FINANCING AFTER THE JOBS ACT:

Arizona and Federal Securities Laws; Traditional Financing Methods and New Alternatives

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OVERVIEW

- Brief history of Securities Regulation – Dual State and Federal Regulation
- Why do Securities Laws Matter?
- What is a Security?

  Notes
  Investment Contracts
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  Others

- Raising Capital

  Traditional Financing
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  Traditional Private Offerings
  The JOBS Act - New Alternatives

SOLICITATION OF INVESTORS BEFORE SECURITIES LAWS

Arizona Republican (September 14, 1910)

$20,000 WANTED

In Amounts From $100.00 Up

A Guaranteed Investment

No Insurances or Taxes to Pay

Eight Per Cent Interest Guaranteed

Ten Per Cent Yearly Increase of Principle

All Money Guaranteed by Deed

Investments All Made in Phoenix Where You Can See Them

Help to Build Up Phoenix

If you have $100 or $10,000, you cannot do better than invest in Home Builders' stock, which sells for $1.00 per share and pays 8 per cent. At the end of this quarter will be advanced to $1.10. See that your money is guaranteed by a deed to every foot of property it goes into.

We Can Use $20,000 at Once

HOME BUILDERS

GREENE & GRIFFIN

127 North Center Street

Arizona Republican (March 10,

We Pay Dividends Every Two Months

OJAI VALLEY PETROLEUM CO.

We entered the dividend-paying class last November, when we declared a dividend of 1 per cent. In January we declared our second dividend and in March we shall pay our third. This is at the rate of 6 per cent per annum on the par value of our stock.

We are offering a limited amount of this stock for public subscription at $50 a share. Par value $100. This makes your stock sure to bring you in 12 per cent on the cost of your investment from the start. The future you can judge from what we have accomplished. Performance speaks louder than promise!

Twenty-Six Wells in Two Years

The present income earned by our company is from the production of 7 wells—four in the Kern River district, and three in the Ojai Valley. We have contracted with the T. M. B. Oil Company to deliver to us 26 producing wells on our two properties within two years. What do you suppose our income will be when all these new wells are earning revenue for us as well as the old?

Every foot of our properties is oil bearing. We have 180 acres—140 in the Ojai, and 40 in Kern. There is room for 90 wells. What amount of dividends will we be able to pay when we have developed our ground to its full capacity?

$100 Shares
At $50
Pay 12
Per Cent

There's This Difference

There's This Advantage

GEORGE B. SCAMMELL, Fiscal Agent for

AGENT OJAI VALLEY PETROLEUM COMPANY
505 Delta Building, Los Angeles.
Please send me your prospectus and reserve for me
.....shares of stock without obligation on my part
to buy.
Name .....
Address .....

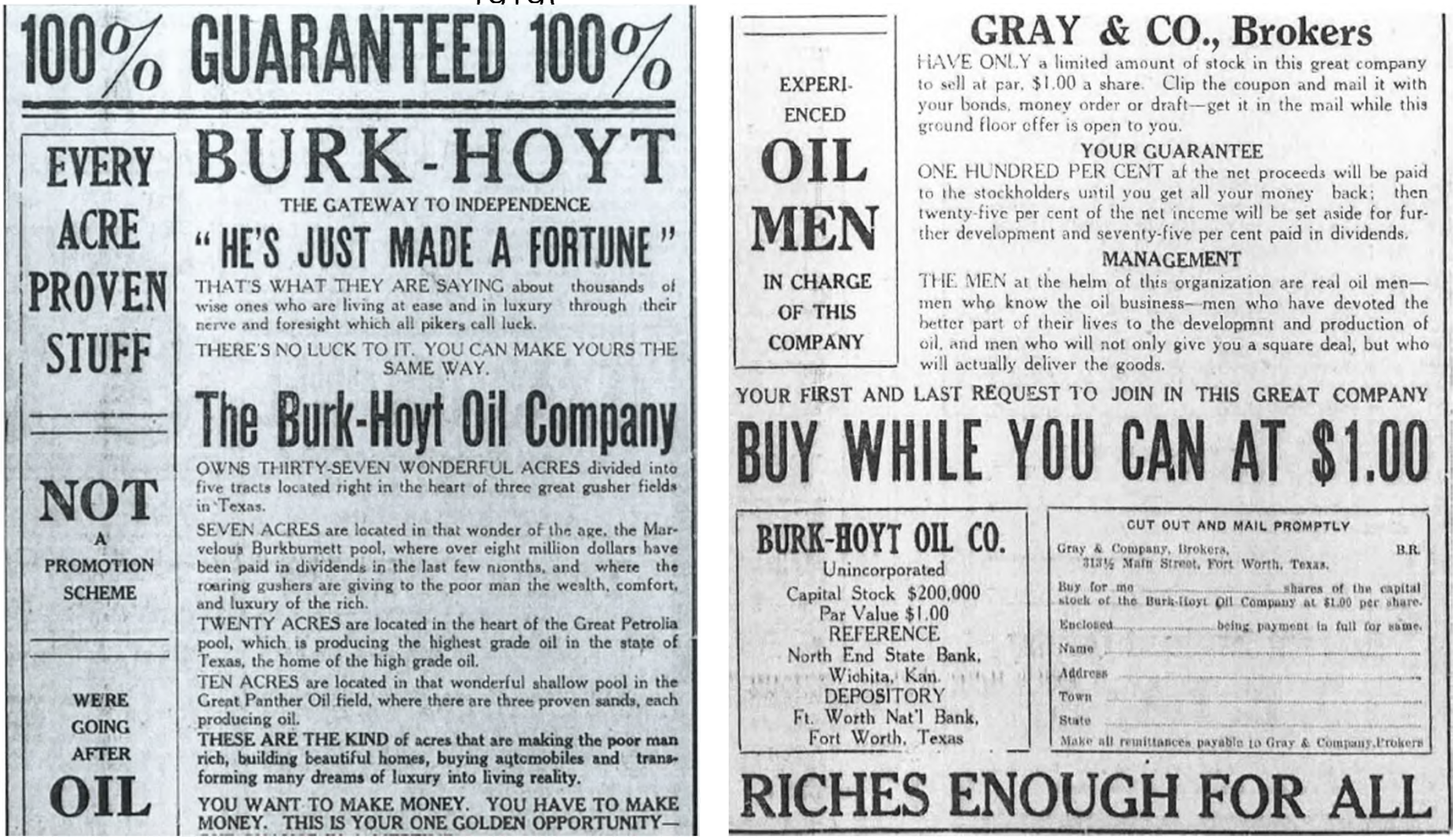
Ojai Valley Petroleum Co.

505 Delta Building, 426 So. Spring St.

Los Angeles, Cal.

SOLICITATION OF INVESTORS BEFORE SECURITIES LAWS

Bisbee Daily Review (June 20, 1919)



100% GUARANTEED 100%

EVERY ACRE PROVEN STUFF

NOT A PROMOTION SCHEME

WE'RE GOING AFTER OIL

BURK-HOYT

THE GATEWAY TO INDEPENDENCE

"HE'S JUST MADE A FORTUNE"

THAT'S WHAT THEY ARE SAYING about thousands of wise ones who are living at ease and in luxury through their nerve and foresight which all pikers call luck.

THERE'S NO LUCK TO IT. YOU CAN MAKE YOURS THE SAME WAY.

The Burk-Hoyt Oil Company

OWNS THIRTY-SEVEN WONDERFUL ACRES divided into five tracts located right in the heart of three great gusher fields in Texas.

SEVEN ACRES are located in that wonder of the age, the Marvelous Burkburnett pool, where over eight million dollars have been paid in dividends in the last few months, and where the roaring gushers are giving to the poor man the wealth, comfort, and luxury of the rich.

TWENTY ACRES are located in the heart of the Great Petrolia pool, which is producing the highest grade oil in the state of Texas, the home of the high grade oil.

TEN ACRES are located in that wonderful shallow pool in the Great Panther Oil field, where there are three proven sands, each producing oil.

THESE ARE THE KIND of acres that are making the poor man rich, building beautiful homes, buying automobiles and transforming many dreams of luxury into living reality.

YOU WANT TO MAKE MONEY. YOU HAVE TO MAKE MONEY. THIS IS YOUR ONE GOLDEN OPPORTUNITY—

EXPERIENCED OIL MEN IN CHARGE OF THIS COMPANY

GRAY & CO., Brokers

HAVE ONLY a limited amount of stock in this great company to sell at par, $1.00 a share. Clip the coupon and mail it with your bonds, money order or draft—get it in the mail while this ground floor offer is open to you.

YOUR GUARANTEE

ONE HUNDRED PER CENT of the net proceeds will be paid to the stockholders until you get all your money back; then twenty-five per cent of the net income will be set aside for further development and seventy-five per cent paid in dividends.

MANAGEMENT

THE MEN at the helm of this organization are real oil men—men who know the oil business—men who have devoted the better part of their lives to the development and production of oil, and men who will not only give you a square deal, but who will actually deliver the goods.

YOUR FIRST AND LAST REQUEST TO JOIN IN THIS GREAT COMPANY

BUY WHILE YOU CAN AT $1.00

BURK-HOYT OIL CO.
Unincorporated
Capital Stock $200,000
Par Value $1.00
REFERENCE
North End State Bank,
Wichita, Kan.
DEPOSITORY
Ft. Worth Nat'l Bank,
Fort Worth, Texas

CUT OUT AND MAIL PROMPTLY

Gray & Company, Brokers, B.R.
313½ Main Street, Fort Worth, Texas.

Buy for me _____ shares of the capital stock of the Burk-Hoyt Oil Company at $1.00 per share.

Enclosed _____ being payment in full for same.

Name _____

Address _____

Town _____

State _____

Make all remittances payable to Gray & Company, Brokers

RICHES ENOUGH FOR ALL

DEVELOPMENT OF SECURITIES LAWS - DUAL FEDERAL AND STATE REGULATION
STATES REGULATE FIRST

- Blue Sky Laws 1911-1933
  - State Securities Laws – First Statute - Kansas 1911
  - 47 states adopted blue sky laws through 1933 to curb "speculative schemes which have no more basis than so many feet of blue sky...." *Hall v. Geiger-Jones Co*., 242 U.S. 539 (1917)
  - Arizona essentially copied Kansas law, adopting its 1912 Investment Company Act.
- Arizona's Current Securities Law
  - The Arizona Securities Act (the "*ASA*"), enacted in 1951, replaced statutes enacted between 1912 and 1921, and was at the forefront of securities law reform. *See* Richard G. Himelrick, *Arizona Securities Law: Civil Liability, Defenses, and Remedies* (4th Ed., 2014)
  - While Arizona legislation and case law direct courts to use interpretations of federal securities laws as a guide, Arizona and federal securities laws sometimes materially differ. *See* Richard G. Himelrick, *Arizona Securities Law: How Relevant is Federal Securities Law?* 10 AZ. SUMMIT L. REV. 115-167 (2017)

DEVELOPMENT OF SECURITIES LAWS - FEDERAL REGULATION

Federal Securities Laws 1933-1940

- Securities Act of 1933 (the "**Securities Act**")
- Securities Exchange Act of 1934 (the "***Exchange Act***")
- Trust Indenture Act of 1940
- Investment Company Act of 1940
- Investment Advisers Act of 1940

Federal Securities Laws 1996-2012

- National Securities Markets Improvement Act of 1996 ("***NSMIA***")
- Sarbanes-Oxley Act of 2002 ("***SOX***")
- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("***Dodd-Frank***")
- Jumpstart Our Business Startups Act of 2012 ("***JOBS Act***")

COMPLIANCE WITH SECURITIES LAWS?

Securities Registration

- Every **offer or sale** of a security must be registered with the SEC and applicable states **unless** an exemption for the transaction or security applies
- Three main requirements for an offering:
  - Full disclosure of all material information is **always required** - what an investor would reasonably want to know about the issuer and the investment
  - Securities – Registration or an Exemption
  - Securities Dealer/Salesman – Registration or an Exemption

Failure to comply

- Criminal charges (fraud)
- Government sanctions
- Private civil lawsuits from investors – securities fraud v. common law fraud
- Rescission
- Practical inability to raise funds in the future - "*Bad Actor*" disqualifications

WHAT IS A “SECURITY”?

Arizona Revised Statutes § 44-1801:

"*Security*" means any note, stock, treasury stock, bond, commodity investment contract, commodity option, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, viatical or life settlement investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, real property investment contract 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.”

WHAT IS A "SECURITY"?

Arizona cases have recognized that the definition of "security" under Arizona law is patterned after and virtually identical to the Federal definition; Arizona courts look to federal interpretations for guidance. *First Citizens Federal Savings and Loan Association v. Northern Bank and Trust Co., N.A.*, 919 F.2d 510 (9th Cir. 1990); *State v. Brewer*, 26 Ariz. App. 408, 549 P.2d 188, 195 (1976); see also *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426, 431 (9th Cir., 1978). *But See*, *Siporin and Anchor v. Carrington*, Arizona Court of Appeals, Division One (April 19, 2001) disagreeing with the Federal Court of Appeals interpretation of "investment contract" as applied to viatical settlements.

Through interpretations, particularly of "investment contract", it is clear that "securities" include interests in many common business structures, such as tenant-in-common arrangements and sales of real estate condominiums with leasing management agreements

WHAT IS A "SECURITY"?
NOTES

Both federal and Arizona statutes begin by defining "security" as any "note." However, promissory notes are issued in a broad range of transactions, and over the years, courts have recognized numerous instances in which notes were not deemed "securities."

The *Reves* Decision

The Supreme Court first considered the question as to whether promissory notes were securities in *Reves v. Ernst & Young*, 110 U.S. 945 (1990). *Reves* arose in the context of a large number of demand promissory notes issued by a farmer's cooperative in Arkansas to support the co-op's operations. The notes carried an adjustable rate of interest and were marketed as an "investment program." The Supreme Court found the notes **were** securities.

In *Reves*, the Supreme Court held that every promissory note is a security unless it bears a strong "*family resemblance*" to a judicially crafted list of notes that are not securities.

WHAT IS A "SECURITY"?
NOTES

Seven types of notes rebut the securities presumption:

a. a note delivered in a consumer financing transaction;

b. a note secured by a home mortgage;

c. a short term note secured by a lien on a small business or some of its assets;

d. a note evidencing a "character" loan to a bank customer;

e. a note which simply formalizes an open-account debt incurred in the ordinary course of business;

f. a short term note secured by an assignment of accounts receivable; and

g. a note evidencing a loan by a commercial bank for a company's current operations.

Based on an analysis of the available legislative history, most lower courts (including the Ninth Circuit) have found that the above statutory exemption applies only to "commercial," as opposed to "investment," notes of short-term maturity. See *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976) (using the "risk capital" approach); *United California Bank v. THC Financial Corp*., 557 F.2d 1351 (9th Cir. 1977); *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc*., 583 F.2d 426 (9th Cir. 1978).

WHAT IS A "SECURITY"?
NOTES

"Notes" in Arizona

In *First Citizens Federal Savings & Loan Ass'n v. Worthen Bank and Trust Company*, 919 F.2d 510 (9th Cir. 1990), the Ninth Circuit held that the *Reves* test for determining when notes are securities under the federal securities laws applies when evaluating whether notes are securities under A.R.S. § 44-1801. A loan by a commercial bank to a developer to finance a project fit the judicial list of exceptions, and was held not to be a security.

Most other Arizona cases on point deal with the relatively simple situation where notes secured by mortgages or deeds of trust were mass marketed as an investment device. *State v. Brewer*, 26 Ariz. App. 408, 549 P.2d 188 (1976), *State v. Lippand*, 26 Ariz. App. 417, 549 P.2d 197 (1976); *Hall v. Security Planning Service*, 371 F. Supp. 7 (D. Ariz. 1974).

WHAT IS A "SECURITY"?
INVESTMENT CONTRACTS

The term "investment contract" is not further defined by statute, and federal and state courts struggled to construct a workable definition. Many transactions that do not involve commonly recognized securities, such as stocks or bonds, may nevertheless involve securities because an "investment contract" exists.

The *Howey* Test

The test for an investment contract is primarily derived from the case of *SEC v. W.J. Howey Co*., 328 U.S. 293 (1946). Under the *Howey* test, as it has evolved, an investment contract consists of:

1) An investment of money or other consideration;
2) in a common enterprise;
3) with the expectation of a profit;
4) to be derived substantially from the efforts of a promoter or others.

WHAT IS A "SECURITY"?
INVESTMENT CONTRACTS: THE *HOWEY* TEST

In *Howey*, the Court held that a land sales contract for units of a citrus grove, together with a service contract for cultivating and marketing the crops, was an investment contract and therefore a security. The Court held that, in essence, what was being offered was "an opportunity to contribute money and to share in the profits of a large citrus fruit enterprise managed and partly owned by respondents." The purchasers had no intention themselves of either occupying the land or developing it, they were attracted only "by the prospects of a return on their investment."

The *Howey* case originally used the phrase "***solely*** from the efforts of others," but this was amended in the Ninth Circuit by *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476 (9th Cir. 1973), in which "*solely*" was modified to "***substantially***." The *Turner* Court adopted

". . . a more realistic test, whether the efforts made by those other than the investor are undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." Id. at 482.

WHAT IS A "SECURITY"? INVESTMENT CONTRACTS: THE *HOWEY* TEST

Ninth Circuit Cases interpreting *Howey*

The primary case from the Ninth Circuit interpreting *Howey* is *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1989), cert. denied, 110 S. Ct. 1805 (1990). *Hocking* involved a Las Vegas resident who purchased a resort condominium in Hawaii which included participation in an optional rental pool with a rental agent. The condominium was not purchased directly from the developer, but from an individual seller. Hocking sued the real estate brokers for securities fraud.

The Court, sitting *en banc*, analyzed each element of the *Howey* test, and overturned a summary judgment entered in favor of the defendants, holding that, depending on the facts, the sale of a condominium with optional participation in a rental pool may constitute sale of an "investment contract" if the condominium and rental pool are presented to the buyer as part of the same transaction or scheme.

The *Hocking* decision was made by the Ninth Circuit sitting *en banc*. By a six to five vote, they held that, depending on the facts, the sale of a condominium with optional participation in a rental pool may constitute sale of an "investment contract" if the condominium and rental pool are presented to the buyer as part of the same transaction or scheme.

WHAT IS A "SECURITY"?
INVESTMENT CONTRACTS: THE *HOWEY* TEST

A "*common enterprise*" may be established by either "horizontal commonality" or "vertical commonality." Horizontal commonality is usually evidenced by a pooling of assets from two or more investors. Vertical commonality does not require pooling. It requires only that "the investor and the promoter be involved in some common venture without mandating that other investors also be involved in that venture. ... Even a venture with one investor can be a common enterprise if the promoter's remuneration depends on the success of the venture." 885 F.2d at 1455. The Second Circuit has held that "broad" vertical commonality does not result in a "common enterprise." *Revak v. SEC Realty Corp*., 93-94 CCH Dec. ¶98,098 (2nd Cir. 1994).

"*Expectation of Profits Produced By the Efforts of Others*" -- This prong of the *Howey* test considers the investor's legal and practical ability to control his investment, and looks to its economic reality. Where the investor is a general partner or a joint venturer, he has legal control over his investment, and has not purchased a security. To claim the investment is a security, the investor must show "practical dependence." In sum, if an investor retains legal control, he must show that his exercise of control was precluded for all practical purposes. See *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981); *Matek v. Murat*, 862 F.2d 720 (9th Cir. 1988); *Deutch Energy Co. v. Mazur*, 813 F.2d 1567 (9th Cir. 1987).

WHAT IS A "SECURITY"?
INVESTMENT CONTRACTS: THE "RISK CAPITAL" TEST

Although the *Howey* test represents the position of the Supreme Court and the SEC, as well as a majority of the states, there are a number of states that apply an additional test. This is known as the "risk capital" test set forth by the California Supreme Court in *Silver Hills Country Club vs. Sobieski*, 361 P.2d 906 (Cal. 1961) in determining whether an interest constitutes a security.

In 1959, some enterprising developers bought land in Marin County to develop a country club. To pay for some of the costs of building the club, they sold charter memberships in the club. The members would not share in the profits or ownership of the club but would have the right to use club facilities. Under the federal definition, these memberships would not be securities because the members joined the club to get the benefits of membership, not for a financial return.

WHAT IS A "SECURITY"?
INVESTMENT CONTRACTS: THE "RISK CAPITAL" TEST

In *Silver Hills Country Club*, the court held that the sale of membership interests in a country club was a security because it fell under the purview of the regulatory intent of California's corporate securities act. The court held that courts have to look through form to substance to protect the public from schemes to attract "risk capital," which it found in this case. The court found that the investors were risking their capital in expectation or receiving the benefits of club membership, which was in the control of the issuers of the membership. Notably, the court stated the "act extends even to transactions where capital is placed without expectation of any material benefits."

The risk capital test is stated broadly as condemning a transaction that involves raising "funds for a business venture or enterprise; an indiscriminate offering to the public at large where the persons solicited are selected at random; a passive position on the part of the investor; and the conduct of the enterprise by the issuer with other people's money." The risk-capital test "focuses retrospectively on what the investor stands to lose rather than prospectively on what he expects to gain."

The risk capital test has been adopted in some form in sixteen jurisdictions (in addition to California).

WHAT IS A "SECURITY"? INTERESTS IN LIMITED LIABILITY COMPANIES, PARTNERSHIPS, JOINT VENTURES

Manager-Managed Limited Liability Companies and Limited Partnerships

Membership interests in manager-managed limited liability companies and limited partnership interests are, by definition, investment contracts, and therefore, securities. Both limited liability companies and limited partnerships require (a) an investment of money or other consideration; (b) in a common enterprise; (c) with an expectation of profit. A limited partnership must be formed to conduct a business for profit. The existence of a manager or general partner means that the members or limited partners are relying substantially on the efforts of others.

Member-Managed Limited Liability Companies, General Partnerships/ Joint Ventures

A member-managed limited liability company or a general partnership *may not* involve a security *if* each general partner or member (a) has the power to participate in management decisions; and (b) is genuinely involved in policy making and administration. If so, the "efforts of others" prong of the *Howey* test is not met. However, meeting their test is difficult, and involves continuous attention and good record-keeping.

WHAT IS A "SECURITY"? INTERESTS IN LIMITED LIABILITY COMPANIES, PARTNERSHIPS, JOINT VENTURES

Initially, courts focused on the legal rights of the partners to control the partnership, irrespective of whether the parties exercise such rights. *Matek v. Murat*, 862 F.2d 720, 730-32 (9th Cir. 1988); THAT CHANGED

Limited Liability Company Cases

Nutek Information Systems, Inc. v. Arizona Corp. Commission, 194 Ariz. 104, 977 P.2d 826 (Ct. App. 1998). In a case of first impression in Arizona, the Court of Appeals decided that membership interests in "member-managed" LLCs without a manager, but with a "managing member" are investment contracts, and therefore securities. The parties agreed that the membership interests satisfied the first two prongs of the *Howey* test, and the question for the Court was whether investors "expected profits based on the efforts of others."

WHAT IS A "SECURITY"? INTERESTS IN LIMITED LIABILITY COMPANIES, PARTNERSHIPS, JOINT VENTURES

Certain individuals and companies, including SMR Advisory Coop, L.C. ("SMR"), which owned radio licenses, formed LLCs to obtain licenses and construct, maintain and operate five-channel dispatch communications systems. The promoters intended that the LLCs would enter into a cooperative operating relationship to form the Western Regional Network, and they collected over $10.4 million from over 900 investors. SMR combined investors' funds into a single administrative account to purchase equipment and pay expenses, which were charged to the respective LLCs. Each LLC entered into a System Construction and Management Agreement with SMR. SMR would negotiate contracts, construct a system and receive customer payments. The agreements provided that the licensee LLC retained ultimate control, but the management agreements would automatically renew unless a court found SMR guilty of gross negligence or fraud.

After the Securities Division initiated proceedings for alleged securities law violations, the promoters offered refunds to investors. At an Arizona Corporation Commission hearing, the promoters were found to have violated securities laws.

The Arizona Court of Appeals affirmed the findings. Its analysis was guided by the three-part test enunciated in *Williamson v. Tucker* (see below), and the panel examined whether managing members had both legal and practical control. Although the LLC documents afforded investors "legal control," the Court found that the agreements among the parties prevented the members from exercising effective control. Principal management functions were performed by the promoter in accordance with management agreements. In addition, the investors lacked the technical expertise to manage the LLCs, and were dependent on the skills of the promoter.

WHAT IS A "SECURITY"? INTERESTS IN LIMITED LIABILITY COMPANIES, PARTNERSHIPS, JOINT VENTURES

The promoters argued that the investors were sophisticated, and had legal rights to exercise control. The promoters also argued that the test adopted in the *Williamson v Tucker* focuses on business acumen generally, not the specific enterprise in question. The Arizona Court adopted the Fifth Circuit's view that the "efforts of others" part of the *Howey* test requires investors to have "meaningful knowledge of the specific business being operated," not just general business knowledge.

The Court refused to analogize LLCs to general partnerships and create a presumption against the existence of a security in a member-managed LLC. The Court reasoned that, unlike general partners, LLC members lacked the key incentive of personal liability to be active in the business. In this case, the Court relied on the finding that, the investors were so dependent on the entrepreneurial ability of the promoter that they could not replace the manager. The Court determined that any profits would arise from the efforts of others, and the membership interests in the LLCs were securities.

WHAT IS A "SECURITY"? INTERESTS IN LIMITED LIABILITY COMPANIES, PARTNERSHIPS, JOINT VENTURES

Ninth Circuit Partnership Cases

In *Koch v. Hankins*, 928 F.2d 1471 (9th Cir. 1991), the Ninth Circuit rejected the lower court's reliance on *Matek*, citing its en banc decision in *Hocking v. DuBois*, 885 F.2d 1449 (9th Cir. 1989), which expressly adopted *Williamson v. Tucker*, 645 F.2d 404 (9th Cir. 1981). *Williamson* sets forth three factors, each of which must be applied to determine when a transaction labeled as a "general partnership" is nonetheless an investment contract and a security:

1. The partnership agreement leaves so little power in the hands of the general partners that the arrangement in fact distributes power as a limited partnership;

2. The partner is so unknowledgeable in business affairs that he is incapable of intelligently exercising partnership powers; and

3. The partner is so dependent on some unique entrepreneurial or managerial ability of the promoter that the partner cannot replace the promoter or otherwise exercise meaningful partnership powers.

Williamson, 645 F.2d at 425.

WHAT IS A "SECURITY"?
TENANT-IN-COMMON INTERESTS

On January 14, 2009, the SEC issued a response to a no-action letter request by *OMNI Brokerage, Inc., Argus Realty Investors, L.P., and PASSCO Companies, LLC* regarding their tenant-in-common interests program. The SEC said no to the "no action" request.

"Based on the facts presented, the Division disagrees with your view that the proposed offer and sale of undivided tenant in common interests pursuant to the Master Lease Transactions and Property Management Transactions (each as defined in your letter) do not involve securities within the meaning of Section 2(a)(1) of the Securities Act of 1933. As a result, the Division is unable to assure you that it would not recommend enforcement action to the Commission unless such offers and sales are registered under the Securities Act or exempt from registration."

Sponsors of Tenant-in-Common ("*TIC*") programs should treat their TIC interests as securities. Assuming that a limited partnership or LLC vehicle is not used, a sale of land in parcels or in the form of undivided interests will likely be a security depending upon the inducements to the purchaser and the extent to which the purchaser is looking to the promoter for essential management.

WHAT IS A "SECURITY"? COUNTRY CLUB MEMBERSHIPS

A country club membership was first held to be a security in *Silver Hills Country Club,* discussed above. However, over the past 30 years or so, the SEC has issued several dozen "no-action" letters that concur with the opinion that a country club membership is not a security where the primary motivation is to be a member in the club, rather than to profit from the ownership of the membership interest. *Golf Club of the Everglades, Inc.* (April 27, 2000). In general, the membership must be structured so that they do not have the "significant characteristics typically associated with 'stock'" described in *Landreth*, above.

Memberships should not have all of the following: (a) transferability or negotiability; (b) the ability to be pledged or hypothecated; (c) proportional voting rights; and (d) the ability to appreciate in value. If memberships do not receive profits or dividends, and if the transfer of memberships is significantly restricted, SEC interpretations have allowed members to potentially make a reasonable profit on the transfer of a membership interest. Currently, interpretations allow members to receive an amount of up to 80% of the purchase price of their memberships. *See Las Sendas Golf Club, Inc.* (March 2, 2004).

WHAT IS A SECURITY?
REAL ESTATE CONDOMINIUMS

The SEC has issued extensive guidelines for determining when an offering of condominiums or other housing units may be seen as a securities offering. The guidelines state that the federal securities laws are applicable when the offer or sale is coupled with an offer or agreement to perform or arrange certain rental or other services for the purchaser. See Release No. 33-5347 (1973) at 1049 CCH Fed. Sec. L. Rep. See *Hocking v. Dubois*, above.

FRACTIONAL UNDIVIDED INTERESTS IN OIL, GAS, OR OTHER MINERAL RIGHTS

Fractional undivided interests in oil, gas and other mineral rights are specifically included in the definition of "security" without regard to whether the transfer is by deed or contract of sale of real estate, or whether the law of the particular state in which the property act is located considers the interests as real estate or personal property. (See 17 CFR 231.185.)

HOW WILL YOU RAISE CAPITAL?

Traditional Bank Loans – even if a financial institution will lend, bank loans will almost always require a first mortgage or other first lien on assets as security, and often personal guarantees.

Mezzanine Financing

Private Money "Bridge" Loans

Hard Money Loans

Equity and Debt Financing by Selling Securities - All of the following methods involve offering and selling securities to investors, typically in an exempt private placement:

- **Friends & Family**
- **Investment Banks**
- **Angel Investors**
- **Private Equity**
- **Venture Capital**

CAUTION - Paying Commissions Requires a License

With few exceptions, any person raising capital, and receiving commissions or other compensation directly or indirectly related to the offer and sale of securities **must** have a securities license. A narrow exemption is described in the SEC's 2014 "*M&A Broker no-action letter*".

Common exemptions, including Regulation D limited offerings, as well as new Crowdfunding and Regulation A+, only apply to **transactions** in securities. They do not exempt the person offering and selling securities from licensure requirements.

Federal law requires licenses for securities "brokers", "dealers" and their "associated persons". It is unlawful for any of those persons to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless they are registered with the SEC.

Arizona requires registration of every dealer and salesman. A dealer is "a person who directly or indirectly engages full-time or part-time in this state as agent, broker or principal in the business of offering, buying, selling or otherwise dealing or trading in securities". A person offering or selling securities must be registered as a dealer or salesman. A violator is guilty of a class 4 felony.

OVERVIEW OF AVAILABLE EXEMPTIONS FROM REGISTRATION OF SECURITIES OFFERINGS

Overview

Companies seeking to raise capital should carefully consider the alterative methods of issuing securities. A variety of factors influence the structure of a company and its securities offerings, including the amount of capital required, the stage of development of the company, tax considerations, the necessity for liquidity, costs, timing, the differing requirements of federal and state law, and other issues. Companies issuing securities must balance these factors in determining which fund-raising method is appropriate.

EXEMPTIONS FROM REGISTRATION

Incorporators and Organizers Exemption - A.R.S. Section 44-1844(10)

This state law exemption, which was in Arizona's 1951 Securities Act, provides a one-time exemption for:

"The issuance and delivery of securities to the original incorporators, not exceeding ten in number," provided

- the securities are not acquired for sale to others
- the securities are not sold within 24 months, barring a change in circumstances
- all incorporators are notified of right to review financials and records

A 2016 amendment extended the exemption to organizers of LLCs, as well as general partners of limited partnerships and limited liability limited partnerships.

This exemption is a "*no-sale*" exemption, and only covers persons who sign the articles of incorporation, articles of organization or certificate of limited partnership.

REGULATION S - EXEMPT OFFERS AND SALES TO NON-U.S. PERSONS

Regulation S is a series of five rules that clarified the position of the SEC that securities offered and sold outside of the United States do not need to be registered with the SEC. Regulation S reiterates that any offer or sale occurring inside the United States or made to U.S. Persons is subject to the registration requirements of the Securities Act in the absence of an exemption from these requirements. The United States securities laws are meant to protect United States capital markets and investors who purchase securities in the United States markets, whether United States or foreign nationals.

Regulation S specifies two safe harbors, an ***issuer*** safe harbor and a ***resale*** safe harbor, which provide that offers and sales made in compliance with certain requirements are deemed to have occurred outside the United States and are, therefore, exempt from the registration requirements of the Securities Act. Since any offer and sale occurs outside the United States, no state or federal regulation applies.

An issuer or other seller can protect itself with appropriate Regulation S subscription documents.

However, any issuer must comply with the laws of any foreign jurisdiction in which securities are offered or sold.

ARIZONA RULE 140
ACCREDITED INVESTOR PUBLIC OFFERING EXEMPTION

Arizona Rule 140

R14-4-140 ("***Rule 140***") is designed to assist small businesses in raising up to $1,000,000 in a matter that does not impose unnecessary expenses. Rule 140 allows issuers who rely on federal Rule 504, and comply with Rule 504(b)(iii), to offer and sell without registration of the offering in Arizona securities to accredited investors, as defined in Rule 126, provided certain conditions are met. A Rule 140 offering must comply with SEC Rule 147 as an intrastate offering.

Rule 140 was designed to comply with the $1,000,000 limit contained in old Rule 504. In October 2016, that limit was moved up to $5,000,000. Arizona Rule 140 has not been changed.

FEDERAL RULE 147-INTRASTATE OFFERINGS

Section 3(a)(11) of the 1933 Act provides an exemption from the federal registration requirements for any offer or sale of securities to residents of a single state by an issuer that resides in or is incorporated in the same state and does business in that state. An investor offering may be registered as a public offering with the state, but is exempt from federal registration.

The "intrastate exemption" has three major components:

1. The issues must be doing business within the state, which has been interpreted to mean having substantial operational activities in the state;
2. All offers and sales must be to residents of the state; and
3. The securities that are sold must "come to rest" in the hands of investors who are residents of the state.

CHANGES TO RULE 147 AND REGULATION D RULE 504

Amendments to Rule 147 were adopted October 26, 2016. The amendments were an attempt to modernize Rule 147 and established a new "intrastate" offering rule, Rule 147A, which has no restrictions on offers, and allows issuers to be incorporated or organized outside of the offering state if certain conditions are met.

Those final rules also adopted changes to Regulation D, increasing the aggregate amount of securities that may be offered under Rule 504 from $1 million to $5 million, and adding "bad actor" disqualifications.

THE TRADITIONAL PRIVATE PLACEMENT EXEMPTION

Section 4(a)(2) of the 1933 Act and Section 44-1844(A)(1) of the Arizona Securities Act provide an exemption from their registration provisions for "transactions by an issuer not involving any public offering."

Traditionally, in order to satisfy the statutory private offering exemption, sales of securities can only be made without advertising (or any other form of "general solicitation") to a limited number of "sophisticated persons" with "access to the information that be included in a registration statement." An offer of securities to even one unsophisticated person could result in the loss of the exemption.

The statutory private placement exemption is self-executing; i.e. has no filing requirement.

The "*no general solicitation*" restriction was changed by the JOBS Act.

FEDERAL REGULATION D AND ARIZONA RULE 126 LIMITED OFFERING EXEMPTIONS

Federal Regulation D consists of Rules 501 through 508 promulgated by the SEC under the 1933 Act that includes exemptions from registration for four categories of offerings. Regulation D was originally adopted in 1982. The Arizona equivalent is Rule 126, sections A through H.

Rule 501 defines or explains a number of terms and related matters under Regulation D, including accredited investor, affiliate, aggregate offering price, business combinations, calculation of number of purchasers, executive officer, issuer, and purchaser representative.

Rule 502 sets forth the requirements regarding the information that an issuer must provide a prospective purchaser, whether accredited or otherwise qualified, under each of the exemptions.

Rule 503 describes the notice filing requirement that is applicable to each of the exemptions.

Rules 504, 506(a) and 506(b) provide exemptions for three categories of limited offerings.

Rule 504 was amended, and Rule 505 was eliminated in October 2016.

RULE 504

Rule 504 exempts offerings of $5,000,000 (changed from $1,000,000 in October 2016) or less from Federal registration requirements. It has no direct Arizona equivalent exemption, but may be used in conjunction with Arizona Rules 101 (existing shareholders), 102 (10 persons; $100,000), 140 (accredited investors only) and 144 (special registrations). Arizona rules have not yet been amended to conform with federal rule changes.

RULE 505 was rarely used: and was ***eliminated October 2016***

Rule 505 provided (and Rule 126(E) Arizona equivalent still provides) an exemption from registration for limited offers and sales not exceeding $5,000,000. Offerings by any issuer of less than $5,000,000 in a 12-month period to an unlimited number of “accredited investors” plus 35 additional persons were exempt from federal registration under Rule 505.

RULE 506 - MOST PRIVATE PLACEMENTS

The SEC adopted Rule 506 of Regulation D as a "safe harbor" for private offerings of an unlimited amount of securities. If an issuer complies with the requirements of Rule 506 of Regulation D, the issuer will be deemed to have met the requirements for the Section 4(a)(2) private placement exemption.

An issuer may be disqualified from using the rule if it or its affiliates or certain other persons associates with the offering were the subject of certain administrative, civil, or criminal actions (so called "bad actor" provisions).

Securities sold under Rule 506 are "restricted securities" and may not be resold without registration or an exemption from registration.

The National Securities Markets Improvement Act of 1996 ("***NSMIA***") provides that securities exempt from registration with the SEC under rules or regulations issued under Section 4(a)(2) (i.e. Rule 506) are "**covered securities**," which are exempt from state registration requirements

RULE 506-PRIVATE PLACEMENTS

As changed by the JOBS Act, Rule 506 provides for two types of offerings, one subject to traditional limitations prohibiting general solicitation, and one not subject to limitations on the matter of the offering.

Rule 506(b) provides an exemption for offerings of any amount by any issuer to an unlimited number of accredited investors plus 35 "sophisticated" persons who are not accredited. Rule 506(b) prohibits use of general solicitation or general advertising.

Rule 506(c) provides an exemption for offerings of any amount by an issuer and allows general solicitation or general advertising, provided sales are only made to accredited investors. Unlike Rule 506(b), an issuer is required to take reasonable steps to verify that purchasers of securities sold under 506(c) are accredited investors. If general solicitation is conducted, the offering must be sold through a dealer registered in Arizona.

GENERAL SOLICITATION
SEC COMPLIANCE AND DISCLOSURE INTERPRETATIONS (C&DI)
AUGUST 6, 2015

- Offer to prospective investor with whom issuer **or its agent** has pre-existing substantive relationship is **not** general solicitation
- Issuer/agent needs sufficient information to evaluate, and must evaluate, investor's financial circumstances and sophistication
- Check-the-box questionnaire is **not** sufficient
- Facts and circumstances tests; no waiting period
- Use of unrestricted public website is general solicitation
- Issuers may be able to contact experienced, sophisticated investors through informal networks like "angel investors"
- Venture fairs or "demo days" may not be general solicitation

RULE 506-PRIVATE PLACEMENTS

Disclosure Requirements – As set forth in Rule 502, If the issuer sells securities under to any purchaser who is not an accredited investor, the issuer must shall furnish essentially the same information as if the offering was registered with the SEC to such purchaser a reasonable time prior to sale. No specific form of disclosure is mandated if the issuer sells securities only to accredited investors.

Filing Requirements - An issuer must file one copy of Form D with the SEC and one copy with each state in which a security is sold no later than 15 days after the first sale of securities in the jurisdiction Arizona. Each state has its own filing fee (Arizona is $250).

WHO CAN PLAY-ACCREDITED INVESTORS

The term "**accredited investor**" is defined in Rule 501 of Regulation D as:

1. a bank, insurance company, registered investment company, business development company, or small business investment company;

2. 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;

3. a charitable organization, corporation, or partnership with assets exceeding $5 million;

4. a director, executive officer, or general partner of the company selling the securities;

5. a business in which all the equity owners are accredited investors;

6. **a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds $1 million at the time of the purchase, or has assets under management of $1 million or above, excluding the value of the individual's primary residence;**

7. **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

8. a trust with assets in excess of $5 million, not formed to acquire the securities offered, whose purchases a sophisticated person makes."

ACCREDITED INVESTOR ISSUES

Qualifications for Accredited Investors. In recent years, there have been several attempts to change the qualifications for accredited investors currently set forth in Rule 501 of Regulation D. The qualifications were originally adopted in 1982 and have not changed. Dodd-Frank directed the SEC to review the accredited investor definition as it relates to natural persons every four years to determine whether the definition should be modified or adjusted.

2015 Study. In March, 2015 an SEC Small Business Advisory Committee found that adjustments for inflation proposed by some legislators would have increased income thresholds to approximately $500,000 and $628,000 (from $200,000 and $300,000) and the net worth threshold to approximately $2.5 million (from $1 million), reducing the number of U.S. households that qualify as accredited investors from 12.4% to approximately 4.4%. Finding that there was "little to no evidence" that using the existing definition of accredited investor has led to widespread fraud or other harm to investors, the Committee determined that the current private offering system is critical to the support of smaller and emerging companies, and that a significant increase to the income or net worth thresholds to account for over 30 years of inflation would materially decrease the current pool of capital available to small business and have a significantly negative effect on the market.

ACCREDITED INVESTOR ISSUES

Accredited Investor Qualifications May Change

Mandated Report. On December 18, 2015, as mandated by Dodd-Frank, the SEC issued a 118-page staff report on the accredited investor definition:

http://www.sec.gov/news/pressrelease/2015-284.html

Pending Legislation. Arizona Congressman Schweikert introduced H.R. 2187, which passed the House of Representatives February 1, 2016, the bill would:

1. protect the current definition of accredited investor to include "any natural person…whose net worth exceeds $1,000,000…" or whose annual income exceeds $200,000 (to be adjusted for inflation by the CPI every 5 years); and

2. add to the current definition (a) individuals registered as investment advisors and securities brokers; and (b) investors whom the SEC "determines have demonstrable education or job experience to qualify … as having professional subject-matter knowledge related to a particular investment."

Moved to Senate; no action there.

FEDERAL AND STATE REGISTRATION OF OFFERINGS

If an issuer cannot, or elects not to, meet the requirements to qualify for an exemption from registration for its offering of securities, the issuer must register the offering with the SEC, Arizona and any other state prior to making any offer or sales. Some types of offerings may be exempt from federal registration, but still require registration in Arizona and other states in which offers or sales will be made.

Federal registration is expensive and time consuming. Most initial public offerings ("IPOs") are conducted by companies with at least $100,000,000 in annual revenues.

NSMIA's "**covered securities**" concept preempts state registration for certain classes of securities, including: (a) securities listed (or approved for listing) on the NYSE, AMEX or NASDAQ/National Market; (b) mutual fund shares; and (c) certain exempt securities.

If state registration is required, two types of state regulation statutes exist:

(a) disclosure review; and

(b) merit review (which includes Arizona) where the state must determine that the offering "would be unfair or inequitable to the purchaser."

THE **J**UMPSTART **O**UR **B**USINESS **S**TARTUPS ACT

The JOBS Act was enacted April 5, 2012, upon signing, President Obama said:

"for start-ups and small businesses … a potential game changer…. Because of this bill, start-ups and small business will now have access to a big, new pool of potential investors -- namely, the American people. For the first time, ordinary Americans will be able to go online and invest in entrepreneurs that they believe in."

- Title I – Emerging Growth Companies
- **Title II – Access to Capital – Rule 506(c)**
- **Title III – Crowdfunding**
- **Title IV – Small Company Capital Formation – Regulation A**
- Title V – Private Company Flexibility and Growth – Section 12(g) requirements
- Title VI – Capital Expansion – Shareholder Threshold
- Title VII – Outreach

The JOBS Act required the SEC to write rules and issue studies on capital formation, disclosure and registration requirements. The SEC began writing the rules…

TITLE II OF THE JOBS ACT – Public Solicitation Under the Private Placement Exemption

- **Section 4(a)(2) of the Securities Act provides an exemption from registration for "transactions by an issuer not involving any public offering"**

- Congress directed the SEC to remove the ban on general solicitation in private securities offerings conducted under Rule 506(c) and Rule 144A (safe harbor for sales to institutional buyers) so long as the securities are **sold only to**:
  - Accredited Investors as defined in Rule 501 of Regulation D – eight categories; includes individuals with a $1,000,000 net worth or $200,000/$300,000 in annual income; and/or
  - Qualified Institutional Buyers ("***QIBs***") – generally large institutional investors with at least $100,000,000 in investable assets

RULE 506(c) - General Solicitation of Investors

- "**Bad actor**" disqualifications for users – Rule 506(d)
- Issuers may publically solicit if "using such methods as determined by the [SEC]" they **verify** that purchasers are accredited
- Issuers must take reasonable steps to verify accredited investor status of purchasers; may no longer rely on investor representations
- The SEC adopted a "safe harbor" verification of investors

RULE 506(c) - General Solicitation of Investors - "Reasonable Steps to Verify"

Four verification methods (non-exclusive, non-mandatory):

1. **Income ($200,000/$300,000)**:

   IRS forms (W-2, 1099, K-1, 1040) that show last 2 years of income and written representations from purchaser

2. **Net Worth ($1,000,000)**:

   Assets – bank, brokerage and other statements, CODs, tax assessment appraisal reports

   Liabilities – report from a nationwide credit reporting agency

3. **Third Party Confirmation**: Written confirmation from

   - Broker-Dealers
   - Registered Investment Advisors
   - Attorneys
   - CPAs

4. **Prior Purchasers**: Certification that they continue to be Accredited Investors

TITLE III of the JOBS Act-Federal Crowdfunding

Final federal Crowdfunding Rules implementing new Section 4(a)(6) of the Securities Act (**Title III of the JOBS Act**) were adopted by the SEC October 30, 2015 and went into effect May 16, 2016. http://www.sec.gov/news/pressrelease/2015-249.html

- The new Crowdfunding Rules enable investors to purchase securities in crowdfunding offerings.
- Issuers may offer and sell a maximum of $1,000,000 in any 12-month period through crowdfunding offerings.
- Investors may invest up to $100,000 across all crowdfunding offerings in the course of a 12-month period, depending on their annual income and net worth.
- A crowdfunding offering is exempt from the registration requirements of the Securities Act, but is open to all types of investors, including ordinary retail, non-accredited investors.

However, it is not clear to what degree small companies will utilize the Crowdfunding Rules given the relatively low investment limits, the complexity of the rules, and the associated compliance costs. Full text of the final 685-page rules release (the "***Crowdfunding Release***") is at: https://www.sec.gov/rules/final/2015/33-9974.pdf

FEDERAL CROWDFUNDING
Intermediaries – Broker-Dealers & Funding Portals

Intermediaries. A crowdfunding offering may be made exclusively "online" on a crowdfunding platform through a single intermediary, which must be a registered *broker-dealer* or registered "***Funding Portal***" (a new concept). A new Form Funding Portal to register as an intermediary is set forth at pages 624-664 of the Crowdfunding Release.

Compensation. Intermediaries may receive compensation from issuers and/or investors in connection with facilitating crowdfunding offerings, including compensation in the form of the issuer's securities. Intermediaries (and issuers) may also compensate third parties for referring people to the intermediary's crowdfunding platform and/or the issuer's offering on the platform, subject to certain restrictions

Compliance Obligations. Intermediaries in crowdfunding offerings also have extensive compliance obligations.

Intermediaries must, among other things:

- Provide investors with certain educational materials
- Take measures to reduce the risk of fraud
- Make an issuer's required disclosures available to the public on its platform
- Provide communication channels to permit discussions about offerings on the platform

CROWDFUNDING – "Bad Actors" Cannot Crowdfund Under Either Federal or State Law

An issuer may not use either federal or Arizona crowdfunding if the issuer or an affiliated person (a "***Bad Actor***") has a relevant criminal conviction, regulatory or court order or other disqualifying event, including:

- Certain criminal convictions
- Certain court injunctions and restraining orders
- Final orders of certain state and federal regulators
- Certain SEC disciplinary orders
- Certain SEC cease-and-desist orders
- SEC stop orders and orders suspending the Regulation A exemption
- Suspension or expulsion from membership in a self-regulatory organization (SRO), such as FINRA, or from association with an SRO member
- U.S. Postal Service false representation orders

"Bad Actor" disqualifications also apply to many exemptions, including private offerings under Regulation D and offerings registered under Regulation A.

ARIZONA CROWDFUNDING

- Largely because of the delay in adopting the federal rules, as of March 2017, Arizona, 31 other states, and the District of Columbia adopted their own **intrastate** crowdfunding laws.
- Governor Ducey signed the Arizona Crowdfunding law April 1, 2015: ***"Small businesses and startups will have a new avenue for growing and creating capital,"*** **said Governor Ducey in April*. "The legislation allows innovators, small businesses, and entrepreneurs to raise money from the public through equity crowdfunding."***
- Under that statute, ARS Section 44-1844 D, which went into effect July 3, 2015 :
  - **Issuers** (Arizona companies, but not selling securities holders) may "distribute a limited notice" containing a link to the website of a **Website Operator**. A Website Operator must (a) be a registered securities dealer or (b) a person who registers, and does not "receive a commission or remuneration, directly or indirectly, for the offer or sale of the security"
  - Website Operator may not purchase securities in any offering made pursuant to this exemption, and may not be affiliated with **any** issuer making an offer or sale pursuant to this exemption -- this means any issuer in any other offerings relying on this exemption
  - Website Operator must give the Arizona Corporation Commission (the "***ACC***") access to the website and must limit website access to Arizona residents

ARIZONA CROWDFUNDING – The Basics

- **Offering Size**
  - Up to $1 million every 12 months, if no audited financial statements
  - Up to $2.5 million every 12 months with GAAP audited financial statements
  - Sales to officers, directors or 10% shareholders do not count towards the total
  - Six-month separation from other offerings of similar securities (avoid integration
- **Escrow of Offering Proceeds is Required**
- **Full Disclosure Throughout Offering**
  - Notice must be filed with the ACC at least 10 days before offering commences
  - Must specify **Target Offering Amount** and **Offering Deadline**
  - Mandated guidelines for disclosure of all material information
  - Must provide quarterly reports throughout offering period, and while securities outstanding
  - Preserve books and records prescribed by ACC for three years

Title IV of the JOBS Act - Regulation A+

- Title IV (2 pages) instructs the SEC to amend existing Regulation A
  - "Mini public offering" provision
  - Regulation A was originally adopted in 1936, with a $100,000 limit, last raised to $5 million in 1992
  - Rarely used - In the four years from 2009-2012, there were 19 qualified Reg A offerings filed with the SEC for a total offering of $73 million
  - Rep. David Schweikert introduced a bill attempting to make Regulation A useful by increasing the maximum offering size from $5 million to $50 million

REGULATION A+ - The Basics

- On March 25, 2015 (effective June 19, 2015), the SEC adopted final rules amending Regulation A (commonly referred to as "***Regulation A+***")
- **Two Tiers.** The SEC rules enable smaller companies to offer and sell up to $50 million of securities, subject to eligibility, disclosure and reporting update and expand the Reg A exemption by creating two tiers of Reg A offerings:
    - **Tier 1** - securities offerings of **up to $20 million in a 12-month period**, including up to $6 million for the account of selling securities holders
    - **Tier 2** - securities offerings of **up to $50 million in a 12-month period**, including up to $15 million for the account of selling securities holders
    - Selling securities holders are limited to no more than 30 percent of an Issuer's Reg A offerings in a 12-month period

REGULATION A+ - The Process; Free-trading Securities

The Reg A+ Process

- File Form 1-A Offering Statement with the SEC for qualification (filed electronically); SEC estimates 750 hours to complete Form 1-A
- May submit to SEC for confidential, non-public review
- Offering Statement must be publicly filed at least 21 days before qualification

"Testing the Waters" – permitted before and after filing Form 1-A

General Solicitation permitted **–** it is a public offering

Securities sold are **freely tradeable** by persons who are not issuers, underwriters or dealers (Rule 144)

REGULATION A+ - Tier 2

- **Additional Tier 2 Requirements**
- In addition to the basic requirements, companies conducting Tier 2 offerings are subject to the following:
  - The financial statements included in the Offering Statement must be audited
  - The companies must file annual and semiannual ongoing reports and current event updates that are similar to, but less onerous than, the requirements for public company reporting under the 1934 Act
  - Investors who are **not** accredited investors are limited to purchasing no more than 10 percent of the greater of the investor's (a) annual income, or (b) net worth

REGULATION A+ - Preemption of Blue Sky Law

Avoiding Two Levels of Registration

- Regulation A offerings have been subject to registration and qualification requirements in the states where the offering is conducted unless a state-level exemption is available. This was identified by the GAO and market participants as a central factor for the limited use of current Regulation A
- The new rules provide that state securities law requirements are preempted for Tier 2 offerings
- Tier 1 offerings are subject to blue sky review, but a coordinated equity review program is being implemented by the North American Securities Administrators Association ("NASAA")

Legal Challenge – Several state regulators, including Massachusetts and Montana, filed a petition for review of the rule, arguing that the SEC cannot preempt state authority over Tier 2 offerings. *Lindeen v SEC*, filed October 27, 2015 in the D.C. Court of Appeals. The petitions for review was **denied** June 14, 2016.

LIMITED OFFERINGS – HOW IT USED TO BE

	Rule 504	Rule 505	Rule 506	Regulation A	§ 4(2)	§ 4(5)
Offering Amount	$1,000,000	$5,000,000	Unlimited	$5,000,000	Unlimited	$5,000,000
Number of Investors	Unlimited	Unlimited accredited; 35 others	Unlimited accredited; 35 others	Unlimited	Unclear; finite number	Unlimited accredited (self verify)
Investor Qualification	None	None	Sophisticated; presumed for accredited	None	Financially sophisticated; registration info	Accredited only (self verify)
State Law Compliance	Yes	Yes	No	Yes	Yes	Yes
Limitation on Manner of Offering	General Advertising may be permitted	No general advertising or solicitation	No general advertising or solicitation	General advertising and solicitation permitted	No general advertising or solicitation	No general advertising or solicitation
Limitation of Resale	May be unrestricted	Restricted	Restricted	Unrestricted	Restricted	Restricted
SEC Filing	Form D w/in 15 days after sale	Form D w/in 15 days after sale	Form D w/in 15 days after sale	Offering Statement (SEC reviewed)	None	Form D w/in 15 days after sale

LIMITED OFFERINGS – NEW ALTERNATIVES

	Fed Crowdfunding	AZ Crowdfunding	Reg A - Tier 1	Reg A - Tier 2	Reg D-Rule 506(b)	Reg D-Rule 506(c)
Maximum Offering	$1,000,000	$1,000,000; $2,500,000	$20,000,000	$50,000,000	Unlimited	Unlimited
Who May Purchase	Unlimited, including non-accredited	Unlimited , including non-accredited investors	Unlimited , including non-accredited investors	Unlimited , including non-accredited investors	Unlimited accredited investors; up to 35 non-accredited investors	Unlimited accredited investors Only
Investment Limits	$2,000 up to 10% of net worth	Accredited – No limit; Unaccredited - maximum of $10,000	No limit	Unaccredited: Greater of 10% of income or 10% of net worth; 10% of revenue for entities	No limit	No limit
Verification of Investor Status	Self-Verification	Must verify Arizona resident and Accredited Status	N/A	Self-Certification	Self-Certification	Verification of Accredited Status; Alternative means
General Solicitation/ Advertising	Internet notice on single B/D or Funding Portal	Notice on Internet to Arizona residents only	Unrestricted	Unrestricted	None	Unrestricted
"Testing the Waters"	No "Testing the Waters"	No "Testing the Waters"	"Testing the Waters" allowed-no pre filing; must file solicitation materials with first offering statement	"Testing the Waters" allowed - no pre-filing; must file solicitation materials with first offering statement	No "Testing the Waters"	No "Testing the Waters"
Filings with SEC /ACC	Form C Offering Statement Prior to Offering	10 day pre-filing with ACC	Offering circular must be filed 48 hours prior to first sale	Offering circular must be filed 48 hours prior to first sale	None; Notice on Form D 15 days after sale	None; Notice on Form D 15 days after sale

Compliance Key: Easy | Caution | Restrictive or Prohibited

LIMITED OFFERINGS – NEW ALTERNATIVES

	Fed Crowdfunding	AZ Crowdfunding	Reg A - Tier 1	Reg A - Tier 2	Reg D: Rule 506(b)	Reg D: Rule 506(c)
Offering Process	Fast-No SEC or State Approval	Medium – ACC Pre-filing	Very Slow - SEC and State Qualification Required	Slow - SEC Approval Required	Fast - No SEC or State approval	Fast - No SEC or State approval
Financial Disclosures Required	Self Certified <$100,000 Independent review <$500,000 Audit >$500,000	Unaudited - $1,000,000 Audited - $2,500,000	Reviewed Financials	Audited Financials	No Specific Requirements; Audited financial s if non-accredited purchasers	No Specific Requirements
Ongoing Reporting Requirements	Updates Final Form C-U Annual Reports	Semi-Annual Reports	None	Annual, Semi-Annual, Current Reports including audited financials	None	None
Termination of Reporting	Five Termination Events	When No Securities Sold Outstanding	N/A	Less than 300 holders of Reg A stock	N/A	N/A
Transfer Restriction	1 Year, except Accredited Investor or Family Member	Intrastate only for 9 months	None	None	1 year	1 year
Investor Limit	None with conditions	None	None with conditions	None with conditions	None; 35 non-accredited	None
Intermediary	Registered Funding Portal or Broker-Dealer	Registered Website Operator or Broker-Dealer	None Required	None Required	None Required	None Required
State Pre-emption	Yes; Pre-empts State Law	No; Federally Exempt	No; Coordinated Review	Yes; Covered Securities; blue sky filing fees	Yes; Covered Securities; blue sky filing fees	Yes; Covered Securities; blue sky filing fees
Federal & State Liability	"Materially Misleading"; Federal §12(a)(2) & State	"Materially Misleading"; ARS § 44-1841	"Materially Misleading"; Federal §12(a)(2) & State	"Materially Misleading"; Federal §12(a)(2) & State	"Materially Misleading"; Federal §12(a)(2) & State	"Materially Misleading"; Federal §12(a)(2) & State
Commissions	Securities License Required	Securities License Required	Securities License Required	Securities License Required	Securities License Required	Securities License Required

Compliance Key: Easy | Caution | Restricted or Prohibited

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Charlie prepared the first "plain English" initial public offering of securities registered with the Securities and Exchange Commission and has extensive experience in securities regulation, public offerings, business mergers, acquisitions and sales, private placements, and compliance with the periodic reporting requirements of the Securities Exchange Act of 1934.

In addition to debt and equity financings, Charlie has represented securities dealers, their registered representatives, and registered investment advisers in connection with regulatory compliance matters and investigations. He has participated in many Financial Industry Regulatory Authority (FINRA) arbitrations, representing claimants and respondents, as well as serving as an arbitrator and conducting arbitrator training.

Charlie is a past chair of the Business Law Section and the Securities Regulation Section of the State Bar of Arizona. He has also served as a faculty member for the State Bar's Course on Professionalism.

A founder of the former Scottsdale, Arizona law firm of Titus, Brueckner & Berry, P.C., Charlie also has experience serving as director and practice chair at other Arizona law firms. He has participated in many continuing legal education seminars and panels for organizations, including the State Bar of Arizona, Association of Corporate Council, Scottsdale Bar Association and FINRA.

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