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RAISING CAPITAL AND EXEMPTIONS FROM REGISTRATION UNDER THE SECURITIES LAWS

Nicholas G. Karambelas, Esq.

These are times when business entities must use increasingly creative methods for raising capital. As traditional sources, such as business loans and venture capital, become scarce, entities have resorted to more non-traditional methods for raising capital. No matter how creative or non-traditional the method or source may be, sooner or later the entity will confront the stark and very traditional realities of the federal and state securities laws and the regulators who enforce those laws. The person raising capital must comply with the securities laws whether the invested capital comes from sophisticated financial types, from college roommates or from grandparents.

Whether an entity is a corporation, partnership or limited liability company, there are two general categories of financing that are available for raising capital: debt financing and equity financing. Debt financing is the method by which the entity borrows the funds from the financing source with an obligation to repay the funds at a certain time in exchange for a determinable rate of interest or other return on borrowed amount. Equity financing is the method by which the entity sells an interest in the entity to the financing source in exchange for which the source participates in the profits or cash flow, if any, realized by the entity and the entity is not obligated to repay the dollar amount of the sales price. The two methods are not mutually exclusive. Entities will often combine elements of each method so that the financing transaction is attractive to the financing source while the financial burden on the entity is reasonable.

Fundamentally, the securities laws regulate equity financing and not debt financing

although certain types of bonds can be subject to the securities laws. The purpose of the securities laws is to require that each entity (referred to as the issuer) which sells interests in the entity (referred to as securities) to persons who will participate in profits but not in the management or governance of the entity (referred to as purchasers or investors) must disclose to such persons certain information about the entity, the managers and the business of the entity.[1] The disclosures are made in a document called a registration statement which must be filed with the United States Securities and Exchange Commission (SEC) and the securities regulatory authorities of each state in which the issuer intends to make or solicit offers to purchase its securities. The SEC and the relevant state securities regulatory authorities examine the registration statement to determine whether the issuer has fully and fairly disclosed the information required by the securities laws. Only after the SEC and the state authority have approved the registration statement is the issuer legally able to sell its securities. The registration process can be prolonged and costly. The penalties for selling securities without the requisite approvals can be severe. The mere offer or sale of nonexempt securities without any fraudulent or criminal intent is sufficient to incur at least civil liability. Violations of federal securities laws are punishable by fines and, in the case of willful violations, imprisonment.[2]

Recognizing that it is neither necessary to the policy objective of the securities nor practical to subject all securities and securities transactions to the registration requirements of the securities laws, Congress and the state legislatures have exempted a narrow category of securities and certain types of securities transactions from the registration requirements of the securities laws. The types of securities that are exempt from registration are bonds or other securities issued by a governmental subdivision, industrial revenue bonds and securities issued by or for the

benefit of certain not for profit entities. Business entities generally do not qualify to issue exempt securities but rather they structure the transaction in which they sell their securities to be exempt from the registration process.

Among the types of securities transactions that are exempt are those transactions which do not involve an offering to the general public but are, rather, an offering to a small group of investors who have a preexisting and substantial relationship with the person who is selling the securities. If the transaction qualifies under one or more of the enumerated exemptions, then the entity is not required to file a registration statement and receive the approval of the SEC and state securities authorities. The practitioner must note that the exemption enables the issuer to avoid the registration process but it does not necessarily relieve the issuer from providing the requisite disclosures to persons to whom the issuer seeks to sell its securities.

THE DEFINITION OF A SECURITY

Any financial instrument that can be defined as a security is subject to the federal and state securities laws.[3] The policy purpose of the securities laws is to assure that persons who purchase securities receive information sufficient in scope and detail about the entity, its business and management to enable that person to make an informed decision as to whether to purchase the securities. The federal securities laws do not contain either a substantive or a functional definition of a security.[4] The Securities Act of 1933 contains a descriptive definition of a security.[5] It lists the types of financial instruments that are securities. Some of the listed financial instruments such as stocks, notes, bonds and debentures are well defined either by law, custom and usage.[6] This descriptive definition of a security works well where the listed financial

instrument, such as stock, has a commonly understood and specific set of attributes. A share of stock will always be a security.[7]

Investment Contracts

The statutory definition lists "investment contracts" and "certificates of interest or participation in any profit sharing agreement" as securities, neither of which have a specific definition in either law, custom or usage.[8] The statutory definition also contains the clause "in general, any interest or instrument commonly known as a 'security'.[9] These conceptual terms are less useful because the practitioner must engraft on them a functional definition in order to derive any practical meaning from the terms.

This descriptive definition is less useful where the listed financial instrument is "investment contracts." In determining whether or not a particular financial instrument is an investment contract, the form of the instrument is irrelevant. It is the substance of the transaction, the relationship between the issuer and the purchaser and the economic realities that determine whether or not a financial instrument is an investment contract and, therefore, a security.[10] The term "investment contract" has been construed for securities purposes as a contract, transaction or scheme whereby a person invests money in a common enterprise and is led to expect profits solely from the efforts of other persons.[11] The key element is "solely from the efforts of other persons." Strictly construed, this definition means that the securities laws would apply only where the purchaser refrained totally from participating in management and governance. This construction does not comport with economic reality of the many possible means and methods by which entities can be structured.[12] Rather than whether profits are expected *solely from the efforts of others*, the inquiry should be whether the efforts made by those other than the purchaser are

undeniably the significant efforts that are essential to the success or failure of the business of the entity.[13] The term "certificates of interest or participation in any profit sharing agreement" has not been construed in case law. However, it should be treated as functionally the same as an investment contract.[14]

Interests in Unincorporated Entities as Securities

The definition of a security in the Securities Act of 1933 does not include interests in non-corporate entities. Consequently, a partnership interest in a partnership, a membership interest in a limited liability company or a beneficial interest in a business trust is a security only if it is an investment contract.[15] Whether or not a membership interest is an investment contract is determined by whether the efforts of persons other than the person who purchases either such interest are undeniably the significant ones that are essential to the success or failure of the enterprise. This determination can only be made by analyzing the terms of the partnership or operating agreement, the powers of management and the business realities of each particular entity.

Where the relevant entity agreement concentrates management control, discretion and governance in persons excluding the purchaser who purport to possess the skills, knowledge or experience to operate and manage the business in a profitable manner, then the partnership interest or membership interest will be an investment contract and, therefore a security subject to the securities laws. Where the relevant entity agreement allocates management control, discretion and governance among all of the persons who purchase interests in the entity, then, then the partnership or membership interest will not be an investment contract. Even if, as a practical matter, the purchaser exercises less control and fewer powers then are available under the relevant

entity agreement, the partnership interest or membership interest is not converted into a security as long as the purchaser legally has the potential to exercise control.[16]

Because a non-corporate entity can be structured in many creative ways, an interest in any non-corporate entity can be formed in a way that would make it resemble shares of stock of a corporation.[17] If an interest in a non-corporate entity is made to have the specific attributes of shares of common stock then it could, on that basis alone, be deemed a security.[18] Those attributes are:

* Right to receive profits based on the apportionment of the holder's interest in the issuing entity;
* Power to vote in proportion to the percentage of interest held;
* Whether or not the interest is assignable or negotiable;
* Power to pledge or hypothecate the interest; and
* Possibility of appreciation in value of the interest.[19]

CATEGORIES OF EXEMPTIONS FROM REGISTRATION

Securities Act of 1933 empowers the SEC to exempt certain securities and securities transactions from the registration requirements.[20] Congress has granted to the SEC broad powers to conditionally or unconditionally exempt any person, security, or transaction or any class or classes of persons, securities or transactions from the registration requirements of the securities laws.[21] The SEC exercises this authority by promulgating rules and regulations. Any such rule or regulation mandating an exemption must be necessary or appropriate in the public interest and consistent with the protection of investors.[22]

Over the decades the exemptions have come to be identified by their statute cite or rule

number. This system is confusing since some the rules in the same regulation are promulgated under different sections of the statute. Also, the statute cites are to the Statutes at Large not to the U.S. Code. There are 3 general categories of exemptions:

Limited Offerings Exemption

A limited offering is an offering in which the aggregate dollar amount of the offering does not exceed $5 million. There are 3 types of limited offerings:

* Offerings to only to accredited investors not involving a public offering under [Section 4(6) (15 USC § 77(d)(6)]

* Offerings not involving not involving a public offering under [Section 3(b) (15 USC § 77(c)(b)) Regulation D 504 and 505]

* Offerings involving a public offering [Section 3(b) (15 USC § 77 § 77(c)(b)) Regulation A Rules 251 - 263]

Private Offerings Exemption

A private offering is an offering which is made to relatively few offerees each of whom have an articulable relationship with the issuer. There are 2 types of private offerings:

* Offerings not involving a public offering referred to as private offerings[23] [Section 4(2) 15 USC § 77d(2)]

* Offerings not involving a public offering referred to as a safe harbor private offerings [Section 4(2) 15 USC § 77d(2) Regulation D Rule 506]

Defined Group Offerings Exemption

A defined group offering is an offering which is made to a defined group. There are 2 types of defined group offerings:

* Offerings to employees and management [Rule 701]

* Offerings made in one state exclusively to persons in that same state, [Section

3(a)(11) 15 USC §77c(a)(11) Rule 147]

* Offerings made by California entities [Section 3(b) Regulation CE Rule 1001]

There are other general categories of exemptions which apply to transactions in securities by brokers and dealers and transactions which involve promissory notes secured by real property.[24] There are also categories of exemptions which are available to issuers who are non-U.S. persons and offerings by issuers who are U.S. persons and the offering is made wholly outside of the U.S.[25] These categories are beyond the scope of this Article.

LIMITED OFFERING EXEMPTIONS

Limited Offering Exemption under Section 4(6)

As long as an issuer makes an offering only to accredited investors and the aggregate dollar amount does not exceed $5 million, that transaction is exempt from the registration requirements. An natural person is an accredited investor if:

* he or she is a director or executive officer of the issuer,
* his or her net worth is more than $1 million, either individually or jointly with a spouse, or
* he or she had an individual income of more than $200,000 or joint income with a spouse of $300,000 in each of the past two years and expects income in excess of those levels in the current year.[26]

Other accredited investors are certain financial institutions, trusts and not for profit 501(c)(3) entities with assets which exceed $5,000,000, any person or entity in management of the issuer and any entity in which each of the equity owners are accredited investors.[27]

The issuer cannot use any advertising or public solicitation in connection with the offering. The issuer is not required to make any disclosures to potential investors. Investors must hold the securities for at least 1 year after the date of purchase. The issuers must report any sales

of securities on Form D which must be submitted by electronic means.[28] Generally, issuers will use the other limited offerings in preference to this exemption.

Limited Offering Exemption under Section 3(b) and Regulation A

This limited offering is, as a practical matter, more a form of abbreviated registration than it is an exemption. It is known as "short form registration" and is used primarily by persons acting on behalf of the issuer rather than by the issuer itself. The aggregate dollar amount of the offering cannot exceed $5 million in a 12 month period including no more than $1.5 million in sales of an issuer's securities by a non-issuer.

Issuer

The issuer must be an entity organized under the laws of the U.S. or Canada. The issuer cannot be any of the following:

* a reporting company, disqualified company or a registered investment company,

* a development stage company with no specific business plan or plan is to merge with an unidentified company.[29]

Public Offering

The issuer may offer the securities using oral or written advertising and public solicitation but no sale or commitment to purchase is binding until the issuer has filed a From 1-A offering statement with the SEC and the Form 1-A is qualified. [30] The issuer must file copies of written materials and scripts of public broadcasts to the SEC.[31] Form 1-A requires information about the issuer, the business of the issuer, the terms of the offering and the terms of the purchase of the securities. As long as there is no delaying notation on the Form 1-A, its qualified on the 20th calendar day after date on which it was filed.[32] Issuers typically sue the Form 1-A process to

determine whether there is any interest in the securities to be offered.

Preliminary Offering Circular and Final Offering Circular

Prior to qualification of the Form 1-A but after it is filed, the issuer may offer the securities in writing as long as the issuers delivers a Preliminary Offering Circular to potential investors which contains the required information, legends and disclaimers.[33] The issuer can make offers with the Preliminary Offering Circular but cannot confirm a sale unless the Final Offering Circular is delivered to the potential investor.[34] The Final Offering Circular must contain the narrative and financial information required by Form 1-A.[35]

Integration

For the purpose of determining the aggregate dollar amount limit, offers and sales made in reliance on Regulation A will not be integrated with prior offers or sales of the issuer. Also, subsequent offers or sales will not be integrated as long as the securities are either duly registered, made to employees and management under Rule 701, made in reliance on Regulation S (*see infra.*) Or made more than 6 months after the completion of the Regulation A offering.[36]

Limited Offering Exemption under Section 3(b) and Rules 504 and 505 of Regulation D

Limited offerings are so called because the aggregate total of funds raised in an offering is limited. The two types of limited offerings are an offering under Rule 504 which is limited to $1 million and the other is an offering under Rule 505 which is limited to $5 million.

Rule 504 Offerings

Rule 504 offerings are the least regulated offerings by the SEC. Rule 504 is designed to

enable state securities agencies to regulate comparatively small offerings on the theory that the states are better able to determine the categories of persons who need the protections of the securities laws and how extensively they should be protected. Consequently, the issuer must comply with the laws and regulations of each state in which an offer to purchase securities is made or in which an offer to purchase securities is solicited in addition to the Regulation D requirements. Many states have adopted the Uniform Limited Offering Exemption (ULOE) while some states have adopted the ULOE along with certain more restrictive conditions to exemption.

Rule 504 is available to all types of issuers except companies that are required to make regular financial reports to the SEC, investment companies and "blank check" companies which are defined as companies in the development stage with no specific business plan or purpose. [37] The aggregate offering price cannot exceed $1 million in any one 12-month period.[38] The issuer can no longer use any form of advertising or general solicitation to offer or sell the securities without restriction. General solicitation and advertising can only be used in transactions that are either registered under a state law requiring public filing and delivery of a disclosure document to investors before sale or exempt under a state law that permits general solicitation and advertising as long as sales are made only to accredited investors. [39]

There are no limits on the number of investors and no requirement that the investors be accredited in terms of wealth or sophisticated in terms of business knowledge and experience. No particular content, format or method of disclosure is mandated by Rule 504. Other than the prohibition on advertising and general solicitation, none of the general conditions contained in Rules 501 through 503 of Regulation D applies to Rule 504 offerings.

The lack of any particular disclosure requirements should not lead issuers to believe that

they need not incur the costs and expend the efforts to disclose material information to investors. The antifraud and civil liability provisions of the Act still apply to Rule 504 offerings. Therefore, a prudent issuer who is advised by a prudent attorney should still prepare a written prospectus or private placement memorandum that sets forth material terms such as a description of the business, risks, use of proceeds raised from the offering and financial "deal" for the investors.

Rule 505 Offering

Rule 505 is available to any issuer for offerings where the aggregate total dollar amount of the offering does not exceed $5 million. The nonaccredited investors need not demonstrate any degree of sophistication in financial matters. Rule 505 specifically obligates the issuer to exercise "reasonable care" to ensure that none of the investors is an underwriter and that each investor is purchasing the securities offered for his or her own account and not for resale.[40] A Rule 505 offering must comply with the general conditions contained in Rules 501 through 503 of Regulation D.

PRIVATE OFFERINGS

Private Offerings under Section 4(2)

The issuer of a private offering under Section 4(2) relies on a certain clause in the Securities Act of 1933 which exempts from registration an offering not involving an offering to the public and more than 70 years of case law that has construed that clause. There are no quantified conditions or factors to guide the issuer as to whether or not the exemption from registration will apply. There is no limit on the amount of capital that an issuer can raise. The following general conditions can be drawn from the case law and experience:

* A personal or business relationship must exist between the issuer and the investor that precedes the offering.

* No advertising or general solicitation can be used.

* Each offeree and investor must have access to or be given all material information about the issuer.

* Each offeree must have sufficient knowledge and experience to understand the nature of the investment and the risks of the investment and be able to bear the loss of the investment. This condition is referred to as the "sophisticated investor" requirement.

* Each investor must be investing for its own account and not as a conduit for other persons.

* The number of offerees must not be so large as to make it unreasonable to deem the offering a private offering.

The issuer who relies on the Section 4(2) exemption takes a risk because there are no quantified factors. The item that can cause the most uncertainty is the level of disclosure that must be provided to investors and whether the disclosed information is all of the *material* information. The prudent issuer should prepare a prospectus or private placement memorandum that would at least approximate the disclosure requirements contained in Rule 502. Also, as with any offering, the antifraud and civil liability provisions apply to any disclosures made to investors.[41]

Private Offerings with Safe Harbor under Section 4(2) and Regulation D Rule 506

Rule 506 was promulgated in an effort to provide a "safe harbor" or quantifiable factors to guide the issuer in structuring an offering as an exempt offering. It is meant to resolve many of the uncertainties that are inherent in Section 4(2) offerings. Like a Section 4(2) offering, there is no limit on the amount of capital that an issuer can raise in a Rule 506 offering. To avail itself of the exemption under Rule 506, an issuer must comply with the general conditions of Rules 501 through 503 of Regulation D.

Unlike Rule 505, this Rule does require that each investor who is not an accredited

investor, either alone or together with his or her purchaser representative, must possess (or be reasonably believed to possess) such knowledge and experience in financial and business matters that he, she or it is capable of evaluating the merits and risks of the prospective investment[42]

GENERAL CONDITIONS

General Conditions which Apply to Limited Offering under Regulation D Rule 505 and Private Offering with Safe Harbor under Regulation D Rule 506

Any issuer which makes either a limited offering under Rule 505 or a private offering with safe harbor under Rule 506 must satisfy the following general conditions:

No General Advertising or General Solicitation: The issuer cannot advertise its offering in any print or electronic medium to attract investors or use such media to solicit offers from potential investors.[43]

Restriction on Transfers of the Shares: Except under certain highly controlled circumstances, an investor is prohibited from reselling the securities he or she bought. The issuer must take certain measures to assure that each investor is advised of the transfer restriction and to assure that, at the time he or she bought the securities, the investor intended to hold the shares and not resell them.[44]

Number of Investors: An unlimited number of accredited investors may buy securities but, of the total number of investors, only 35 nonaccredited investors may buy shares. A legal entity is an accredited investor if it has assets worth more than $5 million or if all of the natural persons who are equity owners are accredited investors. A natural person is an accredited investor if:

* he or she is a director or executive officer of the issuer,

* his or her net worth is more than $1 million, either individually or jointly with a spouse, or

* he or she had an individual income of more than $200,000 or joint income with a spouse of $300,000 in each of the past two years and expects income in excess of those levels in the current year.[45]

Nonfinancial Information Disclosure Requirements: If the securities are sold only to accredited investors, no specific information must be disclosed to the investors. If one or more nonaccredited investors buys the securities and the issuer is eligible to use Regulation A, then the issuer must disclose the nonfinancial information required in Part II of Form 1-A. If the issuer is not eligible to use Regulation A, then it must disclose the nonfinancial information required by Part I of a registration statement. For civil liability and anti fraud purposes, the information which

Regulation D requires for nonaccredited investors should be provided to all investors without regard to accredited status.[46]

Financial Information Disclosure Requirements: If the offering is up to $2 million, then the issuer shall provide the financial information required by Item 310 of Regulation S-B to all purchasers except that only a balance sheet dated within 120 days of the offering need be audited. If the offering is up to $7,500,000, then the issuer shall provide the financial information required by Form SB 2 and statements need not be audited except for a balance sheet dated within 120 days of the offering. If the offering exceeds $7,500,000, then the issuer shall provide the financial information required by a registration statement and statements need not be audited except for a balance sheet dated within 120 days of the offering.[47]

Filing Form D. The issuer must file Form D, which is a notice filing, with the SEC no later than 15 days after the date of the first sale of securities. A willful or unexcused failure to file Form D could disqualify an issuer from making any subsequent offering under any rule of Regulation D. Form D must be filed by electronic means.[48]

Proposed Revisions to Rules 501 - 506 under Regulation D

In an effort to usher Regulation D into the 21st century, the SEC has proposed a set of revisions to Regulation D.[49] The revisions are made to the following four concepts: creating a new exemption for large accredited investors, expanding the definition of an accredited investor, the integration of offerings safe harbor and creating disqualification criteria which would apply to all Regulation D offerings.

Large Accredited Investors

Proposed Rule 507 would create a new exemption for large accredited investors to whom the offering could be advertised subject to certain limitations. A large accredited investor is defined as an entity or institution that has more $10 million in investments, individuals who own more than $2.5 million in investments or jointly with a spouse or who have had an annual income of more than $400,000 or $600,000 jointly with a spouse in the immediately preceding two years and who expect to have at least that same level of income in the year of the offering and an entity in which each owner of the equity of the entity is a large accredited investor. The foregoing dollar

minimums would be adjusted for inflation every five years with the first 5-year period beginning on July 1, 2012.

The issuer may advertise the offering in writing in print or online but not through any form of radio, television or infomercial. At a minimum, the advertisement must state that securities will be sold only to large accredited investors, no funds or other consideration are solicited by or through the advertisement and the securities have not been registered with the SEC and are being offered under an exemption from registration. The advertisement may but is not required to state the name, address and contact person for the issuer, a 25-word or less description of the business of the issuer, price, type and description of the securities being offered, definition of large accredited investor and suitability requirements for an investor. If, in response to the advertisement a potential investor seeks further information from the issuer, the issuer can only provide further information if the issuer reasonably believes that the investor qualifies as a large accredited investor. Sales of securities to large accredited investors will be deemed "covered securities" for state securities regulation purposes.

Revised Definition of Accredited Investor

The proposed revisions to the definition of an accredited investor would provide another means of meeting the definition. Entities that own $5 million in investments would meet the definition of an accredited investor. Individuals who own $750,000 in investment either singly or jointly with a spouse would also meet the definition. For the purpose of determining real estate investments a personal residence could not be included in calculating the investment minimum. The foregoing dollar minimums would be adjusted for inflation every five years with the first 5-year period beginning on July 1, 2012.

The proposed revision expands the list of entities that can meet the definition of an accredited investor. The list includes limited liability companies, business trusts, Indian tribes, labor unions and governmental bodies or other entities which have attributes similar to the foregoing entities.

Disqualification Provisions

The proposed revisions would apply the disqualification provisions under Regulation D to violations of all Regulation D offerings. An issuer and any person who are affiliated with the issuer, such as a director, officer, owner of 20% of the beneficial interests or predecessor, will be disqualified from using any exemption under Regulation D exemption if any such person has violated state or federal securities laws, is subject to a cease and desist order or has been expelled or suspended from a securities membership organization.

Integration of Multiple Offerings

The securities laws prohibit the use of multiple smaller offerings which are in effect a single offering to avoid having to register the securities. If the multiple smaller offerings are really part of a single large offering depends on, among other factors, whether the offerings are made simultaneously, involve the same securities and the same consideration. In its current form, Regulation D mandates that offerings made more than six months before or six months after an offering is completed will not be considered the same offering even if the foregoing factors are present. The proposed revision would shorten the six months to 90 days. Even if the security is exempt from registration or is transferred in an exempt transaction, the anti fraud provisions of the Securities and Exchange Act of 1934 will apply to the offer, sale, distribution and purchase of exempt securities or securities transferred in an exempt transaction.[50]

DEFINED GROUP OFFERINGS

Offerings to Employees and Management under Rule 701

A private company may sell its securities to its employees, officers, directors, partners, trustees, consultants or advisors without having to file a registration statement under certain conditions.[51] The aggregate amount of securities that may be sold in any 12-month period is the greatest of $1 million, 15% of the issuer's total assets, or 15% of the outstanding securities of the class be offered under the Rule.[52] This exemption is available to a consultant or advisor as long as such person is a natural person who provides bona fide services to the issuer and the services are not rendered in connection with the offering or with promoting the offering.[53] The issuer must deliver to person a copy of the compensatory plan or contract.[54]

If the amount of securities sold in any 12 month period is more that $5 million, the issuer must deliver written disclosure of the compensatory plan if the plan is subject to the Employee Retirement Income Security Act of 1974 (ERISA). If it is not subject to ERISA, the issuer must provide a summary of the material elements of the plan, the risks associated with the investment in the securities and financial statements required under Form 1-A .[55] The resale of these securities is restricted.[56]

Intrastate Offerings under Section 3(a)(11) Rule 147

Any security which is a part of an issue offered and sold only to persons who are resident within one state as long as the issuer of the is also person who is resident in that and doing business in that state.[57] The issuer must satisfy each condition of the intrastate exemption.[58]

Person Resident

The offering must be made only to a person who is an individual who has his or her

principal residence in the state or an entity with its principal office in the state and each of whose beneficial owners is a resident of the state.[59]

Issuer

The issuer must be a resident of the state. If the issuer is an individual, then his or her principal residence must be located in the state. If the issuer is an entity, then it must be organized under the laws of the state if it is an entity that requires a filing under state law to commence its legal existence such as a corporation or limited liability company. If it is not such an entity *i.e.* a general partnership, then it must have its principal office located in the state.[60]

Doing Business in the State

The issuer must be doing business in the state. The issuer is doing business in the state if for its most recent fiscal year it derived 80% of its gross revenues from the state if the offering is made within the first 6 months of that fiscal year. If any part of the issue of the offering is made during the current fiscal year, then 80% of the gross revenues as long as the total gross revenues of the issuer exceed $5,000.[61]

Offerings that are not Part of the Issue

Any offering of the issue that is made to a non-resident is not part of the issue and renders the exemption unavailable to the issuer.[62] Also, if any part of the offering is made under any other exemption or the securities are registered, then that part of the offering is not part of the issue and the exemption is unavailable to the issuer.[63]

Resales

Any person who has purchased securities is prohibited from reselling those securities for a period of 9 months from the date of the last sale of securities in the issue to any person or entity

who or which is not a resident of the state.[64]

Offerings made by California Entities under Section 3(b) Regulation CE Rule 1001

An exemption is available to issuers who are corporations or other business entities organized under the laws of California. The offering must satisfy the conditions under the California state exemption.[65] Those conditions are similar to the conditions to a private offering under the safe harbor Regulation D Rule 506.[66] The offering must be made only to qualified purchasers who are defined in a manner similar to accredited investors under Regulation D Rule 506.[67] The resale of these securities is restricted.[68]

EXEMPTIONS FROM REGISTRATION UNDER STATE SECURITIES LAWS

The states regulate the offer and sale of securities within the state and offers and sales made into the state from without the state. Referred to as "blue sky laws", state securities laws require that each issuer must register its securities with the relevant state authority before making any offer or sale in the state unless the securities are either exempt securities or the securities transaction is exempt from registration. Similar to the federal securities laws the state securities laws distinguish between exempt securities and exempt transactions. The securities that are exempt under the state securities laws are generally the same as the securities which are exempt under the federal securities laws.

The state securities laws generally distinguish between limited offerings and private offerings in the way as the federal securities laws make that distinction. The legislative structure of the state securities exemptions derive from the Uniform Securities Act of 1956. Most of the states have so modified and amended this structure that uniformity among the states is modest.

The exemption provisions of the Uniform Securities Act of 2002 promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) will foster greater and needed uniformity. However, most states have yet to enact these provisions. Consequently, the practitioner must analyze and understand the securities laws of each state in which the issuer makes and offer or sale. A future article will compare and analyze the exemptions under securities laws of each of the local jurisdictions.

ENDNOTES

1. See generally Hazen, Thomas Lee. Federal Securities Laws (Federal Judicial Center 2nd Edition 2003)

2. See generally Hicks, William J. Civil Liabilities: Enforcement and Litigation Under the 1933 Act (West 2009) [Westlaw Database SECCIVIL].

3. 15 U.S.C.A. §§ 77a to 77aa

4. See generally Lowenfels and Bromberg, *What is a Security?* 56 Alb L Rev 473 (1993).

5.15 U.S.C.A. § 77b(1).

6.15 U.S.C.A. § 77b(1)

7. *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 105 S. Ct. 2297, 85 L. Ed. 2d 692 (1985)

8. 15 U.S.C.A. § 77b(1)

9. 15 U.S.C.A. § 77b(1)

10. *Tcherepnin v. Knight*, 389 U.S. 332, 88 S. Ct. 548, 19 L. Ed. 2d 564 (1967)

11. *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244, 163 A.L.R. 1043 (1946)

12. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975)

13. *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973)

14.*Goodwin v. Elkins & Co.*, 730 F.2d 99 (3d Cir. 1984).

15. *S.E.C. v. Shreveport Wireless Cable Television Partnership*, Fed. Sec. L. Rep. (CCH) ¶90322, 1998 WL 892948 (D.D.C. 1998).

16. *Keith v. Black Diamond Advisors, Inc.*, 48 F. Supp. 2d 326 (S.D. N.Y. 1999). See also *Nelson v. Stahl*, 173 F. Supp. 2d 153 (S.D. N.Y. 2001)

17. See generally Steinberg and Conway, *The Limited Liability Company as a Security*, 19 Pepp L Rev 1105 (1992)

18. *Landreth Timber Co. v Landreth*, *supra.* n. 9; *Gould v. Ruefenacht*, 471 U.S. 701, 105 S. Ct. 2308, 85 L. Ed. 2d 708 (1985)

19. *Landreth Timber Co. v Landreth*, *supra.* n. 9

20. 15 USC § 77d

21. 15 USC § 77z-3

22. *Ibid.*

23. 15 U.S.C.A. § 77d(2).

24. 15 U.S.C. § 77d(3)-(5)

25. 17 CFR § 230.801; Regulation S 17 CFR § 230.901

26. 17 CFR 230.215

27. *Ibid.*

28. 17 CFR § 230.503(b)

29. 17 CFR § 230.251(a)

30. 17 CFR § 230.251(d); 17 CFR § 230.254

31. 17 CFR § 230.256

32. 17 CFR § 230.252(g)

33. 17 CFR § 230.255

34. 17 CFR § 230.251(d)(2)

35. 17 CFR § 230.253(a)

36. 17 CFR § 230.251©

37. 17 CFR § 230.504(a)(3)

38. 17 CFR § 230.504(b)(2)

39. See SEC Release No. 33-7644; 17 C.F.R. § 230.504(b)(1)(I) to (iii)

40. 17 CFR § 230.505

41. 15 U.S.C. § 77(d)(2)

42. 17 CFR § 230.506(b)(2)(ii)

43. 17 CFR § 230.502©

44. 17 CFR § 230.502(d)

45. 17 CFR § 230.501(a)

46. 17 CFR § 230.502(b)

47. 17 CFR § 230.502(b)(2)

48. 17 CFR § 230.503(a)-(b)

49. SEC Release No. 33-8828 (August 3, 2007)

50. 15 U.S.C. § 78a

51. 17 CFR § 230.701(b)-©

52. 17 CFR § 230.701(d); see Release No. 33-7645

53. 17 CFR § 230.701(c)(1)(I)

54. 17 CFR § 230.701(e)

55. 17 CFR § 230.701(e)(4); 17 C.F.R. §§ 239.90, 230.251 to 230.26317

56. 17 CFR § 230.701(g)

57. 15 U.S.C. § 77c(a)(11)

58. 17 CFR § 230.147

59. 17 CFR § 230.147(d)

60. 17 CFR § 230.147©

61. 17 CFR § 230.147(c)(2)(I)

62. 17 CFR § 230.147(f)

63. 17 CFR § 230.147(b)

64. 17 CFR § 230.147(e)

65. 17 CFR § 230.1001

66. Cal Corp Code 25102(n)

67. Cal Corp Code 25102(n)(2)

68. 17 CFR § 230.701(g)