

GUIDANCE DOCUMENT

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Raising Small Business Capital in Nebraska through Securities Sales



The Nebraska Department of Banking and Finance, Bureau of Securities, regulates the capital markets in Nebraska by registering securities offerings, securities brokers and their salespersons, and investment advisers and their representatives, and by reviewing business opportunities. Where appropriate under the statutes it administers, the Bureau also regulates commodities brokers, salespersons and loan brokers.

Through consumer protection functions, the Bureau attempts to prevent the investing public from being defrauded.

The Bureau provides a positive climate for small business development in Nebraska. It offers the possibility of pre-filing conferences for issuers and their attorneys to discuss the proposed offering and compliance with the Securities Act and the Department's regulations. These conferences can cut costs and reduce the time required for an offering to clear the Bureau and become eligible for sale to investors.

This publication is meant only to acquaint the small business person with the possibility of raising capital through a securities offering. It should not be relied upon to actually make a securities offering. The explanations in this publication are general. Anyone making a securities offering should review the relevant statutes and regulations prior to effecting a securities transaction. There are many important, but technical, items with which a person making a securities offering must comply. This publication summarizes only some of these issues. If more information is needed, contact the Nebraska Department of Banking and Finance, Bureau of Securities.

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**Raising
Small Business Capital
in Nebraska
through
Securities Sales**

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(SEC2000SBC)

Raising Small Business Capital Through Securities Sales

This publication is designed to provide a small businessperson with information concerning the process of raising capital under the Securities Act of Nebraska. These laws serve to protect investors and promote capital formation, both of which are essential for maintaining a healthy business economy. Strong enforcement of the securities laws, including the provisions against fraud, creates an environment in which individual investors can feel some degree of safety and in which the capital markets can operate in an orderly fashion. Most states that have strong business economies have the same or similar laws and active enforcement of those laws.

These laws may sometimes seem confusing to individuals seeking to raise capital. This publication will provide guidance as to how to raise capital in compliance with the securities laws with a minimum burden to small businesses.

Businesses, particularly small businesses, require capital to be successful. Whether a business wants to expand its production capacity, introduce new products or offer new services, a key issue is financing.

Many businesses raise capital by issuing securities. Issuing securities involves attracting people willing to invest their money in a business in return for either (1) a promise by the business to repay the investment plus interest OR (2) a permanent equity ownership interest in the business. Funds raised from investors may be used only for the business purposes for which the funds were raised.

Can Any Business Issue Securities?



Basically, yes. The more relevant questions are (1) whether the business has developed to the point that a securities offering makes good business sense; and, (2) whether the business promoter possesses the self-discipline to do it right. In deciding whether to issue securities, remember that by issuing securities, the business assumes certain legal responsibilities and obligations to investors under state and federal securities laws and other state regulatory statutes.

What Kind of Securities Should Be Issued?

Securities issued by small businesses will generally be either debt or equity securities.

A debt security is a promise to repay the person from whom the business is borrowing money the amount invested (principal) plus a rate of interest by a certain date. The rate of interest and the timing of repayment of the principal and interest due are set by the company. If a business issues a debt security (note, bond, debenture), it is entering into a legally enforceable obligation to pay the debt.

An equity security is a permanent ownership interest in the business. Purchasers of equity securities are entitled to share in the profits of the business and a voice in the management of the business. Equity securities include stock, limited partnership interests, and limited liability company interests. The specific rights of owners of these securities is established by the statutes governing their organization.

Stock is the most common type of equity security. To issue stock, a business must be incorporated under state law. The articles of incorporation filed with the state must specify the amount and type (common or preferred) of authorized capital stock. The business may not issue more stock than is authorized by the articles of incorporation. Stock ownership is evidenced by a certificate issued by the business identifying the name of the investor, the number of shares held and the class of stocks held. Generally, a stockholder will be entitled to receive the dividends (when declared) and to vote on certain matters relating to governing the corporation. A stockholder also has other rights relating to access to corporate records and receiving corporate information, including periodic financial reports.

Preparation

Success in raising capital requires substantial preparation and planning. It may be helpful to consult with an attorney and/or accountant before beginning the process.

1 Develop a Plan. A small business person considering issuing securities should begin by developing a business plan. The plan should describe the business in detail. In addition to basic information on the company, including its location and organization, the plan should describe the products and/or services offered by the company, the management, the competition, and the current financial condition. The plan should be accompanied by copies of all documents which are relevant to the statements contained in the plan, including financial statements, credit reports, letters of reference, job descriptions, personal resumes of the management team, leases, and contracts.

2 Determine the Type and Amount of Securities to be Sold. Small business persons raising capital through issuing securities should concentrate on the amount of funds needed to accomplish immediate (12- to 24- month) business goals. If those goals are successfully reached, it may be possible to offer additional securities to finance the next objective. Beware of trying to do too much at once. A person is more likely to invest in a business in which the owner is perceived as having a clear idea of the step-by-step progress of the business.

3 Decide to whom the Securities will be Offered. Generally, a small business person turns to friends, relatives and business professionals as the most likely persons to purchase securities of the business. In addition, suppliers, local merchants and business persons may be potential investors. In determining who to offer the securities to, the small business person must consider where such individuals reside. As explained below, offering securities in more than one state raises additional regulatory issues which should be considered before any offers are made.

Regulation of Capital Markets

Securities Act of Nebraska

The Securities Act of Nebraska is designed to insure that investors are provided with all the information necessary to make an informed investment decision. It also serves to protect investors from being victimized by promoters of fraudulent business schemes.

The Securities Act and the rules of the Bureau impose certain obligations on businesses selling securities in Nebraska. Through these requirements, the state seeks to maintain the integrity of the investment climate which, in the long run, benefits all businesses attempting to raise capital from local investors.

U.S. Securities & Exchange Commission and Other State Regulators

The U.S. Securities and Exchange Commission (SEC) is a federal agency which administers the Securities Act of 1933 and the Securities Exchange Act of 1934. These federal laws regulate national securities exchanges and deal broadly with interstate securities transactions. Generally, compliance with SEC regulations is necessary when an offering of securities is made across state lines, whether by use of the mails or other methods of communication.

As each state has a securities law, a person offering securities in more than one state should consult each state's securities commission on applicable rules for conducting a securities offering in that jurisdiction. In a multi-state securities offering, compliance with the rules of the Nebraska Department of Banking and Finance, Bureau of Securities, does not constitute automatic compliance with SEC rules or the requirements of any other state securities commission.

With respect to SEC requirements, the SEC maintains an Office of Small Business Policy within the Division of Corporation Finance at 100 F Street, N.E., Washington, D.C. 20549, (202) 942-2950. The addresses and the telephone numbers of the state securities commissions may be obtained from the North American Securities Administrators Association, 750 First Street, N.E., Suite 1140, Washington, DC 20002, (202) 737-0900, www.nasaa.org.

Legal Obligations

Both state and federal securities laws imposed important legal obligations on businesses issuing securities. These obligations are:



Disclosure

A business offering securities is obligated to provide each person to whom the securities are offered all material information about the business.

Material information includes the background of persons operating the business (including compensation paid, percentage of ownership in the business and any transactions between the individuals and the business); a description of the use of monies to be received in the offering; a description of the terms of the offering and the type of security being offered; financial information on the assets, liabilities and cash flow of the business; and a description of the risks associated with investing in the business. The business must also disclose all other information which is material and required for a reasonable person to be able to make an informed investment decision. To protect the business from future legal disputes, it is generally required to provide this information in writing, in advance of any sale.

Registration

The securities laws have the greatest impact on small businesses in the area of registration of securities. Nebraska law provides that all securities sold in the state must either be registered with the Bureau or be exempt from registration. Because the registration of securities often involves significant costs, including legal and accounting fees of \$15,000 to \$20,000, registration should be considered only in those situations in which a fairly large amount of money is to be raised or when no exemptions are available. Most offerings made by small businesses will be exempt from registration. The Nebraska securities laws provide several exemptions which might be available for small business offerings. The following list describes the basic exemptions which a small business might consider.

Fifteen-or-less Exemption

The Securities Act of Nebraska provides an exemption for the sale of securities to not more than fifteen persons during a period of twelve consecutive months. The conditions that must be met by the seller to qualify for this exemption are: the seller cannot pay commissions or remuneration for soliciting the sale except to a registered agent of a registered broker-dealer; the buyers must purchase for investment (generally, this condition can be satisfied by imposing a one-year holding period); no solicitations can be made by newspaper, radio, or television; and the seller must file a specified notice with the Bureau within thirty days after the first sale for which the exemption is claimed. If the offering is advertised or compensation for solicitation is paid, the exemption is not available. There is no filing fee for this exemption.

Private Offering Exemption

The private offering exemption was adopted with the intent of assisting small businesses to raise capital, both federally and at the state level. It is based upon the Uniform Limited Offering Exemption and federal Regulation D. Because it ties directly to a federal exemption, this exemption is often relied upon if the offering is going to be made in a number of states.

This exemption allows for sales to thirty-five “nonaccredited” investors and an unlimited number of accredited investors. Accredited investors are, in general, defined as financial institutions, business organizations, or individuals whose net worth exceeds \$1 million, or whose income in the two most recent years exceeds \$200,000.

An attorney is usually involved in these offerings because of the technical nature of the disclosure requirements. The document filing requirements vary depending on the particular provision of federal law which will be relied on. A filing fee of \$200 is required for private offering exemption filings. A small business person interested in relying on this exemption should discuss this issue with his/her attorney preparing the Form D. This exemption may not be available for issuers or sellers with previous violations of the law.

The advantage of this exemption is that it can allow an unlimited dollar amount to be raised and ties into a federal exemption if securities are to be offered or sold across state lines. The disadvantage is that the costs of using this exemption are substantially greater than other possible exemptions.

Nebraska Intrastate Issuer Exemption

This exemption was designed for Nebraska businesses that seek to raise up to \$750,000 and would use 80% of the proceeds in Nebraska. This exemption was designed exclusively for Nebraska businesses and allows an unlimited number of Nebraska investors. It allows the business to offer either stock or, under pay a filing fee of \$200 and file a copy of its disclosure document with the Bureau at least 20 days prior to any sale in reliance on the exemption. This exemption is not available for certain issuers with previous violations of the law. The advantages of this exemption are that it allows an unlimited number of investors and can utilize a simple fill-in-the-blank disclosure document that issuers can obtain from the Bureau. Issuers are encouraged to schedule pre-filing conferences with the Bureau staff to discuss issues of particular importance.

The burden to prove all of the above exemptions remains with the person claiming them. In addition, the exemptions only exempt the transactions from the registration requirements of the Securities Act. The antifraud provisions will still apply, including the requirement to disclose all material information. It is no defense to an action based on the antifraud provision of the Act that a business thought it had an exemption or tried to make full disclosure.

The consequences for not making a filing when required or exceeding these numerical limitations can be costly as well as embarrassing. A phone call to the Bureau at (402) 471-3445 before acting is a low-cost way to obtain accurate information about specific circumstances.

Liability

The Securities Act imposes civil liability on businesses and principals selling securities in violation of the Act. Generally, an investor who purchased a security from the business while the business was in violation of the Securities Act may sue the business for the full price paid plus interest at 6% from the date of purchase. As the business probably already has spent the funds received from investors, it has precious little capital left to repay investors for securities law violations, let alone the expense of defending a lawsuit.

In addition, the Securities Act imposes criminal liability for violating the provisions of the Act and authorizes the Bureau to take administrative action against sellers of securities and to impose civil fines for such violations.

The Bureau has the authority to investigate consumer complaints, issue subpoenas, issue cease and desist orders, and pursue criminal prosecutions, civil injunctions, rescissions, and other administrative law remedies.

Where Can a Small Business Get Help?

Several sources are available. First, it may be desirable to consult with an attorney or accountant. If the business is not yet incorporated, most likely an attorney would be needed to accomplish that task.

Second, the Bureau can provide additional information and assistance to small business persons who wish to raise capital by issuing securities. The staff of the Bureau is available to answer questions between the hours of 8 a.m. to 5 p.m. The office is located at:

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A Word of Caution

Undertaking a securities offering is a serious matter. It will cost money and will take time away from operating the business. When offering an equity security, a business promoter is selling a permanent part ownership in the business to other persons. Although the business owner may retain control, the investors will have legal rights, and the business will have obligations to them, including providing annual financial information.

When offering a debt security, the business becomes legally obligated to repay the principal and interest in accordance with the terms of the security.

Before making the decision to offer securities, some basic questions should be answered.

- ✓ Is there a clear sense of where the business is going and why the funds are needed?
- ✓ Is there a business plan?
- ✓ Is there a willingness to provide written documentation to investors describing the business, the offering and the risks associated with investing in the enterprise?
- ✓ Will there be compliance with all applicable requirements of the Securities Act?

The Nebraska securities laws are designed to protect investors and to promote capital formation in the state. The Bureau has taken a number of steps to assure that, while investor protection is the foremost job of the agency, small businesses will be able to raise the capital they need to keep the Nebraska economy vibrant and growing.