required in SEC Form SB-2, with certain exceptions.

(III) In offerings exceeding \$7,500,000 (generally Rule 506) - Information as required in full registration statement, generally Form S- I, requiring 3 years of audited financials, unless not available without "unreasonable effort and expense."

(c) Other General Conditions

-No general advertising or solicitation may be used. (Seminars, newspaper articles, etc.) SEC position: preexisting relationship between issuer and each offeree must exist to establish this (causes problems). Note: the definition and application of "general solicitation" is particularly confused by the Missouri Securities Commission and Missouri case law. See In the Matter of John Robert Moses, Case No. CD-03-16; Moses v. Carnahan, 186 SW3d 889 (Mo. App. W.D. 2006).

-Restrictions on further resale (implemented by legends on certificates, investment letters, etc.)

3. Rule 503 - Requires filing of Form D no later than 15 days after first sale. Presently filed by US Mail. SEC presently considering electronic filing.
4. Rule 507 - Issuer subject to an order or decree for failing to file Form D is disqualified from future use of Regulation D.
5. Rule 508 - Good Faith Compliance Attempt - Except as to certain specific requirements, exemption is available despite failure to comply with a requirement, if requirement was not intended to protect specifically the complainant, the failure is insignificant to whole offering, and there has been a good faith attempt to comply with all requirements.

NOTE: In a May 23, 2007 press release, the SEC indicated it is considering proposing numerous amendments to Regulation D, which would (i) add an exemption for "qualified investors", (ii) permit issuers to engage in limited advertising, (iii) expand the definition of "accredited investors" to include types of investments owned to the current total assets and net worth standards, and (iv) shorten the integration safe harbors from six months to 90 days.

V. SECTION 4(2) "PRIVATE OFFERINGS"

Another exemption is available if (1) offers are made only to small number of persons, (2) all offerees (not just purchasers) possess investment sophistication, (3) all offerees have "access" to all information which a registration statement would provide (which may require "insider" status), (4) no general solicitation, and (5) all purchasers have "investment intent." The concept is that investors who can be shown to be able to "fend for themselves" in obtaining material information do not need the protections of registration. SEC vs. Ralston Purina Co., 349 US 119 (1953). "Offers" interpreted broadly. Implication is that only face-to-face negotiations are private. Securities purchased are "restricted".

VI. COMPARISON OF REGULATION D AND SECTION 4(2)

Regulation D, Rule 506, is a "safe-harbor" version of Section 4(2) which establishes more provable criteria for the existence of the exemption.

VII. SECTION 4(6) ACCREDITED INVESTOR EXEMPTION

Section 4(6) of the 1933 Act exempts transactions involving offers or sales by an issuer of not in excess of \$5,000,000 in securities provided that (1) the securities are sold only to one or more "accredited investors", (2) there is no advertising or public solicitation in regard to the offering, and (3) the issuer files Form D with the SEC. Infrequently used.

VIII. THE INTRA-STATE EXEMPTION OF SECTION 3(a)(11) AND RULE 147

Exempts offerings of issuers where securities are offered and sold and "come to rest" within the state of incorporation and where issuer is doing most of its business, and has most of its assets. Eighty percent tests. All offerees must be residents of the state.

Rule 147 "Safe harbor": (1) "comes to rest" means held in state for 9 months, (2) requires legends on certificates and stop transfer orders on ledgers, disclosure on certificates, and written representations of residence by purchasers.

IX. REGULATION A: "MINI-REGISTRATION"

"Safe harbor" version of 1933 Act §3(b) "small offering" exemption. Used infrequently after adoption of Regulation D, Rules 504 and 505

Available for sales up to \$1,500,000 during 12 month period. Must file Form 1-A with SEC, including special Regulation A offering circular.

Securities in Regulation A offerings not subject to secondary trading prohibitions (i.e., they are not "restricted") (securities sold under other exemptions are generally restricted – i.e., may be sold only under limited circumstances).

X. MISSOURI EXEMPTIONS: STATUTORY - §§409.2-201 and 202, Missouri Uniform Securities Act

-§409.2-202(13)(A) - sales to institutions. See 15 CSR 30-54.125.

-§409.2-202(14) – "limited offering" exemption for sales to not more than 25 purchasers per twelve month period in Missouri.

-§409.2-202(15) exempts offers to existing security holders (commissions prohibited unless waived by Commissioner). See 15 CSR 30-54.160.

-§409.2-202(20) – reorganizations to which the issuer is a party.

XI. MISSOURI EXEMPTIONS: ADOPTED BY THE SECURITIES COMMISSIONER

A. REGULATION D COORDINATING EXEMPTION (UNIFORM LIMITED OFFERING EXEMPTION – "ULOE" – adopted in numerous states)

15 CSR 30-54.210 - Exempts Missouri offerings complying with federal Regulation D Rules 505 or 506 (not available to Rule 504 offerings).

-Issuer must (1) file Form D and fee with Missouri Commission no later than 15 days after first sale and (2) reasonably believe investment is "suitable" for investors.

-No prohibition on commissions.

-Separate state "suitability" requirements for non-accredited investors. Suitability presumed if investment is not more than 20% of investor's net worth.

-Not available if issuer or principals involved in certain securities law or fraud violations ("bad boy" provision).

-Commissioner may waive restrictions.

A. MISSOURI ACCREDITED INVESTOR EXEMPTION

15 CSR 30-54.215. Exempts offerings if sales are made only to persons who are, or the issuer reasonably believes are, "accredited" and are purchasing for "investment".

- Not available if issuer or principals involved in certain securities or fraud violations ("bad boy" provisions).

- Exemption not restricted by prohibition on "general solicitation", in that a "general announcement" of the offering may be made containing information specified in 15 CSR 30-54.215(7) and (8). Telephone solicitations may be made only to persons that issuer reasonably believes are "accredited".

- Issuer files with Commissioner a notice of Form AI, consent to service and filing fee within 15 days of first sale in Missouri.

XII. COORDINATION OF FEDERAL AND MISSOURI EXEMPTIONS

For offerings under \$1,000,000 simultaneous use of Rule 504 for federal exemption and RSMo. §§409.402(b)(9) and 409.402(b)(10) (first 25 and 15 per year exemptions) is most frequent. Could also use Rule 147 (intra-state) for federal exemption.)

For larger offerings, could use Rules 505 and/or 506 federally and the Missouri Uniform Limited Offering Exemption in Missouri.

XI. LIABILITIES FOR FAILURE TO COMPLY

Generally, under both federal and state law, the purchaser is given a "put"-- back to the issuer and to all individual "sellers" of the securities -- if the issuer cannot prove an exemption for its unregistered offering. This is a rescissionary remedy which would require the liable persons to return the amount of consideration paid for the securities, plus interest and attorney's fees, less the amount of income received on the security. Persons liable under federal and Missouri law include every partner, officer, or director of the issuer and every broker-dealer, agent or other person who materially aids in the sale of the security.

Under federal and Missouri law, there is a one year period of limitations from the date of "the violation". 15 U.S.C. §77m(13); §409.5-508(j)(1) R.S.Mo.

X. CONCLUSION/NOTES:

A. In litigation, the issuer bears the burden of proof of availability of exemption.

B. In all sales of securities (regardless whether exempt from registration requirements), full and clear positive disclosure must be made to all investors which a reasonable investor would consider useful in making the investment decision.

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