

**RAISING CAPITAL:
OVERVIEW OF REGISTRATION OF SECURITIES OFFERINGS AND
EXEMPTIONS
FROM REGISTRATION**

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Overview

Companies seeking to raise capital should carefully consider the alternative methods of issuing securities. A variety of factors influence the structure of a company and its securities offering, including the amount of capital required, the stage of development of the company, tax considerations, the necessity for liquidity, costs, timing, the differing requirements of federal and state law, and other issues. Companies issuing securities (“issuers”) must balance these factors in determining which fund-raising method is appropriate.

Issuers may consider several alternative methods of issuing securities to raise capital: a private placement pursuant to statute or the “safe harbor” of federal Regulation D Rule 506; a federally and state-registered public offering using various SEC registration forms, a public offering pursuant to federal Regulation D Rule 504 and Arizona Rule 140 of up to \$1 million solely to “accredited investors”; a public offering pursuant to Rule 504 and Arizona Rule 134 “Uniform Limited Offering Registration” (“ULOR”) of up to \$5 million; an Arizona-registered “intrastate” offering in an unlimited amount; or a federal Regulation A public offering registered in Arizona of up to \$20 million.

The Securities Division of the Arizona Corporation Commission (“Division”) is available to answer questions of a general nature regarding the registration process or exemptions from registration. The Division cannot, however, provide legal counsel.

This document is an overview and is not intended to be a comprehensive analysis of securities offerings, registration, or exemptions from registration. This document is not a substitute for competent legal counsel. Issuers of securities should consult with legal counsel, accountants, and investment bankers regarding the specifics of various alternative methods of raising capital, and the application of those methods to the specific facts and circumstances of the issuer. Issuers should not rely on the accuracy of this document, but should carefully review all applicable statutes and regulations.

The following overview discusses in general terms several of the commonly used methods of issuing securities to raise capital. For additional information about raising capital and a discussion of federal law, see “Q&A: Small Business and the SEC” on the Securities and Exchange Commission web site at <https://www.sec.gov/info/smallbus/qasbsec.htm>. In this paper, explanations and citations are provided in footnotes, which should be reviewed in connection with the narrative. The document is organized as follows:

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I. Introduction.

The Arizona Securities Act governs the sale or offer for sale of securities within or from Arizona,¹ dictating registration and antifraud provisions. “Security” is defined in A.R.S. § 44-1801(26),² “offer to sell” or “offer for sale” is defined in A.R.S. § 44-1801(15),³ and “sale” or “sell” is defined in A.R.S. § 44-1801(21).⁴

To determine whether an instrument falls within the statutory definition of “security,” the substance rather than the form of the instrument is considered. Judicial interpretation and tests supplement the statutory definition. An issuer should be cautious in its determination of the nature of the instrument it intends to offer and the applicability of the Arizona Securities Act. Essentially, if the purchaser will be a passive owner—relying on someone else’s efforts or conduct in order to make money on the investment—the instrument is probably a security.

The Arizona Securities Act offers a number of exemptions from registration for transactions and securities offered in a variety of circumstances, including circumstances other than offerings by an issuer for the purpose of raising capital (e.g. exchange offers, offers by nonissuers, etc.). These exemptions are not discussed in this document.⁵ For purposes of raising capital through offerings of securities, an issuer should be familiar with the registration requirements and exemptions from registration outlined on the following pages.

II. Exemptions from Registration.

Securities sold or offered for sale within or from Arizona must be registered with the Securities Division of the Arizona Corporation Commission (“Division”) or be subject to an exemption from such registration.⁶ Registration or an exemption therefrom must also occur on the federal level⁷ and in any other state in which the issuer wants to offer the securities. Many state exemptions correspond with federal exemptions, but the requirements of state exemptions are not necessarily identical to those of federal exemptions. If an issuer does not register the offering,

¹ Offers for sale of securities placed on the Internet in compliance with A.A.C. R14-4-142 are exempt from the provisions of A.R.S §§ 44-1841, 44-1842, and 44-3321, except offers for sale from Arizona or involving securities that will be sold in Arizona.

² “‘Security’ means any note, stock, treasury stock, bond, commodity investment contract, commodity option, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, viatical or life settlement investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, real property investment contract or, in general, any interest or instrument commonly known as a ‘security’, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.”

³ An “‘offer to sell’ or ‘offer for sale’ means an attempt or offer to dispose of, or solicitation of an order or offer to buy, a security or interest in a security for value”

⁴ “‘Sale’ or ‘sell’ means a sale or other disposition of a security or interest in a security for value, and includes a contract to make such sale or disposition. . . .”

⁵ See Arizona Revised Statutes §§ 44-1843 and 44-1844. See also the National Securities Markets Improvement Act of 1996 (15 U.S.C. 77r) for “covered securities” as defined by that act that are exempted from state regulation regarding securities registration.

⁶ A.R.S. § 44-1841. Section 44-1842 requires registration of any dealer or salesperson (as defined in § 44-1801) offering or selling securities from or within Arizona. Violation of either of these sections is a class 4 felony.

⁷ 15 U.S.C. § 77a, *et seq.*

failure to meet the requirements of an exemption results in an unregistered offering and the accompanying penalties and liabilities, including potential criminal liability.⁸

The following is a general discussion of the federal and Arizona exemptions from registration most commonly used by issuers offering securities for the purpose of raising capital in Arizona and an exemption from registration of offers made solely to solicit indications of interest. This discussion is not a comprehensive treatise on the applicable securities law, does not address factors specific to an issuer, and is not a substitute for competent legal counsel. An issuer should review the applicable rules and statutes for the specific requirements that the issuer must meet to qualify for the exemption or for registration.

A. Statutory Private Placement Exemption.

Section 4(a)(2) of the federal Securities Act of 1933 (the “1933 Act”) provides an exemption from the registration provisions of section 5 of the 1933 Act for “transactions by an issuer not involving any public offering.” Section 44-1844(A)(1) of the Arizona Securities Act provides a similar exemption. These exemptions from the registration requirements of the 1933 Act and the Arizona Securities Act each are referred to as a “statutory private offering exemption.” The statutory private offering exemption has developed over the years through interpretations by the Securities and Exchange Commission (the “SEC”) and court cases.⁹

The SEC and judicial interpretations¹⁰ have developed the requirement that in order to satisfy the statutory private offering exemption, sales of securities can only be made without advertising (or any other form of “general solicitation”) to a limited number of “sophisticated persons”¹¹ with “access to the information that would be included in a registration statement.”¹² An offer of securities to even one unsophisticated person, however, can result in the loss of the exemption.¹³ If an issuer intends to rely upon the statutory private placement exemption, the Division recommends that the issuer obtain assistance to understand and comply with the requirements of the exemption, as expressed in case law and SEC interpretations. The statutory private placement exemption is self-executing; i.e. has no filing requirement.

B. Federal Regulation D and Arizona Rule 126 Limited Offering Exemptions.

Arizona has adopted Arizona Administrative Code (“A.A.C.”) R14-4-126 (“Rule 126”) as its counterpart to federal Regulation D. Federal Regulation D consists of Rules 501 through 508 promulgated by the SEC under the 1933 Act and includes exemptions from registration for four

⁸ See Arizona Securities Act, Articles 14 and 16. See also A.R.S. §§ 13-601, *et seq.*, regarding Arizona criminal penalties and liabilities. These are not exclusive remedies.

⁹ Arizona looks to federal interpretations of securities law for guidance. Vairo v. Clayden, 153 Ariz. 13, 734 P.2d 110 (Ct. App. 1987).

¹⁰ The Ninth Circuit Court of Appeals has adopted a four-part test to analyze the validity of an asserted private offering exemption, which focuses on the number and sophistication of offerees, the size and manner of the offering, and the relationship of the offerees to the issuer. See SEC v. Murphy, 626 F.2d 633 (9th Cir. 1980).

¹¹ “Sophisticated” purchasers are purchasers who either alone or with their purchaser representatives have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of the prospective investment.

¹² The issuer should provide the offeree with an offering document that discloses the pertinent information, unless offeree occupies a privileged position relative to the issuer that affords the offeree actual access to the information.

¹³ See Mark v. FSC Securities Corporation, 870 F.2d 331 (6th Cir. 1989).

categories of offerings. The Arizona equivalent is Rule 126, sections A through H.¹⁴ Rule 501¹⁵ defines or explains a number of terms and related matters under Regulation D, including accredited investor, affiliate, aggregate offering price, business combinations, calculation of number of purchasers, executive officer, issuer, and purchaser representative. Rule 502¹⁶ sets forth the requirements regarding the information that an issuer must provide a prospective purchaser under each of the exemptions. Rule 503¹⁷ describes the notice filing requirement that is applicable to each of the exemptions.

Federal Regulation D, Rules 504, 505, 506(b), and 506(c) provide exemptions for four categories of limited offerings:

1. Rule 504 (no direct Arizona equivalent, but may be used in conjunction with Arizona Rules R14-4-101, R14-4-102, or R14-4-140 or A.R.S. § 44-1891 and Rule R14-4-144 or ULOR) provides an exemption from registration for limited offerings and sales not exceeding \$1 million. Offerings by nonreporting companies (i.e., companies without a class of equity securities registered under the federal Securities Exchange Act of 1934 (the “1934 Act”) and not subject to the reporting requirements of the 1934 Act) of not more than \$1 million in a 12-month period are exempt from federal registration under Rule 504, provided that an appropriate federal filing is made. “Blank check” companies (i.e., companies in the development stage¹⁸ with no specific business plan or purpose or a plan to merge with an unidentified company or companies) and investment companies may not rely upon Rule 504.

Rule 504 allows general solicitation and the securities sold are transferable without restriction under federal law if the offering is made in **one** of the two following methods:

- a. The securities are sold exclusively in one or more states that provide for the registration of the securities and require the public filing and delivery to investors of a substantive disclosure document before the sale, or
- b. The securities are sold exclusively according to state law exemptions from registration that permit general solicitation and general advertising so long as sales are made only to accredited investors.

In Arizona, sales of securities relying on federal Rule 504 for an exemption from federal registration, and in compliance with Rule 504(b)(i), (ii), or (iii), may rely on Arizona Rule 140 for an exemption from registration for offerings to accredited investors or register in Arizona as a “ULOR” or special offering. Offerings under federal Rule 504 that do not comply with Rule 504(b)(i), (ii), or (iii) generally register or rely on Arizona Rule 101 for sales to existing securities

¹⁴ Arizona Rule 126 is substantially similar to federal Regulation D, and compliance with Regulation D for Rule 505 and Rule 506(b) offering requirements generally will result in compliance with Rule 126(E) and (F) when proper filings are made in Arizona. Arizona does not have an equivalent rule for an offering under Rule 506(c).

¹⁵ See A.A.C. R14-4-126(B).

¹⁶ See A.A.C. R14-4-126(C).

¹⁷ See A.A.C. R14-4-126(D). Section A.A.C. R14-4-126(D) also provides the amount of the filing fee.

¹⁸ “A company shall be considered to be in the development stage if it is devoting substantially all of its efforts to establishing a new business and either of the following conditions exists: (1) Planned principal operations have not commenced. (2) Planned principal operations have commenced, but there has been no significant revenue therefrom.” Definition of Terms Used in Regulation S-X 17 C.F.R. § 210.1-02(h).

holders and/or employees,¹⁹ Arizona Rule 102 for an exemption for restricted public offerings,²⁰ or some other exemption.²¹ See Discussion of Rule 140, ULOR, and Special Registration offerings below.

2. Rule 505 (Rule 126(E) Arizona equivalent) provides an exemption from registration for limited offers and sales not exceeding \$5 million. Offerings by any issuer of less than \$5 million in a 12-month period to an unlimited number of “accredited investors”²² plus 35 additional persons are

¹⁹ A.A.C. R14-4-101 adds to the class of transactions exempt from registration under A.R.S. § 44-1844 offerings of securities made exclusively to employees and/or existing securities holders of the issuer or its subsidiaries. Such offerings are limited to an aggregate of \$500,000 over the lifetime of the issuer. No commissions or remuneration of any kind, other than transfer agents’ fees may be paid by the issuer in connection with the distribution or sale of such securities.

To use the Rule 101 exemption from registration, ten business days prior to making an offer an issuer must file:

1. a notice filed in duplicate prepared in the format outlined in Rule 101,
2. a fee pursuant to A.R.S. § 44-1861(G),
3. financial statements consisting of a balance sheet as of a date within 90 days of the date of the petition and statements of operations, stockholders’ equity and retained earnings, and changes in financial position for the preceding three years or such lesser period as the issuer has been in business, prepared in accordance with generally accepted accounting principles, and either audited by an independent public or certified independent public accountant or verified under oath by an officer, general partner, joint venturer, trustee, or sole proprietor, and,
4. if the issuer is not organized under the laws of or domiciled in Arizona, a consent to service of process.

Offerings made pursuant to Rule 101 are added to the class of transactions exempt under A.R.S. § 44-1844 from offering and dealer registration.

²⁰ A.A.C. R14-4-102 adds to the class of transactions exempt from registration under A.R.S. § 44-1844 offerings of securities made to not more than ten persons in Arizona. Such offerings are limited to an aggregate of \$100,000 over the lifetime of the issuer. No commissions or remuneration of any kind, other than transfer agents’ fees may be paid by the issuer in connection with the distribution or sale of such securities.

To use the Rule 102 exemption from registration, ten business days prior to making an offer an issuer must file:

1. a notice filed in duplicate prepared in the format outlined in Rule 102,
2. a fee pursuant to A.R.S. § 44-1861(G),
3. financial statements consisting of a balance sheet as of a date within 90 days of the date of the petition and statements of operations, stockholders’ equity and retained earnings, and changes in financial position for the preceding three years or such lesser period as the issuer has been in business, prepared in accordance with generally accepted accounting principles, and either audited by an independent public or certified independent public accountant or verified under oath by an officer, general partner, joint venturer, trustee, or sole proprietor, and,
4. if the issuer is not organized under the laws of or domiciled in Arizona, a consent to service of process.

Offerings made pursuant to Rule 102 are added to the class of transactions exempt under A.R.S. § 44-1844 from offering and dealer registration.

²¹ If an issuer is relying on federal Rule 504 for an exemption from registration at the federal level, but would meet the criteria for a Rule 505 or Rule 506(b) exemption, the issuer may rely upon the Arizona equivalents of Rules 505 or 506, which are Rules 126(E) and 126(F), for an exemption from registration in Arizona.

²² Federal Rule 501 (Arizona Rule 126(B)(1)) sets forth the definition of accredited investor, which includes eight categories of investors. The introductory language provides that any person who falls within one of the eight categories, or who the issuer reasonably believes falls within one of the categories, is an accredited investor. This formulation permits someone who in fact falls within one of the categories to qualify as an accredited investor even if the issuer had no reasonable basis for believing such person was an accredited investor. Investors are accredited if they fall into one of the enumerated categories “at the time of the sale of securities to that person,” regardless of a later change in status of the person after the sale of securities, such as resignation by the purchaser from a position as a director of the issuer. “Reasonably believes” is a factual determination and the steps that must be taken to establish reasonable belief may vary with the circumstances of each case. The eight categories of accredited investors are as follows:

1. A natural person whose net worth at the time of purchase is at least \$1 million. Net worth can be the joint net worth of the investor and investor's spouse.
2. A natural person whose individual income has been in excess of \$200,000 in each of the last two years or joint income with that person's spouse has been in excess of \$300,000 in each of these years and who reasonably expects to

exempt from federal registration under Rule 505.²³ An issuer could be disqualified from using the rule if it or its affiliates or certain other persons associated with the offering were the subject of certain administrative, civil, or criminal actions (so-called “bad boy” provisions).²⁴ Investment companies are precluded from relying upon Rule 505. Regulation D prohibits the use of general solicitation or advertising under Rule 505. Securities sold under Rule 505 are “restricted securities” and may not be resold without registration or an exemption from registration. “Restricted securities” are securities upon which some limitation is imposed on the purchaser’s ability to resell the securities. Such restrictions may be stated in a legend printed on the certificate that represents the security.²⁵

3. Rule 506 Private Placements. To introduce certainty into the area of private placements, the SEC adopted Rule 506 of Regulation D as a “safe harbor” for certain types of private offerings. A “safe harbor” is a rule that explicitly states the requirements an issuer must meet. If an issuer complies with all of the requirements of the rule, it will be deemed to have complied with the statute. If an issuer complies with the requirements of Rule 506 of Regulation D, the issuer will be deemed to have met the requirements for the section 4(a)(2) private placement exemption.

reach that same income level in the current year. An individual may rely upon only one of the income tests for the entire three-year period. What monies fall within the term “income” is not defined, but is left flexible.

3. Certain institutional investors. These include banks, insurance companies, registered investment companies, business development companies, savings and loan associations and similar institutions (e.g., credit unions), broker-dealers purchasing for their own accounts, and employee benefit plans under ERISA advised by a bank, savings and loan association, insurance company, or registered investment advisor. In addition, an accredited investor includes any employee benefit plan under ERISA that has total assets in excess of \$5 million or, if the plan is self directed, with investment decisions made solely by accredited investors.

4. Private business development companies that meet the definition in Section 202(a)(22) of the Investment Advisers Act of 1940.

5. Any corporation, Massachusetts or similar business trust, partnership, or any organization described as exempt in Section 501(c)(3) of the Internal Revenue Code, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of \$5 million.

6. Directors, executive officers, and general partners of the issuer, as well as directors, executive officers, and general partners of general partners of the issuer. The term executive officer includes the president, vice president in charge of a principal business unit, and any other persons, including officers of subsidiaries, who perform a policy making function for the issuer.

7. Any trust, with total assets in excess of \$5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person. A sophisticated person is a person who “has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment.” If the trustee of a trust is a bank or savings and loan association, the trust will be qualified as an accredited investor, regardless of assets, since a bank or savings and loan association is accredited whether acting in its individual or fiduciary capacity.

8. Any entity in which all of the equity owners are accredited investors. The beneficiaries of a trust are not considered its equity owners. Thus a trust typically cannot qualify as an accredited investor in this category. However, when powers are retained by the grantors to amend or revoke the trust, a trust as a legal entity would be deemed not to exist. Thus, if the grantors of such a revocable trust are accredited, the trust is accredited. If securities are purchased by an Individual Retirement Account and the participant is an accredited investor, the account would be accredited. If all participants of an employee benefit or retirement plan are accredited investors under any of the categories of Rule 501, except 501(a)(8), then the plan is deemed accredited.

²³ See A.A.C. R14-4-126(E).

²⁴ A.A.C. R14-4-126(G) “bad boy” provisions apply to both 126(E) and 126(F) offerings.

²⁵ See 17 CFR 230.144.

An issuer could be disqualified from using the rule if it or its affiliates or certain other persons associated with the offering were the subject of certain administrative, civil, or criminal actions (so called “bad actor” provisions).²⁶ Securities sold under Rule 506 are “restricted securities” and may not be resold without registration or an exemption from registration.

Rule 506 provides for two classifications of offerings, one subject to limitations on the manner of the offering, and one not subject to limitations on the manner of the offering.

- a. Rule 506(b) (Rule 126(F) Arizona equivalent) provides an exemption for offerings of any amount by any issuer to an unlimited number of accredited investors plus 35 “sophisticated” persons.²⁷ Rule 506(b) prohibits use of general solicitation or general advertising.
- b. Rule 506(c) (no Arizona equivalent) provides an exemption for offerings of any amount and allows general solicitation or general advertising, provided sales are only made to accredited investors. An issuer is required to take reasonable steps to verify that purchasers of securities sold under 506(c) are accredited investors. If general solicitation is conducted, the offering must be sold through a dealer registered in Arizona.²⁸

The National Securities Markets Improvement Act of 1996 (“NSMIA”) provides that securities exempt from registration with the SEC under rules or regulations issued under section 4(a)(2) (i.e. Rule 506) are “covered securities.” Arizona’s rules or regulations regarding these securities are affected by NSMIA. With respect to registration requirements, only the Division’s authority to impose notice filing requirements is preserved in A.R.S. § 44-1843.02(C). Therefore, issuers relying on Rule 506 for an exemption from registration on the federal level need only file in Arizona a copy of Form D no later than 15 days after the first sale of securities in or from Arizona and the initial filing fee.²⁹

Reliance on any particular exemption in Regulation D does not act as an exclusive election. An issuer may always claim the availability of any other applicable exemption. Regulation D is available only to an issuer and not to its affiliates or others for resale. Thus, Regulation D is not available for firm underwritings (as opposed to best-effort offerings)³⁰ because securities are resold by definition in a firm underwriting of securities. Even though there may be technical compliance with the Regulation, if an offering is part of a plan or scheme to evade the registration requirements, the exemption under the Regulation is not available.

If an issuer sells securities to accredited investors, no specific disclosure to the investors by the issuer is mandated. If securities are sold under Rules 505 or 506(b) to nonaccredited investors, the type of information to be furnished depends on the size of the offering and whether the issuer is subject to the reporting requirements of the 1934 Act.

²⁶ See 17C.F.R. § 230.506(d).

²⁷ See A.A.C. R14-4-126(F).

²⁸ See A.R.S. § 44-1843.02(D) and A.A.C. R14-4-126(F).

²⁹ See also A.R.S. § 44-1843.02(D).

³⁰ “Firm underwriting” - an underwriter purchases all of the securities offered by the issuer to the public and resells the securities to the public. “Best-efforts” - either the issuer or its agents do their best to sell the offered securities to the public.

To take advantage of the exemption from registration offered by the Arizona Securities Act Rule 126, an issuer must file one copy of Form D³¹ no later than 15 days after the first sale of securities in or from Arizona and an amended Form D no later than 30 days after the termination of an offering under this rule. If the offering is completed within 15 days after the first sale, then only one notice need be filed.³² Again, if the transaction is exempt from federal registration under Rule 506, no Arizona exemption is required, only the notice filing under A.R.S. § 44-1843.02(C).

The issuer shall pay the fees prescribed by A.R.S. § 44-1861(E), currently \$250 with the first filing and \$100 with the final filing, if the final filing is made separately from the first filing. The issuer should indicate at the top of the Form D filed in Arizona the exemption upon which it is relying. Federal Regulation D requires that five copies of Form D be filed with the SEC no later than 15 days after the first sale of securities.³³

A dealer or salesman (as defined in A.R.S. § 44-1801) engaged in an offering under Rule 126 shall be registered in Arizona if the dealer or salesman is engaged principally and primarily in the business of making a series of private offerings.³⁴ “Series” means in excess of four private offerings in any consecutive 12-month period made anywhere in the United States, not just in Arizona. Federal law may require registration of a salesperson if that individual participates in selling an offering of securities for any issuer more than **once** every 12 months.³⁵

C. Rule 139 Qualified Purchaser Public Offering Exemption.

The Division requested that the SEC adopt an exemption from federal registration similar to 17 CFR 230.1001 for issuers who satisfy the conditions of Rule 139. Unless and until the SEC adopts such a “wrap” exemption, an exemption from federal registration for which a Rule 139 offering would qualify may be limited to the intrastate offering exemption under federal Rule 147. *See infra* Section III.A.

A.A.C. R14-4-139 (“Rule 139”) is designed to assist small businesses in capital formation in a manner that does not impose unnecessary expenses. Securities sold in reliance on Rule 139 are restricted securities.³⁶

Rule 139 allows issuers to offer and sell, without registration of the offering in Arizona, up to \$5 million of securities during any 12-month period to qualified persons, as defined in Rule 139, provided certain conditions are met. In addition, issuers may sell their own securities without registering as a dealer under the Arizona Securities Act. Officers, directors, and employees of the issuer not retained for the primary purpose of making offers of securities may sell the issuers’ securities in a Rule 139 offering without registration as salespersons. Of course, issuers can use a registered dealer to sell their securities if they so desire.

For an issuer to take advantage of Rule 139, the sale of securities may not exceed \$5 million in any 12-month period.³⁷ In addition, the offers of securities must specify that sales will

³¹ Manual or facsimile signatures accepted. A.A.C. R14-4-126(D)(3).

³² A.A.C. R14-4-126(D).

³³ 17 C.F.R. § 239.500.

³⁴ A.A.C. R14-4-104(4).

³⁵ See 15 U.S.C. 78o and 17 C.F.R. Rule 240.3a4-1.

³⁶ See the discussion regarding restricted securities in Section II.B of this paper.

be made only to qualified purchasers, and sales of securities must be made to qualified purchasers or to persons the issuer reasonably believes to be qualified purchasers.³⁸ At least five days before a sale, the issuer must provide disclosure to the prospective purchaser as described in A.A.C. R14-4-126(C)(2).³⁹

Certain issuers are ineligible to use Rule 139. Under the rule, the issuer may not be offering a blind pool or securities in a business planning to engage in a merger or acquisition of an unidentified entity.⁴⁰ Additionally, the issuer, or any of its predecessors, affiliates, directors, officers, general partners, or beneficial owners of 10 percent or more of any class of its equity securities, or any underwriter of the securities, cannot fall within the disqualification provisions of Rule 139, which relate to prior securities violations.

The issuer must file a notice, consent to service of process, and fee at least ten business days in advance of either the initial offering of securities or the publication of a general announcement of the offering, whichever occurs first.⁴¹ The offering documents or subscription agreement must contain a legend warning that the securities may only be sold to qualified purchasers. The certificate representing the security issued in accordance with the rule must have a similar legend.⁴²

The Division Director (“Director”) may revoke the availability of Rule 139 with respect to a particular issuer, seller, or transaction if the Director determines that there is a reasonable likelihood that the sale of the securities would work or tend to work a fraud or deceit upon the purchasers thereof. If the Director makes such a determination, the seller of the securities may request a hearing in accordance with the provisions of article 11 of the Arizona Securities Act.⁴³

D. Rule 140 Accredited Investor Public Offering Exemption.

A.A.C. R14-4-140 (“Rule 140”) is also designed to assist small businesses in capital formation in a manner that does not impose unnecessary expenses. Rule 140 significantly benefits issuers by allowing them to seek capital from accredited investors without registration of the transaction and in a significantly more cost-effective manner than that of an offering of securities registered under federal securities laws or the Arizona Securities Act. At the same time, since initial offers and sales of securities are limited to accredited investors, the risk of substantial harm to the general investing public is limited.

Rule 140 allows issuers who rely on federal Rule 504, and comply with Rule 504(b)(iii), to offer and sell without registration of the offering in Arizona securities to accredited investors, as defined in Rule 126, provided certain conditions are met. In addition, issuers may sell their own securities without registering as a dealer under the Arizona Securities Act. Officers, directors, and employees of the issuer not retained for the primary purpose of making offers of securities may sell the issuers’ securities in a Rule 140 offering without registration as

³⁷ A.A.C. R14-4-139(G).

³⁸ A.A.C. R14-4-139(M).

³⁹ A.A.C. R14-4-139(L).

⁴⁰ A.A.C. R14-4-139(C).

⁴¹ A.A.C. R14-4-139(N).

⁴² A.A.C. R14-4-139(M).

⁴³ A.A.C. R14-4-139(P).

salespersons. Of course, issuers can use a registered dealer to sell their securities if they so desire.

For an issuer to take advantage of Rule 140, the issuer must comply with federal Rule 504, including Rule 504(b)(iii). In addition, the offers of securities must specify that sales will be made only to accredited investors, and sales of securities must be made exclusively to accredited investors.⁴⁴ **There is no “reasonable belief” defense for a failure to limit sales to accredited investors.** Since initial sales of securities can only be made to accredited investors, no specific information is required to be furnished by the issuer to investors. A legend is required on any offering documents or subscription documents.⁴⁵

Certain issuers are ineligible to use Rule 140. Under federal Rule 504, the issuer may not be a development stage company⁴⁶ with no business plan or with a plan to engage in a merger or acquisition of an unidentified entity, may not be subject to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, and may not be an investment company under the Investment Company Act of 1940. Additionally, under Rule 140, the issuer may not be offering a blind pool⁴⁷ and the issuer, or any of its predecessors, affiliates, directors, officers, general partners, or beneficial owners of 10 percent or more of any class of its equity securities, or any underwriter of the securities, cannot fall within the disqualification provisions, which relate to prior securities violations.⁴⁸

Issuers must file a copy of Form D within 15 calendar days after the first sale within or from Arizona, a consent to service of process, a copy of the general announcement of the offering, and the fee in A.R.S. § 44-1861(G).⁴⁹

The issuer must reasonably believe that each purchaser is buying the securities for investment purposes and not to resell. Resales of securities issued in accordance with this rule are limited to accredited investors for 12 months or until the issuer registers the securities or qualifies for another exemption.⁵⁰

E. Listed Securities Exemption.

A.R.S. § 44-1843(A)(7), as supplemented by A.A.C. R14-4-115, provides that securities listed or approved for listing on the New York Stock Exchange, the American Stock Exchange, the Chicago Stock Exchange, the Pacific Exchange, the Philadelphia Stock Exchange, or the Chicago Board Options Exchange, or approved for quotation on the NASDAQ National Market System, and all securities senior or equal in rank and any warrant or right to purchase or subscribe to any of the foregoing, are exempt from registration in Arizona.

⁴⁴ A.A.C. R14-4-140(D).

⁴⁵ A.A.C. R14-4-140(J).

⁴⁶ See *supra* note 18.

⁴⁷ A.A.C. R14-4-140(C).

⁴⁸ A.A.C. R14-4-140(M).

⁴⁹ A.A.C. R14-4-140(L).

⁵⁰ A.A.C. R14-4-140(E).

For sales made after October 10, 1996, NSMIA,⁵¹ as supplemented by 17 CFR § 230.146, preempts state filing and fee requirements for securities listed or authorized for listing on the New York Stock Exchange, the American Stock Exchange, Tier I of the Pacific Exchange, Tier I of the Philadelphia Stock Exchange, or the Chicago Board Options Exchange or approved for quotation on the NASDAQ National Market System or securities of the same issuer that are equal or senior in seniority.

Dealers or salesmen who engage in transactions involving securities exempt from registration pursuant to A.R.S. § 44-1843(A)(7) must be registered in Arizona unless the offer or sale is directed to securities holders or employees of the issuer or the dealer or the salesman is acting without compensation other than a standby charge relating to any balance of the offering remaining unsubscribed by existing securities holders or employees of the issuer, or through another available exemption.⁵²

F. Rule 141 Solicitation of Interest Exemption.

Rule 141 provides an exemption from registration of offers by an issuer, or a registered dealer on behalf of the issuer, made solely to solicit an indication of interest in the issuer's securities. To use the exemption, the issuer must be, or will be, organized under the laws of a state of the United States or Mexico or a province or territory of Canada and must not be conducting a blind pool offering.⁵³ To use Rule 141, the issuer, its predecessors, affiliates, directors, officers, general partners, or beneficial owners of 10 percent or more of any class of equity securities must not be in violation of the "bad boy" provisions contained in subsection (D) of Rule 141.

Ten business days before its initial solicitation under Rule 141, the issuer must file with the Division a Solicitation of Interest Form⁵⁴ along with any other items to be used in the solicitation of interest. Any amendments to these items, or any additional items, must be filed with the Division five business days before they are used.⁵⁵ The filing fee is \$100, under A.R.S. § 44-1861(G).⁵⁶

The issuer must give a copy of the Solicitation of Interest Form to an offeree within five business days of a communication with the offeree, unless the communication is made by scripted broadcasts or published notices or advertisements.⁵⁷ All communications made under Rule 141 are subject to the antifraud provisions of the Arizona Securities Act.⁵⁸

While soliciting interest, an issuer may not solicit or accept money or a commitment to purchase securities.⁵⁹ All solicitations under Rule 141 must stop after a registration statement is filed in Arizona.⁶⁰ An issuer may not make a private offering in reliance on an exemption from

⁵¹ 15 U.S.C.77r(c)(2)(D).

⁵² A.A.C. R14-4-104(2).

⁵³ A.A.C. R14-4-141(B)(1).

⁵⁴ See A.A.C. R14-4-141(J) for the format of and information that must be contained in a Solicitation of Interest Form.

⁵⁵ A.A.C. R14-4-141(B)(3) and (4).

⁵⁶ A.A.C. R14-4-141(B)(3).

⁵⁷ A.A.C. R14-4-141(C).

⁵⁸ A.A.C. R14-4-141(H).

⁵⁹ A.A.C. R14-4-141(B)(6).

⁶⁰ A.A.C. R14-4-141(B)(8).

registration under A.R.S § 44-1844(A)(1) or Rule 126 until six months after the last Rule 141 communication with a prospective investor.⁶¹

G. Federal Rule 147 Intrastate Offerings.

Section 3(a)(11) of the 1933 Act provides an exemption from the federal registration requirements for any offer or sale of securities to residents of a single state by an issuer who resides in or is incorporated in the same state and does business in that state. The “intrastate exemption” has three major components:

1. The issuer must be doing business within the state, which has been interpreted to mean having substantial operational activities in the state;
2. All offers and sales must be to residents of the state; and
3. The securities that are sold must “come to rest” in the hands of investors who are residents of the state.

In an attempt to provide some certainty for those who wished to rely on the statutory intrastate exemption, the SEC adopted the “safe harbor” of Rule 147. To qualify under the rule, the issuer must at the time of any offers and sales, be a **person residing and doing business** within the state. Under the rule, an issuer will be deemed to be doing business within a state if the issuer derives at least 80 percent of its gross revenues from doing business within the state, has 80 percent of its assets within the state, **and** uses at least 80 percent of the net proceeds of the offering within the state. The issuer must be incorporated in the state to rely on Rule 147. Rule 147 also requires that the offerees and purchasers be residents of the state of the offering. No resales may be made outside the state for a period of at least nine months after the date of the last sale.

No federal filing requirement exists to claim the exemption. However, state registration or exemption requirements must be satisfied. As discussed next, the federal intrastate exemption can be used in connection with the Arizona exemption for crowdfunding offerings. The federal intrastate exemption can also be used in connection with a registered offering in Arizona. See *infra* Section III for a discussion of Registration by Qualification and Special Registration in Arizona.

H. A.R.S. § 44-1844(D) Exemption for Intrastate Crowdfunding Offerings

A.R.S. § 44-1844(D) provides a statutory exemption from registration for small offerings that raise capital from a large pool of investors contributing limited amounts of money in exchange for equity in an enterprise. Commonly referred to as “crowdfunding,” this form of capital formation can be used pursuant to A.R.S. § 44-1844(D). Following is a partial list of the exemption requirements.

1. The issuer of the security is an entity organized under Arizona laws, authorized to do business in this state, and does business pursuant to the Securities Act of 1933 and federal rule 147(c).⁶²

⁶¹ A.A.C. R14-4-141(G).

2. The transaction meets the requirements of the federal exemption for intrastate offerings pursuant to Section 3(a)(11) of the Securities Act of 1933, and 17 CFR 230.147(c).⁶³
3. The aggregate offering price of the securities offered may not exceed \$1 million or \$2.5 million in a 12-month period, depending upon whether the issuer has undergone a financial audit in the most recently completed fiscal year and makes the opinion letter and applicable documentation available to the prospective purchasers and the Corporation Commission.⁶⁴
4. All sales that are part of the same offering, made in reliance on the exemption, meet all the terms and conditions of the exemption. Offers and sales that are made more than six months before the start of an offering or are made more than six months after the completion of an offering may not be considered part of the offering if certain conditions are met.⁶⁵
5. The issuer does not accept more than \$10,000 from any single purchaser, unless the purchaser is an accredited investor pursuant to the Securities Act of 1933, 17 CFR 230.501.⁶⁶
6. The issuer submits to the Commission not less than ten days before commencement of an offering of securities (a) a notice filing on a form prescribed by the Commission, (b) a copy of the disclosure document to be provided to prospective purchasers, (c) a copy of the escrow agreement, and (d) any other documents or information as required by the Commission.⁶⁷
7. All cash and other consideration paid for securities sold in relation to the exemption are deposited into a single escrow account maintained by a bank, credit union or other depository financial institution in this state that is authorized to do business in this state.⁶⁸
8. Offers state a target offering amount and an offering deadline of not less than 21 days and not more than 1 year from the date the offer is made.⁶⁹
9. The sum of all cash and other consideration received and held in escrow is not less than 80% of the target offering amount on the expiration of the offering deadline or the early closing of the offering.⁷⁰
10. A purchaser is permitted to cancel the commitment to invest at a defined time if certain conditions are met.⁷¹

⁶² A.R.S. § 44-1844(D)(1).

⁶³ A.R.S. § 44-1844(D)(2).

⁶⁴ A.R.S. § 44-1844(D)(3).

⁶⁵ A.R.S. § 44-1844(D)(4).

⁶⁶ A.R.S. § 44-1844(D)(5).

⁶⁷ A.R.S. § 44-1844(D)(6).

⁶⁸ A.R.S. § 44-1844(D)(7).

⁶⁹ A.R.S. § 44-1844(D)(8).

⁷⁰ A.R.S. § 44-1844(D)(9).

11. If an issuer closes an offering before the offering deadline, the issuer delivers notice of the closing to each purchaser and posts the notice conspicuously on each internet website on which the offer was posted, at least 5 days before the early closing.⁷²
12. Before or as a result of the offering, the issuer cannot be (a) an investment company as defined by the Investment Company Act of 1940, (b) an entity that would be an investment company but for an exemption, (c) a reporting company under the Securities and Exchange Act of 1934, or (d) a company that has not yet defined its business operations, does not have a business plan or a stated investment goal for the funds being raised, or plans to engage in a merger or acquisition with an unspecified business entity.⁷³
13. The issuer informs prospective purchasers the securities have not been registered and are subject to resale restrictions.⁷⁴ The issuer displays a notice on the disclosure document regarding making an investment decision⁷⁵ and requires each purchaser to certify in writing their understanding and acknowledgment regarding the risks of investment.⁷⁶
14. The issuer obtains evidence from each prospective purchaser indicating in-state residency and, if applicable, investor accreditation.⁷⁷
15. The issuer provides a disclosure document to each prospective purchaser at the time the offer of securities is made containing information regarding the issuer and the offering. The exemption requires a number of specified disclosures as well as any other information that may be material to the offering.⁷⁸
16. The exemption is not available if an issuer or person affiliated with the issuer or offering is subject to certain disqualifications.⁷⁹ The Commission may set aside a disqualification in certain circumstances.⁸⁰
17. The sale is made exclusively through one or more internet websites that are operated by a dealer registered with the Division or by a person who does not receive compensation or remuneration directly or indirectly for the offer or sale of the security. Each issuer and website operator must comply with certain requirements for the offering or sale of securities on the website.⁸¹
18. The issuer makes and keeps all accounts, correspondence, memoranda, papers, books, and other records that the Commission prescribes by rule or order,⁸² and the issuer

⁷¹ A.R.S. § 44-1844(D)(10).

⁷² A.R.S. § 44-1844(D)(11).

⁷³ A.R.S. § 44-1844(D)(12).

⁷⁴ A.R.S. § 44-1844(D)(13).

⁷⁵ *Id.*

⁷⁶ A.R.S. § 44-1844(D)(14).

⁷⁷ A.R.S. § 44-1844(D)(15).

⁷⁸ A.R.S. § 44-1844(D)(16).

⁷⁹ A.R.S. § 44-1844(D)(17).

⁸⁰ A.R.S. § 44-1844 (D)(18).

⁸¹ A.R.S. § 44-1844(D)(19).

⁸² A.R.S. § 44-1844(D)(20).

provides a quarterly report to purchasers until no securities issued under the exemption are outstanding.⁸³

III. Registration.

If an issuer cannot or elects not to meet the requirements to qualify for an exemption from registration for its offering of securities and is not making offers solely to solicit interest under the provisions of Rule 141, the issuer must register the offering prior to making any sales or offers for sale in Arizona. Some types of offerings may be exempt from federal registration, but still require registration in Arizona and other states in which offers or sales will be made. For instance, the 1933 Act provides an exemption from federal registration for intrastate offerings (Rule 147) and Regulation A of the 1933 Act provides an exemption for offerings up to \$50 million.⁸⁴ Absent any other exemption, these types of offerings are registered in Arizona.

The Arizona Securities Act provides for two primary methods of registration--qualification and description. The Arizona Securities Act does not provide for registration by coordination with SEC registration. Certain securities may be registered by qualification pursuant to modified requirements--those that qualify to be registered by definition, those that qualify to be registered by the Uniform Limited Offering Registration, those that qualify to be registered through Special Registration, and those that qualify to be registered by Coordinated Equity Review.

A. Regulation A Offerings (“Reg A+”).

Federal Regulation A allows sales up to \$50 million annually of securities in a manner similar to that of a registered offering. Securities sold pursuant to Regulation A are issued at the federal level pursuant to section 3(b)(2) of the 1933 Act, which gives the SEC authority to exempt up to \$50 million of an offering of securities from the registration requirements of the 1933 Act.

The treatment of offerings under Regulation A is bifurcated into two tiers: Tier 1, for securities offerings of up to \$20 million in a 12-month period; and Tier 2, for offerings of up to \$50 million in a 12-month period. The tiers retain many existing conditions regarding issuer eligibility, offering circular contents, “testing the waters” guidelines, and “bad actor” disqualifications. In Tier 2 offerings, investors must be “accredited investors,” as defined in Rule 501(a) of Regulation D or face limitations on investment. Investors that are not accredited may only purchase securities in an amount no more than 10% of their annual income or net worth if they are natural persons, or may not invest more than 10% of the greater of annual revenue or net assets at fiscal year-end if a non-natural person (such as a corporation). Tier 1 offerings do not have such investment restrictions.

State securities registration requirements differ for Tier 1 and Tier 2 offerings. Regulation A provides for the preemption of state securities registration requirements for securities offered or sold to “qualified purchasers” as described in the SEC’s final rules for Regulation A. The SEC has defined these “qualified purchasers” as any person to whom securities are offered or sold in a Tier 2

⁸³ A.R.S. § 44-1844(D)(21).

⁸⁴ Under Regulation A, offerings up to \$20 million conducted under Tier 1 may be subject to state securities registration requirements. State securities registration requirements are preempted for offerings up to \$50 million conducted under Tier 2.

offering. State securities registration requirements are not preempted for Tier 1 offerings. Tier 1 offerings must either register or find an exemption from registration.

In Arizona, a Regulation A offering is made under the statute providing for registration by qualification. Thus, audited financial statements are required. Special Registration may be available. See discussion below. “Testing the waters,” or solicitations of interest, may be made in Arizona pursuant to the provisions of Rule 141, discussed above.

B. Registration by Qualification.

Applications for registration of securities offerings are reviewed by two general methods. The SEC and some states review registration documents for disclosure issues only (disclosure review). Disclosure review means that the documents are reviewed to ensure that the issuer clearly and adequately discloses all material information. Some states, including Arizona, also give registration documents a merit review. Merit review requires that the offering not be “unfair or inequitable”⁸⁵ and requires, among other things, compliance with the statute and rules listed below. Issuers should review each of the following requirements (as well as the Arizona Securities Act in its entirety), paying particular heed to § 44-1894(A)(7) and A.A.C. R14-4-105, R14-4-106, and R14-4-107. If an issuer has a unique circumstance or mitigating facts that prevent full compliance with a statute or rule, the issuer should discuss its particular situation with the Division so that the statutes and rules may be imposed as appropriate to those facts and circumstances.

1. Section 44-1894(A)(7) (use of proceeds). This statute requires that the issuer explain in the offering document the specific uses to which the offering proceeds will be applied and the approximate amount to be devoted to each use. Generally, no more than 10 to 15 percent of the net offering proceeds should be allocated to working capital or general corporate purposes. Additionally, no more than 5 percent of the offering proceeds should be allocated for payment to a promoter or affiliate for any purpose. If the issuer wishes to reserve the right to reallocate the offering proceeds, it should explain the circumstances under which it would reallocate the proceeds and the categories among which the proceeds may be reallocated. If the issuer is allocating a portion of the proceeds to use for the acquisition of additional unidentified businesses, it should explain the explicit criteria it will review in selecting an acquisition target. In the event an issuer is in a unique position that prevents full compliance with the statute, the issuer should explain to the Division the issuer’s position, why the position is unique, and why the issuer cannot fully comply with the statute.

2. R14-4-103 (advertising and sales literature). Any advertising, communication, prospectus, or sales literature must be filed with the Division at least three days prior to its proposed use.

3. R14-4-105 (promotional securities). This rule applies to corporations that have no or thin public markets for their shares and have no significant earnings. Securities held by promoters of these corporations in excess of 15 percent of the total securities to be outstanding at the completion of the proposed offering that have been issued for less than the following consideration must be subject to a restrictive sales agreement for a period of up to three years: if issued within one year prior to the public offering, 85 percent of the proposed public offering price; if issued

⁸⁵ See A.R.S. § 44-1921 providing for denial of registration.

within two years but not less than one year prior, 75 percent; if issued within three years but not less than two years prior, 65 percent.

4. R14-4-106 (options, warrants, and rights to purchase). Rule 106 requires the justification of all grants of options, warrants, and rights to purchase. “Grants” include all the securities that the company has **authorized** for issuance to officers, directors, and other employees, whether or not issued or vested at the time of the offering. The grant of these securities that qualify as incentive securities in accordance with section 422 of the Internal Revenue Code of 1986 is considered justified. All nonqualified securities must conform to the requirements of Rule 106(B)(1) through (5) to be deemed justified.

5. R14-4-107 (promoter’s equity). The organizers and promoters of a company must have paid or contributed capital to the corporation in cash or other **tangibles** an amount equal to the following percentages of the total proposed public offering: 10 percent of the first \$200,000, 5 percent of the second \$200,000, and 1 percent of the balance. For example, the organizers and promoters must have contributed capital to the corporation in cash or other tangibles in the total amount of \$76,000 in order to raise \$5 million from the public.

6. R14-4-108 (sales commission and expenses). Generally, the issuer is deemed to have complied with sales commission and expenses requirements if an offering meets the requirements of the Financial Industry Regulatory Authority (“FINRA”) with respect to the payment of sales commissions and expenses.

7. R14-4-110 (installment sales). Marginal sales of securities are permitted on an installment basis with approximately 50 percent paid at the time of subscription and the balance payable within ten months.

8. R14-4-111 (commissions to officers and directors). An issuer selling its own securities may not pay a commission or sales fee to its officers, directors, or promoters for the sale of such securities unless they receive no other salary or remuneration from the issuer and do not sell securities in more than one issue at the same time.

9. R14-4-112 (impoundment of funds). Funds held as a condition to registration shall be deposited with an entity prescribed in Rule 112.

10. R14-4-113 (impound dates). Ordinarily, an issuer may only attempt for a maximum of one year to raise the minimum funds necessary to finance its proposed enterprise.

11. R14-4-116 (statements of policy). Securities or transactions that fall within the enumerated North American Securities Administrators Association (“NASAA”) statements of policy must meet the requirements contained in those statements.

12. R14-4-117 (requirements for debt). An issuer offering debt instruments must demonstrate its ability to service its debt obligations as they become due. Such demonstration must include components outlined in Rule 117.

13. R14-4-118 (statement required in prospectuses). Rule 118 requires a cover legend essentially stating that the Division has not approved the offered securities. Additionally, Rule 118 requires a cover legend in six specified instances that states that the securities are speculative.

14. R14-4-119 (requirements for preferred stock). The Commission may deny registration of preferred stock if the issuer's previous adjusted net earnings would not have been sufficient to pay the issuer's fixed charges and the dividends and any redemption requirements, if applicable, of the preferred stock being offered.

15. R14-4-120 (financial statements). Rule 120 prescribes the requirements for audited financial statements. Additionally, the rule requires that an issuer file a consent from any accountant or other professional expert who has prepared or audited any report or opinion for use in connection with the application for registration or an exemption from registration.

In addition to the foregoing requirements, the application for registration, prospectus, financial statements, and any exhibit or amendment thereto must be complete, accurate, and sufficient for a true appraisal of the securities.⁸⁶

In determining whether to register a public offering to raise capital, an issuer should consider, among other factors, the stage of development of the company. Offerings of securities to raise capital in order to initially establish a company may be more appropriately offered to venture capitalists, as a private offering to sophisticated investors, or as a Rule 140 offering to accredited investors. Offerings that place the expense and risk of establishing a company on the general public without commensurate investment and risk on the part of the promoters likely are "unfair and inequitable" to the investing public and may have difficulty complying with the above-referenced rules.

The Corporation Commission may, after a hearing or notice and opportunity for hearing as provided by article 11 of the Arizona Securities Act, enter an order denying registration of an offering on any of the following grounds:⁸⁷

1. The application for registration or documents filed therewith are incomplete, inaccurate, or misleading, or the information contained therein is insufficient for a true appraisal of the securities.

2. The issuer or any dealer or salesman designated to engage in the sale of the securities has violated any provision of the Arizona Securities Act.

3. The sale of the securities works or would tend to work a fraud or deceit upon the purchasers or is or would be unfair or inequitable to the purchasers.

4. The issuer is insolvent, or is in an unsound financial condition.

⁸⁶ A.R.S. § 44-1921(1).

⁸⁷ A.R.S. § 44-1921.

5. The issuer has refused to permit the Corporation Commission to examine its affairs or to furnish information required by the Arizona Securities Act or any rule or order of the Corporation Commission.

6. The issuer or any officer, director, trustee, partner, or other fiduciary or controlling person of the issuer or person controlled by or in common control with the issuer has been convicted within the last five years of a felony or misdemeanor involving a transaction in securities or of which fraud is an essential element or is subject to an order, judgment, or decree entered within the past three years enjoining or restraining the person from engaging in or continuing any conduct or practice in connection with the sale or purchase of securities.⁸⁸

Registration by qualification⁸⁹ requires the filing of the following documents and a nonrefundable filing fee:⁹⁰

1. Form U-1 - Uniform Application for Registration of Securities⁹¹ with attachments that include the issuer's organizational documents; the underwriting agreement, if any; the indenture, if any; opinion of counsel as to the validity of issuance of the securities and consent;⁹² and a specimen certificate of the security to be registered.

2. If the issuer is not domiciled in and organized under the laws of Arizona, Form U-2 - Uniform Consent to Service of Process;⁹³

3. Form U-2A - Uniform Corporate Resolution;⁹⁴ and

4. Prospectus containing the information set forth in A.R.S. § 44-1894.⁹⁵

If the securities are being registered under the 1933 Act, the Director may allow an issuer to file the same prospectus with the Division as that filed with the SEC.⁹⁶ Generally, an issuer will file with the Division the registration statement that has been filed with the SEC.⁹⁷

After the appropriate documents and fee have been filed with the Division, the file is assigned to an examiner for review.⁹⁸ The examiner may issue a comment letter to the issuer asking for additional information or explanation regarding the offering. The issuer needs to reply to the comment letter. The most common impediment to expeditious registration of an offering is an

⁸⁸ The "bad boy" provision applicable to offerings applying for registration by qualification.

⁸⁹ A.R.S. §§ 44-1891 through 44-1898.

⁹⁰ A.R.S. § 44-1892(3). The registration fee is one-tenth of 1 percent of the aggregate offering price of the securities to be sold in Arizona, but the fee shall not be less than \$200 nor more than \$2,000.

⁹¹ A.R.S. § 44-1892(1). See also A.R.S. § 44-1893.

⁹² A.R.S. § 44-1893(B). See also A.A.C. R14-4-120(D), which requires the filing of a consent from the professional that the opinion or report may be used in connection with the filing.

⁹³ A.R.S. § 44-1892(4). See also A.R.S. § 44-1862.

⁹⁴ A.R.S. § 44-1893(D).

⁹⁵ See A.R.S. §§ 44-1894(A)(9) and (10), 44-1895, and A.A.C. R14-4-120 regarding financial statements.

⁹⁶ A.R.S. § 44-1896.

⁹⁷ The Director shall determine that the nature and scope of the information disclosed is substantially equivalent in informative value to that prescribed under § 44-1894. A.R.S. § 44-1896(B).

⁹⁸ A.R.S. § 44-1898.

issuer's failure to provide a prompt and adequate response to the comment letter. The Division encourages issuers to discuss a comment letter with the reviewing examiner.

Every offering registered in Arizona must be sold by a dealer registered in Arizona. This requirement may be satisfied by one of two means. An offering may be sold by a dealer registered with the FINRA and Arizona. If this method of distribution is to be utilized, the offering document **must** be filed with the FINRA for review. The filing should be made simultaneously with the filing of the registration statement with the SEC or, in the event no filing is made with the SEC, with the filing of the application for registration in Arizona.

Alternatively, the issuing company may register with the Division as a dealer in its own issue.⁹⁹ Under this type of registration, the issuer becomes the dealer for the purpose of selling this one particular offering. The individuals selling the securities are either company employees or individuals hired by the company to sell the securities. The Division charges a fee¹⁰⁰ for issuer-dealer registration and the individuals selling the securities may be subject to registration and testing requirements. For additional information on issuer-dealer registration, please contact the Division and request an issuer-dealer registration information package or review the information on the Division's [web site](#).

1. Registration by Definition.

An issuer that meets specific criteria, as set forth in A.R.S. § 44-1901, may take advantage of the "fast-track" registration by qualification process. Registration under § 44-1901 becomes effective the latter of:

1. Twenty business days after filing the documents, except that if an application is filed with the Division more than ten days after the initial registration statement is filed with the SEC, this period is extended by the number of days between ten days after the filing of the initial registration statement with the SEC and the filing of an application with the Division;
2. In the case of an offering of limited partnership interests, ten business days after filing any amendment containing such material changes to the registration statement that recirculation of the prospectus would be required if a preliminary prospectus was circulated;
3. Concurrently with effectiveness of the registration statement under the 1933 Act; or
4. A later date as the issuer requests.¹⁰¹

To qualify to use the fast-track registration procedure, the offering must be a firm-commitment underwriting by a dealer that is a member of FINRA, registered in Arizona, and not an affiliate of the issuer; if the offering is of shares, or units consisting of shares and rights to purchase, the initial offering price of the shares must not be less than \$5 and the exercise or conversion price for any rights to purchase shares not less than \$5; the total amount of securities offered and sold must not be less than \$3 million; the issuer must provide certain undertakings required by statute;

⁹⁹ See A.R.S. § 44-1801(9)(b)

¹⁰⁰ A.R.S. § 44-1861(B).

¹⁰¹ A.R.S. § 44-1901(K).

and the issuer's most recent audit report cannot express reservations about its ability to continue as a going concern or show both negative shareholders' equity and negative working capital.¹⁰² Fast-track registration is not available if the issuer or any of its predecessors, affiliates, directors, officers, general partners, or beneficial owners of 10 percent or more of any of its equity securities, or the managing underwriter of the securities has violated the "bad boy" provisions found in § 44-1901(G).

If qualified to register under § 44-1901, an issuer files with the Division the same documents and nonrefundable filing fee as required for general qualification registration, one copy of the prospectus on file with the SEC in its most recent form, one copy of all amendments or supplements to the prospectus, and a final prospectus.¹⁰³ The front cover or a sticker attached to the front cover or the inside front cover of the prospectus must contain the legend prescribed in § 44-1901(F). Dealer and salesperson registration requirements are the same as for general qualification registration.

2. Uniform Limited Offering Registration ("ULOR") Offerings.

Recognizing the need for a less expensive registration avenue for small offerings, § 44-1902 of the Arizona Securities Act provides that offerings not exceeding \$5 million¹⁰⁴ in any 12-month period may be registered under the Arizona Securities Act's uniform limited offering registration pursuant to a modified registration by qualification process.¹⁰⁵ Arizona participates with ten other states to provide issuers with a coordinated review process for ULOR¹⁰⁶ offerings for concurrent registration in two or more of the participating states.¹⁰⁷ Issuers engaging in these types of offerings generally rely upon Regulation D, Rule 504, on the federal level. In order to register securities under § 44-1902, an issuer must satisfy the following criteria:

1. The offering may not be a blind pool offering. A blind pool offering is defined under A.R.S. § 44-1801(1) as an offering in which either the offering materials do not describe specific operational plans, or 80 percent or more of the net offering proceeds are not specifically allocated for the purchase, construction, or development of identified property or products, for the payment of indebtedness or overhead expenses, or for other activities set forth in the issuer's business plan.

¹⁰² A.R.S. § 44-1901(B). See also § 44-1901(D); the Division may prescribe greater income and net worth requirements.

¹⁰³ A.R.S. § 44-1901(E).

¹⁰⁴ The aggregate offering price for an offering of securities under Rule 504 is limited to \$1 million less the aggregate offering price for all securities sold within a 12-month period in reliance on any federal exemption adopted pursuant to section 3(b) or in violation of section 5(a) of the Securities Act of 1933.

¹⁰⁵ A.R.S. § 44-1902 and A.A.C. R14-4-134.

¹⁰⁶ Also known as SCOR or ULEO in some states.

¹⁰⁷ Arizona, Alaska, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming participate in the Western Regional Review program that provides coordinated review for small corporate offering registration or uniform limited offering registration and Regulation A offerings. California participates in the program for Regulation A offerings. To register an offering in more than one of the participating states, an issuer may simultaneously submit its application for registration to the states in which it wishes to register along with a Western Regional Review Application Form requesting regional review. The states will coordinate their comments with a lead state (the state in which the corporation is located) and the lead state will comment to and work with the issuer. Registration will occur in all of the applied to states when the application is cleared by the lead state. For more information, please contact the Division.

2. The issuer must not be an investment company subject to the Investment Company Act of 1940.

3. The issuer must not be subject to the reporting requirements of section 13 or 15(d) of the 1934 Act.

4. The issuer of debt offerings must demonstrate ability to service the debt on the basis of historical financial information. The ability to meet the requirements of federal Regulation S-K, Item 503(d) will be deemed to be a sufficient demonstration of ability to service debt. The Division will require an issuer of preferred stock to make the same demonstration regarding the ability to pay the preference.

5. The issuer must pay a nonrefundable fee of \$250.¹⁰⁸

A.A.C. R14-4-134 provides that an issuer that files an application to register securities by qualification under A.R.S. § 44-1902 shall file a disclosure document on Form U-7 with the required exhibits and other required documents set forth in the instructions for use of Form U-7.¹⁰⁹ Form U-7 is a question and answer form that may reduce legal expenses because the typical issuer should be able to prepare a first draft for review by counsel. Alternatively, the Division will allow the use of a more traditional disclosure document, provided that it provides disclosure of all of the material information required by Form U-7. The documents required to be filed with the Division include:

1. Financial Statements. An issuer seeking to raise over \$500,000 in a ULOR offering is required to submit audited financial statements. If the issuer is selling up to \$500,000 in securities, then reviewed financial statements are acceptable. The issuer must provide an audited (or reviewed, if applicable) balance sheet as of the end of the most recent fiscal year. If the company has been in existence less than one fiscal year, then a balance sheet as of the date within 135 days of the date of filing the registration statement is required. If the first effective date of state registration is within 45 days after the company's fiscal year-end, and financial statements for the most recent fiscal year-end are not available, the balance sheet may be as of the end of the preceding fiscal year and an unaudited balance sheet as of an interim date at least as current as the end of the company's third fiscal quarter of the most recently completed fiscal year must be provided. Also, the issuer must provide audited statements of income and cash flows and statements of changes in stockholders' equity for the last fiscal year preceding the date of the most recent balance sheet or such shorter period as the company has been in existence. In addition, the issuer must provide statements of income and cash flows for any interim period between the latest audited balance sheet and interim balance sheet provided.¹¹⁰

2. Form of selling agency agreement.

3. Company's articles of incorporation and all amendments thereto.

4. Company's by-laws as amended to date.

¹⁰⁸ A.R.S. § 44-1902(B)(7) and § 44-1861(M).

¹⁰⁹ Form U-7 and instructions thereto may be obtained by request from the Division.

¹¹⁰ A.A.C. R14-4-134(E).

5. Copy of any resolutions by directors setting forth terms and provisions of capital stock to be issued.
6. Any indenture, form of note, or other contractual provision containing terms of notes or other debt, or of options, warrants, or rights to be offered.
7. Form of escrow agreement for escrow of proceeds.
8. Consent to inclusion in the Form U-7 (or other offering document) of the accountant's report.
9. Consent to inclusion in the Form U-7 (or other offering document) of the tax advisor's opinion or description of tax consequences, if applicable.
10. Consent to inclusion in the Form U-7 (or other offering document) of any evaluation of litigation or administrative action by counsel, if applicable.
11. Form of any subscription agreement to be used in connection with the distribution of the securities.
12. Schedule of residence street addresses of officers, directors, and principal stockholders.
13. Work sheets showing computations of responses to questions 6, 7(a), 8(a), 8(b), and 17(b) of Form U-7.
14. Opinion of counsel that the securities to be sold in the offering have been duly authorized and when issued upon payment of the offering price will be legally and validly issued, fully paid and nonassessable, and binding on the Company in accordance with their terms.
15. A copy of the Form D filed with the SEC.
16. Additionally the issuer must file the following Uniform Forms with the Division:
 - a. Form U-1, Uniform Application to Register Securities;
 - b. If the issuer is not domiciled in and organized under the laws of Arizona, Form U-2, Uniform Consent to Service of Process; and
 - c. Form U-2A, Uniform Corporate Resolution.

The Division applies a “modified” merit review approach to ULOR offerings. The following rules relating to registration of securities apply to a ULOR offering:¹¹¹

1. R14-4-103 (advertising and sales literature). All advertising and sales materials must be cleared by the Division prior to use. All advertising must be filed with the Division at least three business days prior to the date of its intended use.

¹¹¹ See A.A.C. R14-4-134(I).

2. R14-4-105 (promotional securities). “60%” shall be substituted for “15%” in subsection C of Rule 105.
3. R14-4-106 (options, warrants, and rights to purchase).
4. R14-4-107 (promoter’s equity).
5. R14-4-108 (sales commission and expenses). In Rule 108, subsection 5, “20%” shall be substituted for “15%.”
6. R14-4-110 (installment sales).
7. R14-4-111 (commissions to officers and directors).
8. R14-4-112 (impoundment of funds) and R14-4-113 (impound dates).
9. R14-4-117 (debt offerings).
10. R14-4-118 (statement required on prospectus cover).
11. R14-4-119 (preferred stock).

As explained above in section III.A, **every** offering registered in Arizona (including ULOR offerings) must be sold by a dealer registered in Arizona. If a ULOR offering is sold by an issuer-dealer, sales of securities must be accompanied by an Investor Awareness Bulletin. For further information, please request a ULOR issuer-dealer registration package from the Division or review the Division’s web site.

After the appropriate documents and fee have been filed with the Division, the file will be assigned to an examiner for review. The examiner may issue a comment letter to the issuer asking for additional information or explanation regarding the offering. The issuer will then need to reply to the comment letter. The most common impediments to expeditious registration of ULOR offerings are the issuer’s failure to thoroughly read the requirements set forth in § 44-1902, A.A.C. R14-4-134, and the instructions to Form U-7 and the issuer’s failure to provide a prompt and adequate response to the comment letter. The Division encourages issuers to discuss the comment letter with the reviewing examiner.

After effectiveness of registration has been granted by the Division,¹¹² the issuer must provide the following reports to the Division (failure to provide the following reports is deemed to be a violation of the issuer's registration that may result in revocation of the issuer's registration):

1. Within ten days following every 90-day period and on completion of the offering:
 - a. a report stating the number of purchases and the dollar amount of securities sold; and

¹¹² The Corporation Commission has authority to deny the registration pursuant to § 44-1921 as discussed in III.A herein.

b. a statement to the effect that no changes in or amendments to the Form U-7 or sales and advertising materials provided to the Division have been made, other than those filed with and cleared by the Division.

2. Within ten days after every six-month period following the effective date of registration and at such time as the proceeds have been completely used, a report stating in reasonable detail the application of the proceeds.

3. As long as any securities sold in the offering are outstanding, any reports required by the Form U-7 or under the 1934 Act to be furnished to investors, unless there are ten or fewer shareholders and all of such shareholders consent in writing to the cessation of such reporting.

4. Any other reports, brochures, letters, or such similar documents furnished, through any medium, to investors or such other materials as the Division may determine.

3. Special Registration.

A.A.C. R14-4-144 provides that issuers engaging in Rule 504, intrastate, and Regulation A offerings and small business issuers under the 1933 Act¹¹³ may apply for a special registration in Arizona. Such issuers apply for registration under Article 7 of the Arizona Securities Act and, additionally, apply to use the suitability standards set forth in Rule 144 in lieu of the conditions and standards prescribed under A.R.S. §§ 44-1876, 44-1877, 44-1878, and 44-1921(1), (3), and (4), and the rules under those sections.¹¹⁴ “Bad boys” under the provisions of A.R.S. § 44-1901(G)(1) through (6) may not use special registration.¹¹⁵

Rule 144 provides that suitability standards are imposed on the purchasers of an offering instead of imposing certain merit standards on the offering. The dealer, or the issuer if it is engaging in the sale of its securities, must have a reasonable belief that the purchasers meet the suitability standards¹¹⁶ and the issuer must include a conspicuous legend on all offering documents

¹¹³ Under 17 CFR 228.10, the integrated disclosure system for small business issuers, a small business issuer is defined as follows:

(1) Definition of small business issuer. A small business issuer is defined as a company that meets all of the following criteria:

(i) has revenues of less than \$25,000,000;

(ii) is a U.S. or Canadian issuer;

(iii) is not an investment company and is not an asset-backed issuer (as defined in § 229.1101 of this chapter); and

(iv) if a majority owned subsidiary, the parent corporation is also a small business issuer.

Provided however, that an entity is not a small business issuer if it has a public float (the aggregate market value of the issuer's outstanding voting and non-voting common equity held by non-affiliates) of \$25,000,000 or more. Note: The public float of a reporting company shall be computed by use of the price at which the stock was last sold, or the average of the bid and asked prices of such stock, on a date within 60 days prior to the end of its most recent fiscal year. The public float of a company filing an initial registration statement under the Exchange Act shall be determined as of a date within 60 days of the date the registration statement is filed. In the case of an initial public offering of securities, public float shall be computed on the basis of the number of shares outstanding prior to the offering and the estimated public offering price of the securities.

¹¹⁴ A.A.C. R14-4-144(A). The subject rules are Rules 105, 106, 107, 108, 110, 111, 116, 117, 118, and 119.

¹¹⁵ A.A.C. R14-4-144(E).

¹¹⁶ A.A.C. R14-4-144(B).

that describes the suitability standards.¹¹⁷ The suitability standards are prescribed by Rule 144 and depend upon whether the offering is listed on the Nasdaq SmallCapSM Market.¹¹⁸

Applicants must file the same forms, documents, and fees as described in Section III.A above. The Corporation Commission may, after a hearing or notice and opportunity for hearing as provided by article 11 of the Arizona Securities Act, enter an order denying registration of an offering on any of the following grounds:¹¹⁹

1. The issuer or any dealer or salesman designated to engage in the sale of the securities has violated any provision of the Arizona Securities Act.
2. The issuer has refused to permit the Corporation Commission to examine its affairs or to furnish information required by the Arizona Securities Act or any rule or order of the Corporation Commission.
3. The issuer or any officer, director, trustee, partner, or other fiduciary or controlling person of the issuer or person controlled by or in common control with the issuer has been convicted within the last five years of a felony or misdemeanor involving a transaction in securities or of which fraud is an essential element or is subject to an order, judgment, or decree entered within the past three years enjoining or restraining the person from engaging in or continuing any conduct or practice in connection with the sale or purchase of securities.

With the exceptions of the inapplicability of the imposition of certain merit requirements, the process for a special registration is the same as described in Section III.A. Again, **every** offering registered in Arizona (including special registration offerings) must be sold by a dealer registered in Arizona. For further information regarding issuer registration as a dealer, please request an issuer-dealer registration package from the Division or review the Division's web site.

4. Registration by Coordinated Equity Review.

A.R.S. § 44-1894(E) of the qualification registration statutes authorizes Arizona to participate with other states (currently 40 jurisdictions) in a program designed to allow issuers to register in two or more of the participating states utilizing a coordinated review process.¹²⁰ An issuer of common stock, preferred stock, warrants, rights, and units comprised of equity securities desiring to register by qualification in Arizona, as well as in one or more of the participating states, may consider using coordinated equity review. To participate in the coordinated review process, an

¹¹⁷ A.A.C. R14-4-144(I).

¹¹⁸ A.A.C. R14-4-144(B) and (C). If the offering is listed, the dealer, or the issuer if engaging in the sale of its securities, must have a reasonable belief that the purchaser has a minimum of \$100,000, or \$150,000 when combined with spouse, in gross income during the prior year and a reasonable expectation of the same income in the current year or a minimum net worth of \$250,000, or \$300,000 when combined with spouse, exclusive of home, home furnishings, and automobiles, with the investment not exceeding 10 percent of the net worth. If the offering is not listed, the dealer, or the issuer if engaging in the sale of its securities, must have a reasonable belief that the purchaser has a minimum of \$150,000, or \$200,000 when combined with spouse, in gross income during the prior year and a reasonable expectation of the same income in the current year or a minimum net worth of \$350,000, or \$400,000 when combined with spouse, exclusive of home, home furnishings, and automobiles, with the investment not exceeding 10 percent of the net worth.

¹¹⁹ A.A.C. R14-4-144(A) and A.R.S. § 44-1921.

¹²⁰ See www.nasaa.org for additional information on the "corporate finance" web site page.

issuer must submit a Form CER-1 to the Pennsylvania Securities Commission¹²¹ in addition to making the requisite filings in the states in which it wishes to register. The states will submit their comments regarding the offering to two lead states (one merit state and one disclosure state) based on guidelines and standards established by the North American Securities Administrators Association, Inc. (“NASAA”) rather than on each state’s own statutes and rules.¹²² The two lead states will issue one comment letter to the issuer, and work with the issuer to resolve those comments. Coordinated equity review is not available for registration of blank check, blind pool, or Regulation A offerings. It is anticipated that most coordinated equity review offerings will be federally registered using forms for “small business issuers.”

C. Registration by Description.

Registration of offerings of securities that meet the criteria of § 44-1871 through § 44-1878 is effective when the appropriate documents and filing fee are filed with the Division.¹²³ The offering is not subjected to a merit review. Registration by description is rare because issuers that meet the financial criteria typically qualify for an exchange listing exemption from registration.¹²⁴

Registration by description is available for securities, other than real property investment contracts, that either:

1. Are commodity investment contracts or commodity option contracts and the financial condition of the party filing the registration statement meets the requirements of A.A.C. R14-4-124,¹²⁵
2. Are of an issuer that has been in continuous operation for not less than three years and has shown for a period of not less than three years during the five years prior to the date of registration average annual net income adjusted by adding back interest expenses net of applicable income tax benefits arising therefrom of securities to be retired out of the proceeds of sale as follows:
 - a. In the case of interest-bearing securities, not less than one and one-half times the annual interest charges on such securities and all other outstanding equal rank interest-bearing securities.
 - b. In the case of securities having a specified dividend rate, not less than one and one-half times the annual dividend requirements on such securities and on all outstanding securities of equal rank.
 - c. In the case of securities without a specified dividend rate, not less than 5 percent upon all outstanding (after the close of the offering) securities of equal rank, based on the maximum offering price.¹²⁶

¹²¹ Pennsylvania Securities Commission, 1010 North 7th Street, 2nd Floor, Harrisburg, Pennsylvania 17102-1410.

¹²² Contact the Division for copies of the guidelines that are utilized in the coordinated equity review process or see CCH NASAA Reports ¶ 10,001 *et seq.*

¹²³ A.R.S. § 44-1873(A). See also § 44-1875. If the information filed is insufficient to establish the fact that the securities are entitled to registration by description, the Division may require additional information.

¹²⁴ See A.R.S. § 44-1843(A)(7) and A.A.C. R14-4-115.

¹²⁵ A.R.S. § 44-1871(A)(1).

To register a securities offering by description, the issuer shall pay a nonrefundable registration fee¹²⁷ and file the following documentation:

1. Form U-1 - Uniform Application to Register Securities;¹²⁸
2. A copy of the prospectus;¹²⁹
3. A statement of the facts showing that the securities are entitled to be registered by description;¹³⁰
4. Financial statements meeting the standards of § 44-1871(A);¹³¹ and
5. If the person registering the securities is not a registered dealer or a corporation organized under the laws of this state, a Form U-2, Uniform Consent to Service of Process.¹³²

Offerings registered by description must be sold by a dealer registered in Arizona.

IV. Conclusion.

Federal and state securities laws provide a number of alternatives for companies seeking to access capital. This outline has provided only a brief introduction as to these varied approaches to raising funds. Issuers seeking to sell securities should consult with knowledgeable legal counsel, accountants, and investment bankers to determine the alternatives that are best suited to their situations. The Division is available to answer any general questions issuers may have about particular registration forms or the registration process in Arizona. The Division cannot provide legal counsel and recommends that issuers discuss their particular circumstances with their attorneys, accountants, and investment bankers.

¹²⁶ A.R.S. § 44-1871(A)(2).

¹²⁷ See A.R.S. § 44-1861(C). The fee is one-tenth of 1 percent of the aggregate offering price of the securities to be sold in Arizona, but not less than \$200 nor more than \$2,000.

¹²⁸ Form U-1 contains the information required by §§ 44-1872(1)(a) through (d).

¹²⁹ A.R.S. § 44-1872(1)(e).

¹³⁰ A.R.S. § 44-1872(1)(f).

¹³¹ A.R.S. § 44-1872(1)(f).

¹³² A.R.S. § 44-1872(2).