

Authority: 15 U.S.C. 78a, *et seq.*, unless otherwise noted;

* * * * *

3. 17 CFR Parts 240 and 249 are amended by removing the reference to "\$5 million" and adding in its place "\$10 million" in the following sections:

- (a) 17 CFR 240.12g-1
- (b) 17 CFR 240.12g-4(a)(1)(ii)
- (c) 17 CFR 240.12g-4(a)(2)(ii)
- (d) 17 CFR 240.12h-3(b)(1)(ii)
- (e) 17 CFR 240.12h-3(b)(2)(ii)
- (f) 17 CFR 249.323(a)

Dated: May 1, 1996.

By the Commission.

Jonathan G. Katz,

Secretary.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 230

[Release No. 33-7285; File No. S7-15-95]

RIN 3235-AG51

Exemption for Certain California Limited Issues

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: In order to reduce regulatory burdens associated with certain offers and sales of securities, the Securities and Exchange Commission ("Commission") today is adopting a new exemption from its registration requirements for limited offerings of up to \$5 million that are exempt from qualification under a 1994 California state securities law.

EFFECTIVE DATE: The effective date of Rule 1001 and the amendment to Rule 144 will be effective June 10, 1996.

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, 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission today is adopting, as proposed, new Rule 1001¹ under Section 3(b)² of the Securities Act of 1933 ("Securities Act").³ The new rule

¹ The rule is being added as Regulation CE (for coordinated exemptions), 17 CFR 230.1001, rather than as Regulation CA, as proposed.

² 15 U.S.C. 77c(b).

³ 15 U.S.C. 77a *et seq.*

exempts 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.⁴ Securities Act Rule 144⁵ also has been amended to include securities issued in reliance upon Rule 1001 in the definition of "restricted securities."

I. Introduction

In June 1995, pursuant to its authority to provide exemptions for small offerings under Section 3(b) of the Securities Act, the Commission proposed a new rule⁶ designed to assist small businesses' capital raising ability by creating a federal exemption for offerings of up to \$5 million⁷ that meet the qualifications of a California exemption. The 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.⁸ Certain methods of general solicitation are permitted under the California law.

The Commission received ten comment letters, which generally were supportive of the proposals.⁹ The Commission believes that the California exemption has the potential to facilitate small business capital raising. It is anticipated that the new rule will result in compliance cost savings for small businesses and others because qualifying issuers will be exempt from both state qualification and federal registration. At the same time, the exemption assures adequate protections to investors. Therefore, the Commission is exercising its exemptive authority in Section 3(b) to provide a parallel federal exemption for the California exemption by adopting new Rule 1001.

II. The California Exemption

On September 26, 1994, an exemption from the issuer transactions qualification provisions of the California Corporations Code became effective.¹⁰ The provision was specifically designed "to facilitate the ability of small

⁴ Cal. Corporations Code Section 25102(n).

⁵ 17 CFR 230.144.

⁶ Release No. 33-7185 (June 27, 1995) [60 FR 35638] ("proposing release").

⁷ This is the maximum dollar amount permitted under the Commission's Section 3(b) exemptive authority.

⁸ 17 CFR 230.501-230.508.

⁹ The letters and comment summary are available for inspection and copying in the Commission's public reference room. Refer to File No. S7-15-95.

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

companies to raise capital to finance their growth."¹¹

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 rollup 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").¹²

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;¹³
- Certain relatives residing with qualified purchasers;
- Promoters;
- Any person purchasing more than \$150,000 of securities in the offering;¹⁴
- 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"),¹⁵ if the transaction

¹¹ Section 3, Senate Bill 1951.

¹² 15 U.S.C. 80a-1 *et seq.*

¹³ 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.*]; entities comprised of accredited investors; banks; savings and loan associations; insurance companies; Investment Company Act companies; non-issuer pension or profit-sharing trusts; and, organizations (corporations, business trusts or partnerships) described in Section 501(c)(3) of the Internal Revenue Code [26 U.S.C. 501(c)(3)] with assets of more than \$5 million. Individuals with a net worth of \$1 million or annual income of more than \$200,000 also are qualified purchasers under the California exemption. All these persons would qualify as "accredited investors" under Rule 501(a) [17 CFR 230.501(a)].

¹⁴ These persons 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. These criteria also apply to individuals who have a net worth of over \$1 million or annual income exceeding \$200,000.

¹⁵ 15 U.S.C. 78a *et seq.*

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);¹⁶

- Pension and profit sharing trusts, as well as 401(k) plans¹⁷ and Individual Retirement Accounts of individual qualified purchasers.

Issuers must provide certain purchasers who are natural persons¹⁸ a disclosure document as specified in Rule 502 of Regulation D¹⁹ five days prior to any sale or commitment to purchase.

Offers, oral or written, are generally limited to qualified purchasers. However, the law does permit general announcements of a proposed offering to be widely published and circulated, so long as they contain only specified information.²⁰ This general announcement process is modeled on the "test the waters" concept being used by several of the states²¹ and by the

¹⁶ 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).

¹⁷ 26 U.S.C. 401(k).

¹⁸ This delivery requirement is limited to those natural persons designated as qualified purchasers because their net worth exceeds \$500,000, or whose net worth exceeds \$250,000 where there is an annual income of \$100,000.

¹⁹ 17 CFR 230.502(b)(2).

²⁰ The California provision limits the content of the general announcement to the following items: the issuer's identity; the full title of the securities being offered; the suitability standards of prospective investors; a statement that no money is being sought or will be accepted, that an indication of interest involves no commitment to purchase and that under certain circumstances a disclosure document will be provided prior to purchase; and the name, address and telephone number of a person who can provide further information about the offering. Only the following additional information may be included at the issuer's option: a brief description of the business, its geographical location and the offering price or method of determination.

²¹ See CCH NASAA Reports § 7036. Arizona, Colorado, Kansas, Massachusetts, Oregon,

Commission in connection with Regulation A.

A notice must be filed with the California Corporations Commissioner at the initial offer of securities or with the publication of a general announcement of proposed offering, whichever comes first, accompanied by a \$600 filing fee. A second filing is required within 10 business days after the close or abandonment of the offering, and in no case later than 210 days after the filing of the initial notice.

III. Regulation CE and Rule 1001

A. Need for a New Exemption

The California exemption combines a form of general solicitation using a "test the waters" concept with a qualified purchaser concept derived in part from the Uniform Limited Offering Exemption ("ULOE"),²² an official policy guideline of the North American Securities Administrators Association, Inc. ("NASAA")²³ that was adopted in coordination with the Commission's adoption of Regulation D.²⁴ California's exemption does not fit well within any current federal exemption, other than Rule 504,²⁵ which is limited to \$1 million, or potentially the intrastate offering exemption.²⁶ Rules 505 and 506 of Regulation D prohibit general solicitations; moreover, California's definition of qualified purchasers is broader than Regulation D's. The intrastate offering exemption is available only for those offerings by issuers incorporated and doing business in California.

The Commission does not believe that these differences need to be an impediment to the ability of small businesses to take full advantage of the California exemption. While the qualified purchaser definition differs somewhat from the accredited investor definition for individuals, the California law includes additional suitability standards. Moreover, the general announcement of proposed offering is subject to significant limitation, thereby

Pennsylvania, Vermont, Virginia and Washington currently are participating in a pilot program in this regard, and Indiana has proposed entering this pilot program as well.

²² See CCH NASAA Reports § 6201.

²³ NASAA is an association of securities commissioners from each of the 50 states, the District of Columbia, Puerto Rico, Mexico and several of the Canadian provinces.

²⁴ State statutes and rules based on NASAA's ULOE exempt offers or sales of securities made in compliance with Rules 501-503, 505 and/or 506 of Regulation D [17 CFR 230.501-230.503, 230.505 and 230.506 respectively], including the prohibition of general solicitations found in Rule 502(c).

²⁵ 17 CFR 230.504.

²⁶ Securities Act Section 3(a)(11) [15 U.S.C. 77c(a)(11)] and Rule 147 [17 CFR 230.147].

protecting against abuse of the procedure. The provisions of the California law are consistent with investor protection and the public interest, and therefore warrant the Commission's full exercise of its exemptive authority under Section 3(b).

B. The Exemption

New Rule 1001 provides that offers and sales of securities, in amounts of up to \$5 million, that are exempt from registration under the California securities law pursuant to paragraph (n) of section 25102 of the California Corporations Code²⁷ are exempt from the registration requirements of Section 5 of the Securities Act, pursuant to Section 3(b) of that Act.²⁸ All issuers that qualify for the state exemption can rely on the Rule 1001 exemption.²⁹ Issuers should look to the state of California for interpretations relating to who qualifies for the exemption, since any person who lawfully relies on the state exemption also could rely on its federal counterpart. Commenters who spoke to the issue supported the Commission's proposal not to impose additional qualifying standards.

As in the proposal, the final rule does not require issuers to notify the Commission when they rely on the California exemption in view of the notification provisions of the California law.

C. Computation of \$5 million amount

Rule 1001 exempts offerings up to \$5 million, the maximum allowed under Section 3(b).³⁰ The \$5 million limit will apply on an offering-by-offering basis.³¹

²⁷ One commenter expressed the view that the Commission should key the exemption to section 25102(n) as it existed at the time it originally became effective. The Commission has determined to adopt Rule 1001 as proposed in order to allow California flexibility to address concerns relating to its exemption without fear of losing the federal counterpart. Nevertheless, the Commission will monitor future changes to the California exemption to assure that the investor protections are not diminished in a fashion that would warrant modification of the federal exemption.

²⁸ Rule 1001(a). While the transactions would not be subject to registration under Section 5, the antifraud provisions of the federal securities laws would continue to be applicable to all exempt transactions. See preliminary note 1 to Rule 1001. Rule 1001 would provide an exemption only for the transactions in which the securities are offered or sold by the issuer; it is not an exemption for the securities themselves.

²⁹ As noted above, California law precludes reliance on the exemption in connection with investment company, blind pool or roll-up offerings; thus, the Rule 1001 exemption also would be unavailable in those cases.

³⁰ Where a transaction involves non-cash consideration, the amount of the offering would be calculated as provided under California law.

³¹ Standard integration analysis concepts would apply. See Release No. 33-4552 (November 7, 1962)

Commenters supported this approach, which differs from that applied in other Section 3(b) rules, where an annual dollar limit for the aggregate of various Section 3(b) offers has been used.³²

D. Resale limitations

The new exemption provides that purchasers in the exempt transaction receive "restricted securities."³³ Consequently, purchasers must either register subsequent resales of the securities or have an exemption for such sales. Categorizing the securities offered and sold pursuant to Rule 1001 as "restricted" is consistent with the California exemption, since the latter requires an investment intent on the part of purchasers in the offering, and such shares could not be resold under California law without qualification or some other exemption under such law. In addition, the treatment is consistent with other federal exemptions, the availability of which depends on the sophistication, wealth or institutional character of the investor.³⁴

IV. Other Matters Addressed in the Proposing Release

A. Exemptions for Other States

The Commission proposed to provide the same exemption for each state that enacts a transaction exemption incorporating the same standards used by California. To date, the Commission has not received any request from a state other than California seeking its own exemption. The Commission reiterates its desire to cooperate with the states and repeats its position that it will create an exemption for any state that adopts an exemption incorporating the same standards used by California. Separate consideration for a federal exemption will be given to states that adopt other similar exemptions that protect the public interest.³⁵

[27 FR 11316]. These concepts are currently under review in connection with the work of the Task Force on Disclosure Simplification and the Advisory Committee on the Capital Formation and Regulatory Processes. See notes 37 and 37, below.

³² See, e.g., Rule 251(b) [17 CFR 230.251(b)], Rule 504(b)(2) [17 CFR 230.504(b)(2)] and Rule 505(b)(2)(i) [17 CFR 230.505(b)(2)(i)].

³³ Rule 1001(c) and amendment to Rule 144.

³⁴ See, e.g., Section 4(6) of the Exchange Act [15 U.S.C. 78d(6)] and Securities Act Rule 506.

³⁵ Three commenters supported this approach. Two commenters, however, believed that the Commission should not proceed on a state-by-state basis; rather, it should take a broader approach by creating a federal exemption that the individual states could then use to fashion their own coordinated exemptions. The Commission will consider this suggestion, together with others put forward by commenters with respect to facilitating small business capital formation, in connection with future rulemaking projects.

B. General Solicitation under Regulation D and ULOE

While not included as a rule proposal, the Commission indicated in the proposing release that it was considering whether amendments to Regulation D should be proposed that would facilitate better use of the exemptions by revising or eliminating the prohibition against general solicitation for Rule 505 and 506 offerings. This question was prompted in part by the approach in the California exemption that allows a form of general solicitation followed by sales only to qualified purchasers. Comment also was sought as to whether the Commission should consult with the states and NASAA about modifying ULOE, which also prohibits general solicitations in these offerings.

A number of commenters supported relaxing the general solicitation prohibition, believing that it would enhance the utility of Rule 505 and 506 offerings. The Commission has determined to proceed with adoption of the California exemption at this time while deferring action on the general solicitation question with respect to other exemptions, since Section 3(b) does not prohibit general solicitation for offerings exempt thereunder. However, these comments will be considered in connection with future initiatives undertaken by the Commission as it evaluates the reports of the Task Force on Disclosure Simplification³⁶ and the Advisory Committee on the Capital Formation and Regulatory Processes.³⁷ The work of both of these groups has

³⁶ The Task Force on Disclosure Simplification was organized in August 1995 to review forms and rules relating to capital-raising transactions, periodic reporting pursuant to the Exchange Act, proxy solicitations, and tender offers and beneficial ownership reports under the Williams Act. Its goal was to identify where the disclosure process could be simplified and, consistent with investor protection, to make regulation of capital formation more efficient. Following a seven-month review, the Task Force completed its report, including a number of recommendations, which the Commission authorized for publication on March 5, 1996. This report is available for inspection and copying at the Commission's public reference room. It also is available through the Commission's Internet web site [<http://www.sec.gov>].

³⁷ The Securities and Exchange Commission Advisory Committee on the Capital Formation and Regulatory Processes was established in February 1995. See Release No. 33-7135 (February 17, 1995) [60 FR 9415]. The objective of the Committee is to assist the Commission in evaluating the efficiency of the regulatory process relating to public offerings of securities, secondary market trading and corporate reporting. The Committee's focus has been the development of a company registration system for adoption by the Commission, which would allow eligible companies to offer and sell securities relying on a more company-focused, as opposed to transaction-focused, system. The Committee plans to issue a report containing its recommendations in the near future.

been dedicated to reassessing and reforming the federal securities disclosure regime where necessary and appropriate in the public interest and consistent with investor protection.

V. Cost-Benefit Analysis

The Commission solicited comments to aid in its evaluation of the costs and benefits that would result from the proposed exemption. It was expected that compliance burdens would decrease with respect to issuers who qualify for the proposed exemption, inasmuch as they would be able to raise up to \$5 million in capital without the burden and expense of compliance with the registration and reporting requirements of the federal securities laws. Commenters supported that view, indicating that the exemption would be beneficial to small business by reducing their capital raising expenses without reducing investor protection. Consequently, the Commission has determined to adopt the rule as proposed.

VI. Final Regulatory Flexibility Analysis

A final regulatory flexibility analysis has been prepared in accordance with 5 U.S.C. 604 concerning the adoption of Rule 1001 exemption and the amendment to Rule 144. A copy of the analysis may be obtained by contacting James R. Budge, Office of Disclosure Policy, Division of Corporation Finance, at (202) 942-2910, U.S. Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

VII. Statutory Basis for the Rules

Regulation CE, Rule 1001 and the amendment to Rule 144 are adopted pursuant to Sections 3(b) and 19 of the Securities Act.

List of Subjects in 17 CFR Part 230

Registration requirements, Securities. Text of the Amendments

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 78l, 78m, 78n, 78o, 78w, 78ll(d), 79t, 80a-8, 89a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

2. By amending § 230.144 by removing the period at the end of paragraph (a)(3)(iv) and adding “; or” in its place and by adding paragraph (a)(3)(v), to read as follows:

§ 230.144 Persons deemed not to be engaged in a distribution and therefore not underwriters.

* * * * *

(a) * * *

(3) * * *

(v) Securities acquired from the issuer that are subject to the resale limitations of Regulation CE (§ 230.1001).

* * * * *

3. By adding a new undesignated center heading and § 230.1001, to read as follows:

Regulation CE—Coordinated Exemptions for Certain Issues of Securities Exempt Under State Law

§ 230.1001 Exemption for transactions exempt from qualification under § 25102(n) of the California Corporations Code.

Preliminary Notes: (1) Nothing in this section is intended to be or should be

construed as in any way relieving issuers or persons acting on behalf of issuers from providing disclosure to prospective investors necessary to satisfy the antifraud provisions of the federal securities laws. This section only provides an exemption from the registration requirements of the Securities Act of 1933 (“the Act”) [15 U.S.C. 77a *et seq.*].

(2) Nothing in this section obviates the need to comply with any applicable state law relating to the offer and sales of securities.

(3) Attempted compliance with this section does not act as an exclusive election; the issuer also can claim the availability of any other applicable exemption.

(4) This exemption is not available to any issuer for any transaction which, while in technical compliance with the provision of this section, is part of a plan or scheme to evade the registration provisions of the Act. In such cases, registration under the Act is required.

(a) *Exemption.* Offers and sales of securities that satisfy the conditions of paragraph (n) of § 25102 of the California Corporations Code, and paragraph (b) of this section, shall be exempt from the provisions of Section 5

of the Securities Act of 1933 by virtue of Section 3(b) of that Act.

(b) *Limitation on and computation of offering price.* The sum of all cash and other consideration to be received for the securities shall not exceed \$5,000,000, less the aggregate offering price for all other securities sold in the same offering of securities, whether pursuant to this or another exemption.

(c) *Resale limitations.* Securities issued pursuant to this § 230.1001 are deemed to be “restricted securities” as defined in Securities Act Rule 144 [§ 230.144]. Resales of such securities must be made in compliance with the registration requirements of the Act or an exemption therefrom.

Dated: May 1, 1996.

By the Commission.

Jonathan G. Katz,

Secretary.

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