



NINE TIPS FOR RAISING CAPITAL IN MISSOURI



Secretary of State Robin Carnahan
Missouri Securities Division
600 West Main Street
PO Box 1276
Jefferson City, MO 65102
573.751.4136
www.sos.mo.gov/securities

Robin Carnahan
Secretary of State

www.sos.mo.gov

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Introduction: Capital is critical to the survival and growth of businesses, especially small businesses. Raising that capital is an important step for any new business and can be a challenging undertaking. Missouri's securities laws regulate how capital can be raised. By not knowing these laws, many businesses commit serious violations when recruiting investors for their businesses. In order to avoid mistakes and violations, and perhaps an investigation by the Missouri Securities Division, the Secretary of State has identified the most common errors businesses make when attempting to raise capital.

Disclaimer: Please be advised that this document is offered only as an overview for issuers of securities. It is not legal advice and you cannot legally rely upon its content. You should seek legal counsel before attempting any offering of securities.

TIP
1

Hire Good Help: Paying for an Attorney Early in the Process can Help Avoid More Expensive Problems Later

"Integrated Offerings." "Reg. D issues." "506 Offers." "Accredited Investors." "PPM." "IPO." "Blue Sky Laws."

The terms and phrases associated with recruiting investors are confusing and unfamiliar by themselves, and do not even touch on the complexity of the actual issues related to securities law. Securities law is traditionally recognized as among the most complex and difficult of all legal areas. Hiring an experienced, knowledgeable lawyer to help navigate the sea of regulations and potential obstacles is the best bet a business can make when launching a capital drive. While it's definitely true that hiring a lawyer can be expensive, getting the proper legal advice early in the process may help you avoid much more expensive disasters down the road.

FAST FACT

In 2006, over twenty actions were taken in Missouri against companies that failed to properly register their securities before offering and selling them. Of those companies, more than half appear to have marketed and sold investments without the advice of an attorney. These violations led to hundreds of thousands of dollars in penalties and payments for the violating companies.

Finding A Lawyer—

The Missouri Bar Association (573.636.3635), the Bar Association of Metropolitan St. Louis (BAMSL; 314.621.6681), and the Kansas City Metropolitan Bar Association (KCMBA; 816.221.9472) are good starting places for finding a referral for a securities lawyer. Your banker, business advisor, accountant or chamber of commerce contact may also have a recommendation.

TIP
2

Is it a “Security?” Many Entrepreneurs Do Not Realize that Securities Laws Apply to Them

Perhaps the most common mistake that business people make is not realizing that securities laws apply to their attempts to attract investors. Though most “issuers” (the people who are offering and selling securities in their company) realize that stocks and bonds are securities and that special laws apply, many do not realize that Missouri law defines “securities” much more broadly than just stocks or bonds.

FAST FACT

In Branson, the performer in a country music show and his wife were asking their audience members to help fund the show and a new theater. Because the performer was selling “stock” in the show, he was offering and selling a security. His failure to comply with the securities laws led to a fine and the eventual close of his business.

The legal definition of a “security” encompasses a wide variety of interests and schemes.

Securities include:

- 1) Some limited partnership interests
- 2) Some real estate investments
- 3) Ownership in oil and gas wells
- 4) LLC interests
- 5) Some types of loans (through promissory notes)

In fact, a security can be any transaction in which one person gives money to another with the agreement that the money will be returned with a profit. These are broadly called “investment contracts.”

To be safe, it is best to assume that any plan where someone invests money with hopes of receiving a profit due to another person's efforts is a security.

FAST FACT

Action has been taken in cases where investors were sold interests in **pay phones, Internet kiosks, jukeboxes** and other equipment. By law, an investment in these types of equipment can qualify as a Security.

TIP
3

No Sale, No Excuse: Discussions with a Possible Investor can be an "Offer," Even if No Sale is Ever Made

Many businesspeople do not realize that even the earliest, most informal of discussions or sales pitches to a potential investor may qualify as an "offer" of securities. And under Missouri law, an offer alone, *even if no sale or purchase is ever made*, is enough for securities regulations to apply.

FAST FACT

In 2006, a Washington based company offered over 150 Missourians the chance to invest in a European real estate venture. And even though not a single Missourian invested with the company, because the investment was not properly registered with the Securities Division, the company paid **a penalty of several thousand dollars.**

Both "offer" and "sale" are broadly defined terms under the securities laws, and these definitions cover a lot of behavior that you may not consider a formal offer or sale. The simple act of "talking up" your business in hopes of generating interest might constitute an "offer" under the securities laws, and these offers can lead to investigations, even if no investment ever results.

FAST FACT

In 2003, a Jefferson City entrepreneur held "informational" meetings about an investment with a few folks from around town. The meetings were held at a sports bar and at a car dealership where many of the attendees worked. Though the entrepreneur did not take any money or even provide a contract to the attendees at this meeting, he was found by Missouri courts to have "offered" securities.

TIP
4

How Much is Enough? When Providing Information to Investors, Provide the Right Facts

A key challenge in attracting investors is giving them the information they need to determine whether they want to invest in a company. In addition, providing the right information is not only important to lining up investments, **it is also required by Missouri securities laws.**

Failure to provide the required, correct information can result in charges of securities fraud. Securities fraud is committed if important facts about the business or the offerings are misrepresented to an investor. Securities fraud can also be committed by saying something that, even if true, is misleading because other crucial facts about the company are withheld.

FAST FACT

A Cape Girardeau businessman was charged with failing to state "material" facts when he did not tell his investors that the business was being sued in a separate matter, and that the investor's money was going to be used to pay the businessman's and his partner's personal expenses, such as rent and car payments.

It is also important to note that under Missouri securities law, it does not matter whether a company *intended* to mislead an investor. The fact that the investor is misled by the omission of important information is enough to constitute a violation of Missouri law.

This means companies must make all *material* disclosures to a potential investor. A fact is “material” **when the average, reasonable investor would consider it when deciding whether or not to invest in a business.** What is material will often depend on the circumstances, but many facts — such as a recent bankruptcy or the business’s trend of operating losses — will almost always be material. For a list of the very minimum of topics that should be disclosed to investors, consult the checklist on the next page.

FAST FACT

A Springfield-area man was fined \$14,000 for this kind of violation when he sought over \$65,000 worth of investments in his cell phone company from one person, but didn’t provide that investor with information on the company’s financial condition, past performance, operating history or management structure.

Most securities lawyers recommend that, at the very minimum, businesses disclose in writing the following to potential investors:

- ✓ A detailed description of your business
- ✓ The risk factors involved in your business, its industry and the securities you are offering
- ✓ Financial information about your business, such as financial statements, earnings reports, budgets and other important financial documents
- ✓ A “management discussion and analysis,” that is, a narrative about your company’s operations
- ✓ How your business is capitalized
- ✓ How you plan to use the money raised from investors
- ✓ A description of the securities being offered, including the rights associated with them, such as whether there are any rights to payments from the business or limitations on the investor’s ability to sell the shares
- ✓ How you are offering these securities, including how broad the offering is, who is doing the offering and whether that person is being compensated
- ✓ Any pending or expected lawsuits against your business
- ✓ Disclosure of past bankruptcies, receiverships, loan defaults or other financial problems of the company or its owners
- ✓ A list of your company’s directors, if any
- ✓ A summary of officers and key employees of the business
- ✓ How your company’s directors, officers and managers are compensated
- ✓ A summary of the company’s transactions with its owners, related parties and insiders
- ✓ A summary of other securities your business has offered, including a list of your business’s principal stockholders, if any
- ✓ The tax aspects of purchasing your securities

TIP
5

One-Size Doesn't Fit All: Offering Documents Must be Specific to Your Company

In an attempt to hold down marketing costs and attorneys' fees, some startup companies will borrow documents from other companies or use earlier offering circulars to market their new securities offering. This initial attempt to cut costs often leads to greater expenses, as each offering is unique and requires unique information and facts. Securities lawyers who regularly assist in offerings will have templates or proven formats into which the data and information unique to your company can be placed, but specific information on your business venture is **always** needed.

Even later offerings by the same company do not always easily fit within the same format or document as the initial offering. Different securities, varying investors, new facts and changing financial conditions must all be reflected in later offerings. Failure to craft a new offering circular or placement memorandum for a new offering may not only frustrate investors and shareholders, but may also lead to an investigation by the Securities Division.

FAST FACT

In 2004, a Kansas City-area entrepreneur was seeking investors in his sports agency by circulating a placement memorandum. One group of investors received a memorandum attributing a quote to one supporter of the entrepreneur, while a second group received a memorandum attributing the same quote to a different supporter. Just one of many mistakes or errors in the offering documents, the entrepreneur was fined and terminated by the investment adviser firm where he worked.

TIP
6

Mass Marketing: General Solicitations Can Lead to Specific Offenses

Securities issuers often advertise and market their private offerings through the use of seminars, meetings, newspapers, magazines or the Internet. For instance, a securities issuer may send a mass mailing, or take out an ad in the local newspaper, informing locals about an upcoming meeting where he or she will summarize the business and the opportunity to invest. Or, an entrepreneur may set up a website with a printable offering circular encouraging people to invest in his business.

These broad-based attempts to notify the public about a private offering are known as a "general solicitations" of the public, and in many circumstances are illegal. In terms of a general solicitation, the "public" **can include any person with whom you do not have a preexisting and substantial relationship.** Further, mistakes, factual omissions or inaccurate information included in a mass communication such as a website can "taint" the offering as it applies to thousands of potential investors.

FAST FACT

In 2006, a Texas oil and gas investments company took out an ad in the *Wall Street Journal* promoting its investment opportunities. After a Missouri resident inquired about the ad and was sent unregistered investment documents, an investigation was launched that resulted in the Texas company being fined \$8,000.

If investments are offered without first filing with the Commissioner of Securities, **then you should not** attempt to find investors through general solicitation.

FAST FACT

In 2006, a church offering bond investments created a website to market its offering. The website included incorrect information and claimed that the investment was “approved” by Missouri, when in fact no such approval had been given. The church’s securities activities were placed under investigation, and the church was instructed to change the language on its website.

TIP
7

Don’t Be Late (Or Early)! Managing Timing Issues with Offers and Sales

Many first-time issuers of securities have trouble complying with the time limitations and restrictions placed on offerings. Many popular exemptions, including those common in the biofuel, ethanol and alternative energy industries, for example, are only effective for one year. In addition, many small and first-time issuers begin solicitations and offers after they have *submitted* their filing or exemption request, but *before* the filing is officially *registered* or ordered exempt by the Commissioner of Securities. When securities are offered after the exemption has expired, or before the filing has been registered, the party offering the investment has committed a securities violation.

FAST FACT

A Southeast Missouri agricultural cooperative was granted a special filing exemption in September 2003. By law, the exemption expired after one year, but the promoters of the cooperative’s securities continued selling them for two additional years. Over 170 farmers invested in the company after the exemption had expired, and the cooperative later was ordered to pay thousands of dollars in penalties and costs for the violations.

In addition to certain regulations which limit the life of an exemption, issuers should be aware of the time limits for a “limited offering exemption.” **Under that exemption, issuers may sell offerings to no more than 25 purchasers who are present in Missouri in any 12 months.**

Also, if the company sold stock to 25 Missourians in one month, and then, two months later, sells stock to another Missourian, the doctrine of “Integration” may require that those offerings all count as one offering. If so, then the company would have sold to 26 purchasers, and *all* 26 sales may no longer qualify for the limited offering exemption.

These timing and integration issues can be particularly troublesome areas, and securities lawyers can be especially helpful in avoiding that trouble.

FAST FACT

In 2006, a biofuel company applied for a specific exemption, and the exemption was granted by the Securities Commissioner. However, the Securities Commissioner later found that the company held at least six investor meetings prior to the exemption being ordered. In those six meetings, over 160 people received “offers” as defined under the Securities law. Facing a possible suspension of the exemption and a halt to its capital drive, the biofuel company paid penalties and made payments of almost \$25,000.

TIP
8

On the Record: Keep Clear, Complete Records of Offers and Sales

Poor securities recordkeeping is another problem which plagues new companies. If companies keep careful track of certain facts as investment offerings proceed, they will be better able to control the offerings. And, in the event of an investigation, all documentation and records will be in order.

FAST FACT

In 2003, the Securities Division ordered a company to provide evidence that it qualified for an exemption from registration of its securities. The company was unable to produce any evidence because there was no documentation about who received a prospectus, no investor lists, no records concerning distribution of shares, or any other evidence which supported its exemption claim. The Securities Commissioner ultimately determined that no exemption applied, and the company was found to be in default.

In addition, if the Securities Division challenges whether offerings qualify for an exemption, the burden is on the company to prove that it qualifies by demonstrating certain facts. This can be done informally in discussions with division staff members during the initial phase of an investigation, or it can be done formally in a hearing before the Securities Commissioner. For a list of the minimal information you should keep concerning each offer and/or sale, see the box below.

Important Information to Record and Keep on each Offer or Sale:

- Investor or potential investor's name, address and telephone number
- Amount of investment offered or made
- Date that offer was made, information that was given, and securities that were purchased
- Basis or nature of the relationship between the issuer and the purchaser
- Advertising and promotional materials used
- Subscription agreement

TIP
9

Handling Investigations and Violations: Immediate Reporting and Cooperation Can Make the Process Smoother

In Missouri, the Secretary of State oversees the regulation of securities. By law, the Commissioner of Securities regulates the offer and sale of securities in the state, which includes investigating potential violations of securities laws. The Securities Commissioner carries out this duty through the staff of the Securities Division in the Secretary of State's office.

While the Office of the Secretary of State wants to encourage Missouri entrepreneurs to raise capital and recruit investors, it is the job of the Securities Division to investigate instances where securities laws may have been violated.

If there is a possible problem with your investment offerings, you will first interact with a member of the Securities Division. For instance, you may receive a letter from a Securities Division investigator asking for information about your offering. Cooperating with investigators on their requests will make the process smoother. An investigation does not always lead to fines and penalties.

FAST FACT

In 2006, a biofuel company's unlawful offering of securities before its exemption was granted was investigated by the Securities Division. By cooperating with the Securities Division and negotiating a settlement, the biofuel company was able to fully settle the matter within six weeks without an interruption of its capital drive.

There are numerous examples of unreported, unadjudicated cases that were closed because the issuer of the securities was able to demonstrate and clarify how the offering was exempt. Keeping good records and communicating with the Division's investigators can help ensure a smoother process and resolution.

* * *

By knowing these nine tips and avoiding common mistakes, you can help protect yourself and your offerings from Securities Division intervention and complaints from your investors. Though neither the staff of the Securities Division nor the Commissioner of Securities can provide specific legal advice, you can contact the Securities Division at (800) 721-7996 or at www.sos.mo.gov/securities if you have any questions.