

**DATES:** Comments should be submitted to the Commission on or before September 8, 1995.

**ADDRESSES:** All comments concerning the proposed rules should be submitted in triplicate to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, Mail Stop 6-9, 450 Fifth Street, N.W., Washington D.C. 20549 and should refer to File Number S7-15-95. Comment letters will be available for inspection and copying in the Commission's public reference room at the same address.

**FOR FURTHER INFORMATION CONTACT:** Richard K. Wulff, Office of Small Business Policy, Division of Corporation Finance, at (202) 942-2950 or James R. Budge, Office of Disclosure Policy, Division of Corporation Finance, at (202) 942-2910.

**SUPPLEMENTARY INFORMATION:** The Commission today is proposing a new Rule 1001<sup>1</sup> under Section 3(b)<sup>2</sup> of the Securities Act of 1933 (the "Securities Act").<sup>3</sup> The new rule would exempt from the registration requirements of the Securities Act offers and sales up to \$5 million that are exempt from state qualification under paragraph (n) of Section 25102 of the California Corporations Code.<sup>4</sup> Rule 144<sup>5</sup> also would be amended to include securities issued in reliance upon Rule 1001 in the definition of "restricted securities."

## I. Introduction

Since the inception of the Securities Act, Congress has delegated to the Commission the authority to exempt small issues from Securities Act registration provisions when such action is consistent with the public interest and the protection of investors. Soon after its creation, the Commission exercised this authority to provide an exemption for small offerings,<sup>6</sup> and since then, has adopted other rules from time to time, including exemptive rules under Section 3(b), to assist small businesses' capital raising ability, where consistent with investor protection.<sup>7</sup>

Today's proposal would provide a federal exemption for offerings of up to \$5 million<sup>8</sup> that meet the qualifications of a new California exemption designed

to assist small business capital formation.<sup>9</sup> The new California law provides an exemption from state law registration for offerings made to specified classes of qualified purchasers that are similar, but not the same as, accredited investors under Regulation D. Unlike Regulation D, various methods of general solicitations are permitted under the California law. The Commission believes that the California exemption facilitates small business capital raising with adequate protections to investors and therefore proposes to exercise its exemptive authority in Section 3(b) to provide a parallel federal exemption.

## II. The California Exemption

On September 26, 1994, a new exemption from the issuer transactions qualification provisions of the California Corporations Code became effective.<sup>10</sup> The provision was specifically designed "to facilitate the ability of small companies to raise capital to finance their growth."<sup>11</sup>

The exemption generally is limited to issuers that are California corporations or any other form of business entity organized in that state, including partnerships and trusts. In addition, non-California organized businesses may use the exemption if they can attribute more than 50 percent of property, payroll and sales to California and if more than 50 percent of outstanding voting securities of the issuer are held of record by persons having addresses in California. It is not available for offerings relating to a rollout transaction, nor may it be used by "blind pool" issuers or investment companies subject to the Investment Company Act of 1940 (the "Investment Company Act").<sup>12</sup>

Sales under the exemption must be effected only to qualified purchasers who buy for investment purposes and not for redistribution. A qualified purchaser is defined as:

- Designated professional or institutional purchasers or persons affiliated with the issuer;<sup>13</sup>
- Certain relatives residing with qualified purchasers;
- Promoters;
- Any person purchasing more than \$150,000 of securities in the offering;<sup>14</sup>
- Entities whose equity owners are limited to officers, directors and any affiliate of the issuer;
- Reporting companies under the Securities Exchange Act of 1934 (the "Exchange Act"),<sup>15</sup> if the transaction involves the acquisition of all of an issuer's capital stock for investment;
- A natural person whose net worth exceeds \$500,000, or a natural person whose net worth exceeds \$250,000 if such purchaser's annual income exceeds \$100,000—in either case the transaction must involve
  - (a) only a one-class voting stock (or preferred establishing the same voting rights),
  - (b) an amount limited to no more than 10 percent of the purchaser's net worth, and
  - (c) a purchaser able to protect his or her own interests (alone or with the help of a professional advisor);<sup>16</sup>
- Pension and profit sharing trusts, as well as 401(k) plans<sup>17</sup> and Individual

<sup>13</sup> Officers and directors of corporate issuers (or persons performing similar duties), general partners and trustees where the issuer is a partnership or a trust, small business investment companies, business development companies subject to the Investment Company Act, private venture capital companies exempted from the Investment Advisers Act of 1940 [15 U.S.C. 80b-1 *et seq.*], certain natural persons, entities comprised of accredited investors, banks, savings and loan associations, insurance companies, Investment Company Act companies, non-issuer pension or profit-sharing trusts, organizations described in Section 501(c)(3) of the Internal Revenue Code [26 U.S.C. 501(c)(3)], business entities (corporations, business trusts or partnerships) with assets of more than \$5 million. All these persons would qualify as "accredited investors" under Rule 501(a) [17 CFR 230.501(a)].

<sup>14</sup> Under the California provision, \$150,000 purchasers and natural persons meeting a \$1 million net worth or \$250,000 annual income test must also satisfy one of the following additional suitability standards: (1) they must have, alone or with the assistance of a professional advisor, the capacity to protect their own interests; (2) they must have the ability to bear the economic risk of the investment; or (3) the investment must not exceed 10 percent of the person's net worth.

<sup>15</sup> 15 U.S.C. 78a *et seq.*

<sup>16</sup> This provision states that each such natural person, by reason of his or her business or financial experience, or the business or financial experience of his or her professional advisor (who is unaffiliated with and who is not compensated, directly or indirectly, by the issuer), can be reasonably assumed to have the capacity to protect his or her interests in connection with the transaction. The California Department of Corporations has indicated that qualified investors under this rubric must have business or financial experience or rely on a professional advisor. Release No. 94-C (September 27, 1994).

<sup>17</sup> 26 U.S.C. 401(k).

<sup>1</sup> The proposed rule would be added as Regulation CA, 17 CFR 230.1001.

<sup>2</sup> 15 U.S.C. 77c(b).

<sup>3</sup> 15 U.S.C. 77a *et seq.*

<sup>4</sup> Cal. Corporations Code § 25102(n).

<sup>5</sup> 17 CFR 230.144.

<sup>6</sup> See Release Nos. 33-158, 159 (April 27, 1934).

<sup>7</sup> See, e.g., Regulation A [17 CFR 230.251-230.263] and Rule 504 [17 CFR 230.504] in Regulation D [17 CFR 230.501-230.508].

<sup>8</sup> This is the maximum dollar amount permitted under the Commission's Section 3(b) exemptive authority.

<sup>9</sup> The Commission has established the Advisory Committee on the Capital Formation and Regulatory Processes ("the Advisory Committee"), chaired by Commissioner Steven M.H. Wallman. The Advisory Committee is considering fundamental issues relating to the regulatory framework governing the capital formation process, including whether the current system of registering securities offerings should be replaced with a company registration system. The Advisory Committee may make recommendations that, if endorsed by the Commission, may result in rule proposals or legislative recommendations that could address the matters discussed in this release.

<sup>10</sup> Chapter 828, Statutes of 1994 (Senate Bill 1951—Killea), adding subdivision (n) to Corporations Code Section 25102.

<sup>11</sup> Section 3, Senate Bill 1951.

<sup>12</sup> 15 U.S.C. 80a-1 *et seq.*