

Small Business Capital Formation Options in California

The following is a brief summary of the options provided by California law that are available to small businesses that may be considering the offer and sales of securities as a means of raising capital. Federal securities laws, while not discussed here, may also be applicable to some offerings. The information contained in this summary should not be considered legal advice or opinion. You should consult a securities attorney before proceeding with your transaction.

California Exemptions

California law provides that certain securities may be offered and sold without review by the Department. Exemption from Department review and qualification are provided for under the following sections of the California Corporations Code:

1. Section 25102(e)

- a. This exemption applies to a non-public offering for the offer and sale of any evidence of indebtedness whether secured or non-secured. Recent legislation imposed additional filing requirements if the exemption is claimed for real estate related investments. Additional filing requirements include providing the names of the issuer's officers, directors, general partners or managers and the offering disclosure document. See Section 25102.2.

Sections 25102(f) and 25102(h) - Exemptions under Sections 25102(f) and 25102(h) are used in many instances by small, family-owned or closely-held corporations or LLCs where capital is raised primarily from family members or friends.

2. 25102(f) – pertinent provisions include:

- a. There is no dollar limitation on the offering size.
- b. The general solicitation for the sale of the securities is not allowed.
- c. The number of purchasers is limited to 35. However, certain purchasers, including high net worth individuals, certain trusts and entities, officers and promoters, are excluded from the count of purchasers for the requirement of not more than 35 persons.
- d. There must be a pre-existing personal or professional relationship between the issuer and investor.
- e. There are recent additional filing requirement for real estate related investments. Additional filing requirements include providing the names of the issuer's officers, directors, general partners or managers and the offering disclosure document. See Section 25102.2.

3. 25102(h) – pertinent provisions include:
 - a. This exemption has been mostly replaced by 25102(f) which has similar requirements, except this section additionally requires that the notice filing must be accompanied by an attorney’s opinion that the offering qualifies for this particular exemption.
 - b. The offering is limited to one class of stock immediately following the sale and issuance.
 - c. The total purchasers must not be more than 35 persons.
 - d. No publication of any advertisement is allowed.

4. 25102(n) – pertinent provisions include:
 - a. Securities can only be sold to qualified purchasers as defined in the section.
 - b. There is no dollar limitation on the offering size.
 - c. Limited advertising is allowed.

5. 25102(o) - pertinent provisions include:
 - a. This section exempts securities issued pursuant to an option or purchase plan or agreement.
 - b. The offering must be exempt from registration under Securities Act of 1933, pursuant to Rule 701.
 - c. The offering must comply with requirements set forth in Title 10, California Code of Regulations sections 260.140.41, 260.140.42, 260.140.45, and 260.140.46.

Other exemptions not requiring any notice filings may also be available. See Section 25102 of California’s Corporate Securities Law of 1968.

California Permit Applications

If an exemption is not available for the capital to be raised, then an application for the qualification of securities may be required. The application for such qualification will be subject to a merit standard of review. This means that the Commissioner of Business Oversight must determine that the transaction is fair, just and equitable. Applicants for qualification of securities should consult with legal counsel prior to submission of this type of application.

1. 25113(b)1- pertinent provisions include:
 - a. Sale of the offering is limited to California residents.
 - b. There is no dollar limitation on the amount of securities being qualified.
 - c. General solicitation for the sale of the securities is allowed with approval from the Department.
 - d. The Department may impose investor suitability standards based on its determination of the risks involved in the investment.
 - e. Qualification is effective for 12 months and requires annual re-submission of application to continue the offering.
 - f. The application is subject to merit standards of review.

2. 25113(b)2- pertinent provisions include:
 - a. The offering is made pursuant to a Small Corporate Offering Registration - filed pursuant to Form U-7 format as adopted by the North American Securities Administrators Association (NASAA).
 - b. The offering amount is limited to \$1 million.
 - c. The issuer must be a California corporation or a foreign corporation subject to Section 2115 of California's General Corporation Law.
 - d. The minimum offering price is \$2 per share.
 - e. Proceeds from the offering must be expended in the operations of the business.
 - f. The application is subject to merit standards of review.

For additional information, please contact the Department of Business Oversight Consumer Services Office at (866) 275-2677.