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Introduction to Private Offerings of Securities

In this article I give a bird's eye view of private offerings of securities (also called limited offerings or private placements). When a company conducts a private offering (that is, sells its stock to investors), it becomes subject to federal and state securities laws. The company must comply with federal securities laws plus the laws of each state where any investor resides. This adds up to a lot of law. Further, you cannot opt out of these laws, and pretending they don't exist won't save you.

The Fundamental Concept. The federal Securities Act of 1933 requires the filing of a registration statement with the SEC prior to an offering of any security, unless an exemption is available. In other words, if you want to sell stock in your company, you must either register your stock, or find an exemption from registration.

This is an either / or requirement: either register or use an exemption. If you register your securities, the offering is public. If you use an exemption, the offering is private. Big companies usually raise capital through public offerings involving registration, and we follow these companies in the Dow Jones, the S&P 500 etc. Registration is a time-consuming process that can cost hundreds of thousands of dollars to initiate and maintain.

Smaller businesses cannot afford registration. Hence smaller businesses raise capital through private offerings in reliance on the exemptions from registration. This is our subject.

Exemptions. When selling your stock, you probably will use the federal and state private placement exemptions. Exemptions are the key to any private offering of securities. The most common federal exemptions are Section 4(2) of the Securities Act and Regulation D. In California, the most popular exemption is Section 25102(f) of the Corporate Securities Law of 1968. These exemptions provide the majority of law applicable to your offering, including the maximum dollar amount of the offering, the number of investors who may buy your stock, the financial sophistication required of the investors, and the disclosures that you must make to the investors.

Private Offerings – No General Solicitation. Most exemptions severely restrict your advertising and solicitation in selling securities. You may not advertise or otherwise solicit the general

public. This applies to your company and anyone acting on its behalf (usually officers and brokers). Hence you may not use any advertisement, article, notice or other communication in any newspaper, TV or similar media. You may not use seminars whose attendees have been invited by any general solicitation or advertising. In brief, you may only sell to investors with whom you have a pre-existing, substantive relationship.

Brokers. Not only does the law restrict how you sell securities, it also restricts the people who help you sell securities. Extensive broker regulations apply to you and all other people who sell your stock. In brief, no one involved in the offering may be regularly engaged in selling securities unless that person is licensed as a securities broker. Many lawyers forget about broker regulations; instead they concentrate exclusively on the exemptions. This can be a fatal mistake.

Liability – Why You Care. If you remember nothing else from this article, remember this: securities laws favor the investors, not you, and you can become personally liable for a violation. Purchasers of stock may sue the company for the return of their money. They may even sue you personally if you committed some bad act in the offering, most commonly securities fraud.

This article only gives a brief introduction to private offerings. I have only scratched the surface. I strongly urge you to get competent legal, accounting and tax counsel when you sell securities.

Ideas

Some tips from Nassim Nicholas Taleb (this year's hot guru):

Wear your best for your execution and stand dignified. Your last recourse against randomness is how you act — if you can't control outcomes, you can control the elegance of your behavior. You will always have the last word.

Don't disturb complicated systems that have been around for a very long time. We don't understand their logic. Don't pollute the planet. Leave it the way we found it, regardless of scientific "evidence."

Learn to fail with pride — and do so fast and cleanly. Maximize trial and error — by mastering the error part.

Skepticism is effortful and costly. It is better to be skeptical about matters of large consequences, and be imperfect, foolish and human in the small and the aesthetic.

Funny Papers

Some more wisdom, this time from Henny Youngman:

- I've got all the money I'll ever need if I die by four o'clock this afternoon.
- Some people ask the secret of our long marriage. We take time to go to a restaurant two times a week. A little candlelight, dinner, soft music and dancing. She goes Tuesdays, I go Fridays.
- What's the use of happiness? It can't buy you money.