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SECURITIES LAWS: DO THEY APPLY TO YOU?

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To many people the term "securities offering" conjures up thoughts of the Securities and Exchange Commission ("SEC") and thick proxy statements. Few people realize however that federal and state security laws apply even when friends or relatives are asked to invest in a company, real estate venture or other business enterprise. These laws apply not just to the sale of voting stock, but also to the sale of promissory notes, bonds, non-voting stock and other investments not commonly thought of as "securities." Failure to comply with these laws can lead to civil and even criminal penalties. Although these security sales do not necessarily require a lengthy and expensive registration process with the SEC, there are requirements that must be met in such "private offerings." Before simply accepting money from investors, an individual or company should verify that all applicable securities laws have been complied with.

In order to avoid SEC registration of a sale of securities, both a federal and a state law exemption to the registration requirements must apply. Some of the primary private-offering exemptions under federal law are as follows:

- Rule 504 of Regulation D, as adopted by the SEC, allows a company to make offerings of less than \$1,000,000 in any twelve month period with no limits on the number of investors.
- Rule 506 places no limit on the amount of the offering, but there are restrictions on the types and number of investors that the company can sell to.
- Section 3(a)(11) of the Securities Act of 1933, places no limit on the amount that can be raised, but among other requirements, the offering is limited to residents of a single state by an issuer who resides or is incorporated in that state and is doing business within that state.

The federal securities laws also place restrictions on how investors can be approached, generally prohibiting advertising or the general solicitation of potential investors.

In addition to federal securities laws, each state has enacted its own securities laws. Indiana enacted the Indiana Securities Act in 1961. The Indiana Securities Act also requires registration of securities before sale in Indiana, unless an exemption applies. The most significant exemption is similar to the private offering exemptions under federal law. The primary conditions for the exemption are:

- Excluding "accredited" investors (generally persons with income exceeding \$200,000 or assets exceeding \$1,000,000) there are no more than 35 purchasers in total, no more than 20 of which reside in Indiana;
- The securities are not sold by general solicitation or advertisement, and
- The purchasers acquire the securities for their own investment.

The requirements are loosened, if among other things:

- The aggregate offering does not exceed \$500,000,
- The total number of purchasers does not exceed 25,
- There are no more than 15 investors who are Indiana residents, and
- Each purchaser is an accredited investor or has access to all material facts regarding the security.

Even though an offering may be exempt from registration under federal and state law, there are generally disclosures that must be made to potential investors, especially to minimize the risk of civil and criminal penalties. In most instances, investors must be given an offering statement containing certain information about the company. Any financial or other information that is considered material must be disclosed. This information includes a description of the securities being offered, the amount the company seeks to raise, the intended use of the proceeds, risks entailed in investing in the company, a description of the company's management and principal shareholders, and information regarding the financial condition of the company. An offering statement should consist of more than simply the company's business plan and its latest financial statements. It should only be prepared with the assistance of an attorney experienced in securities laws.

Further, although there may be no federal or state registration requirements, there are oftentimes disclosures that must be made to the SEC or to the Indiana Securities Commissioner.

Private offerings of securities, whether stocks, bonds or promissory notes, requires the advice of attorneys knowledgeable and experienced in securities laws. Kahn, Dees, Donovan & Kahn has that experience.

If you are considering approaching investors for a new or existing business venture, or if you have questions regarding securities laws, please call Jeff Helfrich or Mark Samila at (812) 423-3183.