



# Securities Law Issues in Raising Capital

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# Two General Types of Lawyers in Capital Raise Transactions:

- Transactional/M&A Lawyers – i.e., Business/Deal Guys
- Securities Lawyers – i.e., Compliance Guys
- Focus should be on the deal – compliance should not be the tail that wags the dog.





# Practical Effect of Securities Laws

- Complicates and adds time and expense to business transactions.
- **BUT, not nearly as expensive as non-compliance.**





# What is a Security

- Any instrument, transaction or scheme where the investor has:
  - An expectation of profits;
  - From a common enterprise;
  - Solely (predominantly) from the efforts of others.

-  Definition is read broadly by securities regulators.



# Sources of Securities Laws

- Both state and federal law have registration requirements and exemptions.
- Sometime the laws work together, sometimes they don't.
- Sometimes the regulators work together, sometimes they don't.





# General Requirements

- For each securities offering you must either:
  - Register the securities offering; or
  - Find an exemption
- You need a registration or exemption both federally and at the state level.





# Registered versus Exempt

- We will focus on unregistered (i.e., private) offerings which are typically used to raise start-up capital.
- There are benefits to registered offerings, but these benefits are usually outweighed by their costs for early stage capital.





# Nature of the Offering

- Exemption and disclosure requirements vary depending on:
  - Who you're selling to (accredited vs. non-accredited)
  - Where you're selling (which states)
  - How much money you're raising (less than \$1 million; less than \$5 million)
  - Who's selling





# Federal Regulation D Exemptions

	Type of Investor	Capital Limit
<b>504 Exemption</b>	Anyone	\$1 million in 12 months
<b>505 Exemption</b>	Accredited Investors + 35 Non-Accredited Investors	\$5 million in 12 months
<b>506 Exemption</b>	Accredited Investors + 35 Non-Accredited Investors	Unlimited





# Who are Accredited Investors

- Generally – rich people; better yet, rich/sophisticated people.
- Eight categories – most common:
  - (Real) directors, officers, general partners of the issuer
  - Persons with net worth greater than \$1 million, or income in excess of \$200,000 annually (or \$300,000 with spouse) for two years
  - Entity with assets in excess of \$5 million not formed for this investment



# General Requirements of Exempt Offerings



- Assume that exempt offerings will be subject to the following (unless counsel confirms otherwise):
  - Prohibition on general solicitations and advertising
    - Need a pre-existing substantive relationship with the investor
  - Limitation on resale (including Rule 144 limitations) – generally, one year limit for non-affiliates
  - Informational requirements, including financial and non-financial information





# Disclosure and Anti-Fraud

- **FULL DISCLOSURE** – this is your insurance policy.
- Generally (with some exceptions) must disclose all material facts an investor would consider important (and any facts necessary to make the disclosures not misleading).
- Risk continuum
  - More risky investment – more disclosure
  - Less sophisticated investor – more disclosure





# Form of Disclosures

- For most offerings, prepare a full prospectus.
- This is similar to a detailed business plan with the securities law disclosures added.
- May need audited financial statements depending on the exemption.





# Liability for Anti-Fraud and Non-Disclosure

- Failure to disclose material facts can result in rescission and/or **PERSONAL LIABILITY** for officers and directors!
- If in doubt, disclose!
- If uncertain, disclose uncertainty!





# Restrictions on Communications

- Subject to numerous limitations and restrictions.
- Failure to comply can result in a “cooling off period,” penalties, or in extreme cases, permanently prevent/invalidate the offering.
- Best approach – consult your attorney (before commencing any communications).





# Broker-Dealer Issues

- Sellers need to either be registered or exempt at both Federal and State level.
- Most common exemption we see – officers/directors selling without compensation and no more than once in 12 months.
- Computation of 12 months is tricky.
- Beware “Finders”



# Typical Documents Prepared for Exempt Offerings



- Typical documents prepared for exempt offerings:
  - Organizational documents for the entity
  - Prospectus (sometimes called Private Placement Memorandum)
  - Subscription Agreement
  - Form D (registration with the SEC)





# Summary/Conclusion

Common sense is not enough – engage  
experienced and practical legal counsel  
and  
follow their advice.

