GOING PUBLIC THROUGH AN INTERNET DIRECT PUBLIC OFFERING: A SENSIBLE ALTERNATIVE FOR SMALL COMPANIES?

William K. Sjostrom, Jr.*

I. INTRODUCTION ........................................... 530

II. THE TRADITIONAL UNDERWRITTEN INITIAL PUBLIC OFFERING PROCESS ................................ 534
   A. Selecting an Underwriter .............................. 534
   B. Registering the Offering with the SEC ............. 535
   C. Marketing the Offering ............................... 538
   D. Going Effective and Closing on the Offering ...... 539

III. INTERNET DIRECT PUBLIC OFFERINGS .................... 540
   A. Complying with Federal Registration Requirements . 540
      1. Rule 504 ........................................... 541
      2. Regulation A ....................................... 542
      3. Registering a DPO ................................. 543
   B. Complying with State Registration Requirements .... 544
      1. Registration by Notification ...................... 546
      2. Registration by Coordination .................... 547
      3. Registration by Qualification .................... 548
      4. Small Company Offering Registration ............. 551
      5. Coordinated Review Programs ..................... 552
   C. Marketing an Internet DPO .......................... 553
      1. Federal Regulation of Marketing Activities ........ 554
      2. State Regulation of Marketing Activities ........ 558
      3. Marketing Techniques ............................. 560
   D. Closing an Internet DPO ............................... 561
   E. Complying with Federal and State Broker-Dealer and State Agent Regulations .................. 563
   F. Secondary Trading of DPO Stocks ..................... 567
   G. The Bottom Line for DPO Companies .................. 569

* Adjunct Professor of Law, William Mitchell College of Law. I would like to thank my wife, Nancy, for her encouragement and support, Tom Stewart-Gordon for his helpful comments on an earlier draft, and Jeffrey Bruzek for his excellent research assistance.

529
I.  INTRODUCTION

Traditionally, a company “goes public”1 by retaining an underwriter2 to sell shares of the company’s common stock to the general public. As a general rule, however, no underwriter will take a company public unless the company has, at a minimum: (1) annual revenue of $20 million, (2) net income of $1 million, and (3) “the potential to achieve and sustain significant growth rates (i.e., 20% or greater in revenues) for the next five years.”

1. The term “going public” can be used generally to describe any securities offering, i.e., common stock, debt, rights, or warrants, to the general public but is more commonly understood to mean a company’s initial public offering of common stock. This Article uses the term in the latter sense.

2. The term “underwriter” is defined broadly in the Securities Act of 1933 (1933 Act) as any person who has purchased from [a company] with a view to, or offers or sells for a [company] in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking.

15 U.S.C. § 77b(a)(11) (2001). The term, however, is commonly understood, and is used in this Article, unless the context indicates otherwise, to describe the department of an investment banking firm that assists companies in going public.
Consequently, many companies that desire to go public are unable to do so because no underwriter will handle their offerings. The Internet, however, has changed this. Now a company can market its stock directly to the public by posting its offering document on the Web, making it accessible to hundreds of millions of potential investors. These types of offerings have been termed Internet direct public offerings (DPOs). The logic of Internet DPOs is straightforward; a company that cannot convince an underwriter to take it public can get around this obstacle by going public through an Internet DPO and save as much as 13% in underwriter commissions and expenses in the process. Internet DPOs provide an example of "disintermediation," the term used to describe the bypassing of middlemen that the Internet has enabled.

Spring Street Brewing Company, a New York beer microbrewer, is regarded as the first company to complete an Internet DPO. Spring Street's story is typical for a small company; it needed funds for expansion but was unable to attract an underwriter and unwilling to accept the terms offered by a venture capitalist. Instead of putting its expansion plans on hold, however, Spring Street decided to raise funds by offering its shares through an Internet DPO.

---

3. GEN. ACCOUNTING OFFICE, REPORT TO THE CHAIRMAN, COMM. ON SMALL BUSINESS, U.S. SENATE, SMALL BUSINESS EFFORTS TO FACILITATE EQUITY CAPITAL FORMATION 21-22 (Sept. 2000) [hereinafter GAO REPORT]. As noted, this is only a general rule and as such is an oversimplification. Exceptions to the rule include companies that have an innovative product in a hot market or that are, or are on track to be, first to market in a particular field. See Laird H. Simons III, Considerations in Selecting the Managing Underwriter(s) for an Initial Public Offering, in HOW TO PREPARE AN INITIAL PUBLIC OFFERING 41 (Practising Law Institute Corporate Law & Practice Handbook Series No. B0-00AF, 1999).


5. GAO REPORT, supra note 3, at 74. DPOs by small companies pre-date the Internet but as a result of the Internet are now viewed as a more realistic financing option. See JAMES B. ARKBAUER, GOING PUBLIC: EVERYTHING YOU NEED TO KNOW TO TAKE YOUR COMPANY PUBLIC, INCLUDING INTERNET DIRECT PUBLIC OFFERINGS 183, 299 (1998).

6. See infra note 314.

7. Andrew L. Shapiro, Digital Middlemen and the Architecture of Electronic Commerce, 24 OHIO N.U. L. REV. 795, 795 (1998). Other examples of disintermediation enabled by the Internet include rock bands bypassing record companies by posting recordings of their music on the Web and authors bypassing publishing companies by posting their work on the Web. See Greg Kot, Not Business as Usual; Pearl Jam, Pumpkins Trump the System with New CDs, CHI. TRIB., Sept. 29, 2000, at C48; Alan Cowell, A "Techno-Peasant" Goes Internet, N.Y. TIMES, Nov. 1, 2000, at C8.


directly to the public over the Internet. To accomplish this, Spring Street posted its offering documents on its Website and included notices of the offering on six-packs of its best selling beer. Spring Street completed the offering in March 1996 raising roughly $1.6 million by selling approximately 900,000 shares to some 3,500 investors at $1.85 per share.

Internet DPOs have received a lot of attention in the popular media following Spring Street’s offering. Perhaps encouraged by this publicity and the growth of the Internet generally, DPO offerings jumped from 336 in 1995 to 498 in 1996, and in 1999, DPO offerings totaled 562. However, according to the SCOR Report, a newsletter that tracks DPOs, less than forty percent of DPOs have been able to raise any money. Considering this poor success rate, does it make sense for a small company to undertake an Internet DPO? A primary objective of this Article is to answer that question.

10. Id.
11. Id.
12. Id.
14. Data provided by Tom Stewart-Gordon, publisher of the SCOR Report, a monthly newsletter that tracks DPO offerings, and is on file with the author. The data does not include DPOs that were registered with the SEC. DPO data since 1990 is as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Offerings</th>
<th>Number of Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>35</td>
<td>33</td>
</tr>
<tr>
<td>1991</td>
<td>75</td>
<td>56</td>
</tr>
<tr>
<td>1992</td>
<td>183</td>
<td>124</td>
</tr>
<tr>
<td>1993</td>
<td>341</td>
<td>203</td>
</tr>
<tr>
<td>1994</td>
<td>415</td>
<td>254</td>
</tr>
<tr>
<td>1995</td>
<td>336</td>
<td>226</td>
</tr>
<tr>
<td>1996</td>
<td>498</td>
<td>266</td>
</tr>
<tr>
<td>1997</td>
<td>652</td>
<td>274</td>
</tr>
<tr>
<td>1998</td>
<td>590</td>
<td>333</td>
</tr>
<tr>
<td>1999</td>
<td>562</td>
<td>257</td>
</tr>
<tr>
<td>2000</td>
<td>341</td>
<td>241</td>
</tr>
</tbody>
</table>

To provide context, Part II of this Article outlines the typical process of going public through an underwritten initial public offering (IPO). Part III then evaluates the DPO method of going public, including compliance with federal and state offering registration requirements, broker-dealer registration requirements, regulation of marketing activities with a focus on marketing an offering over the Internet, closing an Internet DPO with a focus on fulfilling federal offering document delivery requirements through electronic means, and secondary trading of DPO stocks. It demonstrates that as a result of the lack of coordination among federal and state securities laws and the lack of uniformity among state securities laws, a company conducting a multi-state DPO has to navigate a complicated maze of overlapping securities regulations.

Part IV describes and analyzes the principal advantages and disadvantages of going public in the context of both a traditional IPO and an Internet DPO. It finds that many of the advantages of going public are not gained, and many of the disadvantages are not avoided, by going public through an Internet DPO as compared to a traditional IPO. It cautions companies not to equate a successful Internet DPO to a successful traditional IPO.

Part V discusses the success rate of DPOs and surmises that most have been unsuccessful because there is little demand by the public to invest in Internet DPOs by small companies. It attributes this lack of demand to the absence of a certification intermediary in the DPO process, lack of liquidity with respect to shares issued in a DPO, highly publicized fraudulent schemes involving small companies and the Internet generally, lack of coordination and uniformity of securities regulations and the passive nature of the Internet. Part V then addresses the advisability of Internet DPOs by small companies. It concludes that at the present time it makes sense for a company to pursue an Internet DPO only as a last resort except under limited circumstances.

Part VI argues that facilitating Internet DPOs by small companies is desirable from a public policy perspective. It therefore proposes regulatory reforms to improve the viability of DPOs as a financing option for small companies. It also speculates that the key to the future of Internet DPOs by small companies is the reintermediation of the DPO market.

Finally, Part VII states a brief conclusion. It suggests that successful Internet DPOs by small companies are likely to remain an anomaly. It then speculates that any future growth in the number of Internet DPOs will come from seasoned public companies.
II. THE TRADITIONAL UNDERWRITTEN INITIAL PUBLIC OFFERING PROCESS

To provide a point of comparison for Internet DPOs, this Part outlines the typical process of going public through a traditional underwritten IPO. From the point of view of the company, the process can be broken down into five phases: selecting the underwriter, registering the offering with the Securities and Exchange Commission (SEC), marketing the offering, going effective, and closing on the offering.

A. Selecting an Underwriter

In a typical underwritten IPO, a company sells newly issued shares of common stock to a syndicate of underwriters who immediately resell the shares to the public through the underwriters’ brokers and the brokers of other securities firms. The company sells the shares to the underwriters at a discount from seven to ten percent of the public offering price. The lead or managing underwriter manages the transaction and puts together the underwriting syndicate. Hence, generally the first step for a company in the IPO process is to select the investment banking firm to serve as managing underwriter.

A company typically selects a managing underwriter by discussing with several firms such issues as the expected public offering price range, underwriting commissions and expenses, and distribution capacity. The quality of the firm’s research coverage in the relevant industry is also a key factor because post-IPO analyst coverage is critical in developing an active secondary trading market for a company’s stock. Once a company makes its selection, the parties normally enter into a non-binding letter of intent specifying the size of the offering, the type of security to be offered, the underwriters’ compensation and expense allowance, and an

---

17. Id.
18. Id. at 342. The underwriters’ commission is also often referred to as the underwriting discount.
19. Id. at 334; see also CHARLES J. JOHNSON, JR. & JOSEPH MCLAUGHLIN, CORPORATE FINANCE AND THE SECURITIES LAWS 106-07 (2d ed. 1997).
20. JOHNSON & MCLAUGHLIN, supra note 19, at 106.
21. Id. at 106-08. See generally Simons, supra note 3 (discussing various factors a company should consider in choosing an underwriter).
22. JOHNSON & MCLAUGHLIN, supra note 19, at 108-09.
23. Generally the letter of intent provides that the only binding provisions are the company’s obligations to pay the underwriter’s accountable expenses even if the offering is not completed and to indemnify the underwriter against claims relating to the engagement.
estimated offering price range or formula for determining the offering price.  

B. Registering the Offering with the SEC

To put the federal registration process in context, it is helpful to keep in mind two broad principles of federal securities law: (1) it is illegal for anyone to offer or sell a security unless the offer or sale is registered with the SEC or is exempt from registration; and (2) it is illegal for anyone to misstate or withhold material facts in connection with the sale of a security. The first principle results in companies filing registration statements with the SEC to register the common stock to be sold in their IPOs. This is because exemptions from registration are generally only available for offerings to a limited number or type of person and/or offerings below a certain total dollar amount, and these limits are not


25. The term security is broadly defined under the 1933 Act to include “any note, stock, treasury stock, bond, debenture, . . . investment contract, . . . option, . . . or warrant or right to subscribe to or purchase, any of the foregoing.” 15 U.S.C. § 77b(a)(1) (1994).

26. Id. § 77e(a); see LOSS & SELIGMAN, supra note 16, § 2-B.

27. Securities Exchange Act of 1934, Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, . . . to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, . . . in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (2000); see also LOSS & SELIGMAN, supra note 16, § 11-C-4-d (analyzing Rule 10b-5). Similar language is contained in Section 11(a) of the 1933 Act, which provides that a purchaser of a security covered by a registration statement may recover damages from the company’s directors, its officers who signed the registration statement, and the underwriter of such security if “any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.” 15 U.S.C. § 77k(a) (1994). See LOSS & SELIGMAN, supra note 16, § 11-C-2-d for an analysis of Section 11(a). Section 12(a)(2) of the 1933 Act makes it illegal for anyone to offer or sell a security by means of a prospectus or oral communication “which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading.” 15 U.S.C. § 77l(a)(2) (1994); see also LOSS & SELIGMAN, supra note 16, § 11-C-2-b for an analysis of § 12(a)(2).

28. The most commonly relied on exemptions for stock offerings by small companies are Rule 505, 17 C.F.R. § 230.505 (2000), and Rule 506, 17 C.F.R. § 230.506 (2000). See GAO REPORT, supra note 3, at 29-30. Under both these exemptions, a company can sell to no more than 35 investors who are not “accredited.” 17 C.F.R. §§ 230.505(b)(2)(ii), 506(b)(2)(i). Rule 501(a), 17 C.F.R. § 230.501(a), defines “accredited investor” as, among other things,

[any natural person whose individual net worth, or joint net worth with that
practical for an underwritten IPO. The second principle impacts the extent of the underwriters’ investigation of the company’s operations or “due diligence investigation,” a goal of which is to verify that the registration statement is accurate and complete.29

Anyone offering or selling securities must also comply with the securities laws of the states in which they are making the offers and sales.30 All states, except New York, require registration of the offering with state regulators unless the offering falls within an exemption therefrom.31 However, this is a non-issue for most underwritten IPOs in light of Section 18 of the Securities Act of 1933 (1933 Act),32 which was amended by the National Securities Markets Improvement Act of 1996 (NSMIA),33 to provide that no state law, rule, regulation or order “requiring, or with respect to, registration or qualification of securities, or registration or qualification of securities transactions, shall directly or indirectly apply to a security that is a covered security or will be a covered security upon completion of the transaction.”34 Section 18 defines a covered security as

a natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person’s spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.


29. “Due diligence” is understood “to include the entire process by which an underwriter . . . reaches the conclusion that its comfort level with the [company] is sufficiently high to justify proceeding with a securities offering.” JOHNSON & MCLAUGHLIN, supra note 19, at 257. This in turn provides investors in the offering comfort that the offering is legitimate. Another goal of the due diligence investigation from the underwriter’s perspective is potentially to shield the underwriter from liability under Section 11 and Section 12(a)(2) of the 1933 Act. See supra note 27 for a brief description of Section 11 and Section 12(a)(2) of the 1933 Act. See supra note 27 for a brief description of Section 11 and Section 12(a)(2) of the 1933 Act. 15 U.S.C. § 77k(b)(3)(A) (1994). Section 12(a)(2) sets forth a “reasonable care” defense against civil liability, i.e., the underwriter is not liable under Section 11 if it can prove that it did not know, and in the exercise of reasonable care, could not have known the registration statement contained an untruth or omission. Id. § 77l(a)(2).

30. LOSS & SELIGMAN, supra note 16, § 1-B-4.
31. For citations to the registration requirements of each state see infra note 90.
34. 15 U.S.C. § 77r(a)(1) (1994); see also JOHNSON & MCLAUGHLIN, supra note 19, at 119; LOSS & SELIGMAN, supra note 16, § 1-B-3. Prior to enactment of NSMIA, offerings registered
a security listed or approved for listing on the New York Stock Exchange, the American Stock Exchange or admitted or approved for admission and trading on the Nasdaq National Market. Thus, Section 18 eliminates state securities registration requirements for IPOs of securities that will be traded on one of the major markets.

Once the company and the managing underwriter execute the letter of intent, the managing underwriter and its counsel typically hold an organizational meeting with the principal officers of the company and the company’s outside attorneys and accountants to establish a timetable for the deal, assign tasks to the working group and address various substantive issues and housekeeping matters. Company counsel then prepares a draft of the registration statement, which, as dictated by SEC regulations, describes among other things, the company’s business operations, financial conditions, risk factors and management. Next, a series of drafting sessions are held where members of the working group comment on the draft and company counsel makes revisions. The draft is then forwarded to a financial printer who formats it and files it electronically with the SEC, and the SEC’s staff begins reviewing it. The staff strives to provide comments on registration statements within thirty days of filing. During the same time frame that the working group is drafting the registration statement, representatives of the managing underwriter and its counsel conduct the due diligence investigation of the company, including review of the company’s organizational documents; financial statements and schedules; material contracts; and interviews with management, customers

under the 1933 Act and listed on a national securities exchange or quoted on the Nasdaq National Market were generally exempt from state registration requirements (except in Florida and Connecticut) under the listing exemptions of the various states.

36. See, e.g., NATIONAL ASSOCIATION OF SECURITIES DEALERS, MANUAL, Rule 4420 (2000) (stating that initial public offerings substantially meeting specified criteria are eligible for immediate inclusion in the Nasdaq National Market upon prior application and with the consent of the managing underwriter of the offering).
37. WALTER E. JOSPIN ET AL., UNDERSTANDING THE SECURITIES LAWS, SECURITIES ACT REGISTRATION PROCESS 44 (PLI 2000).
38. Id. at 48.
40. JOSPIN ET AL., supra note 37, at 48.
41. JOHNSON & MCCLAUGHLIN, supra note 19, at 145. The SEC does not review all registration statements filed but almost always reviews IPO registration statements. Id. The purpose of the review is to ensure that the registration statement materially complies with the disclosure requirements of the 1933 Act. JOSPIN ET AL., supra note 37, at 49-50.
and suppliers.\textsuperscript{43} Additionally, the managing underwriter begins putting together the underwriting syndicate.\textsuperscript{44}

\section*{C. Marketing the Offering}

Depending on the timetable for the offering, the company will have several thousand copies of the preliminary prospectus\textsuperscript{45} printed and delivered to the managing underwriter shortly after filing the registration statement with the SEC or after receiving initial comments from the SEC.\textsuperscript{46} The managing underwriter will forward copies of the preliminary prospectus to prospective members of the underwriting syndicate.\textsuperscript{47} These firms then start marketing the offering to their customers.\textsuperscript{48}

Permitted marketing activities for a registered securities offering are limited. During the period after the registration statement is filed but before it is declared effective by the SEC (often referred to as the “waiting period”), generally the only written materials that can be used to market the offering are the preliminary prospectus and a “tombstone” advertisement that contains only basic information about the offering.\textsuperscript{49} Thus, most of the marketing of an offering is done through oral

\begin{footnotesize}
\begin{enumerate}
\item See Jospin et al., supra note 37, at 44-46.
\item Id. at 41.
\item The preliminary prospectus, which is often referred to as the “red herring,” is a subset of the registration statement. Harold S. Bloomenthal et al., Securities Law Handbook 219 (2000); Form S-1, General Instructions, Part I, Fed. Sec. L. Rep. (CCH) ¶ 7121 (Oct. 13 1999) (specifying what part of the registration statement constitutes the prospectus).
\item Bloomenthal et al., supra note 45, § 502[2]. Waiting to print and distribute a preliminary prospectus until after the company has received comments from the SEC and revised the prospectus accordingly eliminates the risk that the SEC will conclude that the prospectus as originally filed was deficient and thus require the company to redistribute a corrected preliminary prospectus to those previously sent a preliminary prospectus. Id.
\item Loss & Seligman, supra note 16, § 2-A-2.
\item Id.
\item The basic regulatory scheme for marketing securities during the waiting period is as follows: Section 5(b)(1) of the 1933 Act makes it unlawful to “transmit any prospectus relating to any security with respect to which a registration statement has been filed” unless it includes essentially the information contained in the prospectus portion of the filed registration statement. 15 U.S.C. § 77e(b)(1) (2001). The term prospectus is defined broadly to include any writing or radio or television transmission relating to the offering. Id. § 77b(2)(a)(10). However, Rule 134 under the 1933 Act specifically excludes from the definition of prospectus a writing that contains certain limited information including the name of the company, the type and amount of securities being offered, a very brief general description of the company’s business, the anticipated price or price range for the offering, and the names of the managing underwriters of the offering. 17 C.F.R. § 230.134 (2000). The end result of these provisions is that generally the only written materials used to market an offering during the waiting period is the preliminary prospectus and advertisements complying with Rule 134 which are commonly referred to as tombstone ads. Note that these provisions do not restrict oral communications relating to the offering made in person or by telephone.
\end{enumerate}
\end{footnotesize}
communications made in person or by telephone, i.e., brokers calling and visiting potential customers to discuss the offering. The managing underwriter also organizes a “road show” where the company’s senior management jet around to various major cities in the U.S. and sometimes abroad over a period of several weeks to give oral presentations to and meet with institutional investors, money managers and securities brokers.

D. Going Effective and Closing on the Offering

Usually within thirty-five days from filing the registration statement, the company receives comments from the SEC on the registration statement. With the working group, the company then revises the registration statement in light of the comments and any material events that may have occurred since the initial filing and then files the revised registration statement with the SEC. The SEC may have comments on the revised registration statement in which case it is again revised and refiled. At some point, the SEC notifies the company it has no further comments.

After the SEC has signed-off on the registration statement, the company and managing underwriter decide whether to proceed with the offering. Since at this point the parties have not executed an underwriting agreement, either party can elect to postpone or withdraw from the offering without liability. A decision to proceed is largely dependent on the success of the underwriting syndicate in securing indications of interest for the offering at a price level acceptable to the company. Assuming the parties decide to proceed, they then agree on a date and time to start selling the IPO shares and request that the SEC declare the registration statement effective on that date and time.

On the night prior to the planned effective date, the company and managing underwriter agree on the public offering price for the offering, and the working group meets at the financial printer to complete the final

50. 1 Harold S. Bloomenthal et al., Going Public Handbook § 3.04[1], at 207 (2001).
52. See Jospin et al., supra note 37, at 50.
53. Id.
54. Id.
55. See id.
56. Id.
57. Liability may attach, however, to the extent that the letter of intent contains binding obligations. See supra note 23.
58. See Drew Field, Direct Public Offerings: The New Method for Taking Your Company Public 67 (1997) (noting that underwriters try to have indications of interest for at least 150% of the shares offered in the event some investors back out).
59. See Jospin et al., supra note 37, at 50.
prospectus. The following morning, the company and the managing underwriter execute the underwriting agreement, the registration statement becomes effective, the underwriters and other securities dealers begin making sales to the public and the stock starts trading in the secondary market. Thereafter, the underwriters and dealers send out sale confirmations and copies of the final prospectus to all purchasers in the offering. Typically three days after the SEC declares the registration statement effective, a closing is held and the company receives the net proceeds from the offering.

III. INTERNET DIRECT PUBLIC OFFERINGS

This Part summarizes the process of going public through an Internet direct public offering. Specifically, this Part discusses complying with federal and state registration requirements, marketing and closing the offering, complying with federal and state securities broker-dealer and state agent regulations, and facilitating secondary trading following the offering.

A. Complying with Federal Registration Requirements

As discussed above, every offering of securities must either be registered with the SEC or qualify for an exemption from registration. Thus, the first step for a company undertaking a DPO is to determine how it will comply with this rule. While the 1933 Act and the regulations and rules promulgated thereunder contain many exemptions from

---

60. JOHNSON & MCLAUGHLIN, supra note 19, at 145.
61. BLOOMENTHAL ET AL., supra note 50, at 215.
62. Pursuant to an agreement among underwriters, the other members of the underwriting syndicate will have granted authority to the managing underwriter to execute the underwriting agreement on their behalf. JOHNSON & MCLAUGHLIN, supra note 19, at 64.
63. See JOSPIN ET AL., supra note 37, at 50.
64. Rule 10b-10 under the 1934 Act requires brokers to send out to each purchaser a confirmation of the sale. 17 C.F.R. § 240.10b-10 (2000). However, a written sale confirmation falls within the definition of prospectus under the 1933 Act unless it is proceeded or accompanied by a final prospectus. 15 U.S.C. § 77b(10)(a) (1994). Thus, to avoid violating Section 5(b)(1) of the 1933 Act, brokers generally always send a sales confirmation accompanied by a copy of the final prospectus. The end result of this regulatory scheme is that every purchaser of securities in a public offering is furnished with a copy of the final prospectus.
65. Rule 15c6-1 under the 1934 Act provides that “a broker or dealer shall not effect or enter into a contract for the purchase or sale of a security . . . that provides for payment of funds and delivery of securities later than the third business day after the date of the contract. . . .” 17 C.F.R. § 240.15c6-1 (2000). Hence, to conform with this rule, the closing for a traditional IPO is held on the third business day following the date the stock starts trading. See BLOOMENTHAL ET AL., supra note 46, § 5.02[5], at 228.
registration, there are really only two that are practical for a DPO, Rule 504 and Regulation A. This is because these are the only exemptions that allow a company to solicit an unlimited number of investors in multiple states regardless of the investors’ net worth and through the use of general advertisement. If one of these exemptions is not available, the company will likely have to register its DPO with the SEC. The Rule 504 and Regulation A exemptions and the process of registering a DPO with the SEC are discussed below.

1. Rule 504

The SEC promulgated the Rule 504 exemption in 1982 in an effort to “aid small businesses raising ‘seed capital.'” Under Rule 504 a company

(i) 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 sale, and are made in accordance with those state provisions; (ii) In one or more states that have no provision for the registration of the securities or the public filing or delivery of a disclosure document before sale, if the securities have been registered in at least one state that provides for such registration, public filing and delivery before sale, offers and sales are made in that state in accordance with such provisions, and the disclosure document is delivered before sale to all purchasers (including those in the states that have no such procedure); or (iii) 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” . . . .

17 C.F.R. § 230.504(b)(1)(i)-(ii). Compare Rule 502(c), 17 C.F.R. § 230.502(c), which requires that an investor in an offering made in reliance on Rule 505, 17 C.F.R. § 230.505, or Rule 506, 17 C.F.R. § 230.506, cannot have been solicited through any form of general solicitation or general advertisement.

72. Revision of Rule 504 of Regulation D, the “Seed Capital” Exemption, 64 Fed. Reg. 11,090, 11,090 (1999).
can offer and sell securities to an unlimited number of persons without regard to net worth. The total dollar amount of the offering, however, cannot exceed $1 million less the aggregate offering price of all securities sold by the company during the preceding twelve months in reliance on Rule 504, Rule 505, Regulation A or in violation of the registration requirements of the 1933 Act. The only filing required to be made with the SEC is the six page Form D setting forth some basic information about the offering. The company must file the Form D no later than fifteen days after the first sale of securities. Securities issued in reliance on Rule 504 can generally be resold freely by investors unaffiliated with the company if the offering meets certain requirements. Rule 504 is not available to a reporting company, i.e., a company that is required to file periodic reports with the SEC under the Securities Exchange Act of 1934 (1934 Act), a start-up company with no specific business plan, or an investment company.

2. Regulation A

While Regulation A is often referred to as a “short form registration” since it does involve filing with and review by the SEC, it is technically a conditional exemption from registration. Under Regulation A, a company must prepare and file with the SEC an offering statement meeting requirements analogous to those for a registration statement. Similar to the registration process, the SEC reviews and comments on the offering statement. The biggest difference between a registration statement and an offering statement is that audited financial statements are not required by SEC regulations to be included as part of an offering statement.

An offering qualified under Regulation A can be marketed to any investor regardless of net worth and through the use of general advertising. However, the total dollar amount of the offering cannot
exceed $5 million, “including no more than $1.5 million offered by all selling security holders, less the aggregate offering price for all securities” sold by the company during the previous twelve months in reliance on Regulation A.84 Shares issued in reliance on Regulation A can generally be resold freely by investors unaffiliated with the company.85 Regulation A is only available to United States and Canadian companies and is not available to a company that is required to file periodic reports under the 1934 Act, a start-up company with no specific business plan, or an investment company.86

3. Registering a DPO

There is no registration statement form designed specifically for a DPO.87 Thus, the company must prepare a registration statement in compliance with the same regulations that dictate the form and content of a registration statement for an underwritten IPO. However, unlike an underwritten IPO, there is no industry practice or custom for preparing a DPO registration statement, and thus, approaches vary. The company may prepare the draft by using computer software designed for this purpose or by obtaining publicly available registration statements of competitors and revising, cutting and pasting as appropriate and then having company counsel review and comment on the draft. Another approach, similar to what is done for an underwritten IPO, is to have company counsel prepare a draft registration statement and then hold a series of drafting sessions where the company’s management comments on the draft and company counsel makes revisions. Once the company is satisfied with the draft registration statement, the company either has its law firm or a financial

84. 17 C.F.R. § 230.251(b) (2000).
85. LOSS & SELIGMAN, supra note 16, § 3-C-6.
86. 17 C.F.R. § 230.251(a) (2000).
87. It is likely that a DPO company could use registration Form SB-1, Fed. Sec. L. Rep. (CCH) ¶ 7312 (July 14, 1999), or Form SB-2, Fed. Sec. L. Rep. (CCH) ¶ 7313 (July 14, 1999). These forms are available for use by a “small business issuer.” A small business issuer is any company with revenue of less than $25 million during its last fiscal year and a public float (shares held by non-affiliates of the entity) with a market value of less than $25 million and that is not a foreign (other than Canadian) private company, an investment company or a majority-owned subsidiary of a non-small business company. 17 C.F.R. §§ 230.405, 228.10(a)(1) (2001). Forms SB-1 and SB-2 are less burdensome to comply with than Form S-1, Fed. Sec. L. Rep. (CCH) ¶ 7121 (Oct. 13, 1999), the form generally used for a traditional underwritten IPO. Specifically, the requirements with respect to financial statements are more easily met than are those for Form S-1 and permit use of financial statements prepared in accordance with generally accepted accounting principles, whereas Forms S-1 requires financial statements to be prepared in accordance with the detailed requirements of Regulation S-X, 17 C.F.R. §§ 210.1-01 through 210.12-29 (2000). See GAO REPORT, supra note 3, at 26.
printer file it electronically with the SEC. The registration statement is then subjected to the same review, comment and revision procedure as with an underwritten IPO.

**B. Complying with State Registration Requirements**

As noted above, a company must also register the offering with each state in which it makes offers or sales unless the offering falls within an exemption therefrom. While as also noted above, blue sky compliance is generally a non-issue for a traditional underwritten IPO because of Section 18 of the 1933 Act, it can be a huge issue for a DPO that the company intends to market in multiple states. This is because it is unlikely that the company will meet the initial listing requirements of the exchanges or Nasdaq in which case it will not be able to rely on Section 18. Therefore,

88. Generally all registration statements under the 1933 Act must be filed electronically. 17 C.F.R. § 232.101(a) (2000).

89. See supra Part II.D.


91. See supra text accompanying notes 33-36.

92. For example, the National Association of Securities Dealers, Inc. (NASD) has promulgated three alternatives under which a company can qualify its shares for initial listing on the Nasdaq National Market. Alternative one requires minimum net tangible assets of $6 million, pretax income in the company’s latest fiscal year or two of its last three years of $1 million, a public float (shares held by non-affiliates of the company) of at least 1.1 million shares, a market value of the public float of at least $8 million, a minimum bid price per share of $5, at least 400
the company will either have to register the offering or structure it so that it qualifies for an exemption in each state in which it intends to offer its shares.

Each of the fifty states has its own blue sky laws, and although the American Bar Association, North American Securities Administrators Association (NASAA) and the SEC approved the Uniform Securities Act in 1956, state blue sky laws lack uniformity in many areas, including registration requirements and exemptions therefrom. Since over thirty jurisdictions currently have in force all or substantially all of the Uniform Securities Act, to facilitate discussion and analysis, this Article will emphasize the Uniform Securities Act with relevant differences among the states described in footnotes.

All else being equal, it is preferable to qualify for an exemption as opposed to registering an offering in a state to avoid the time and expense of preparing and filing the necessary registration documents. However, it is not generally practical for a DPO company to structure its offering to fall within an exemption, because like exemptions under the 1933 Act, exemptions from blue sky registration requirements are, for the most part, only available for offerings to a limited number or type of people and/or offerings below a certain total dollar amount. Thus, it is likely that a

Each of the fifty states has its own blue sky laws, and although the American Bar Association, North American Securities Administrators Association (NASAA) and the SEC approved the Uniform Securities Act in 1956, state blue sky laws lack uniformity in many areas, including registration requirements and exemptions therefrom. Since over thirty jurisdictions currently have in force all or substantially all of the Uniform Securities Act, to facilitate discussion and analysis, this Article will emphasize the Uniform Securities Act with relevant differences among the states described in footnotes.

All else being equal, it is preferable to qualify for an exemption as opposed to registering an offering in a state to avoid the time and expense of preparing and filing the necessary registration documents. However, it is not generally practical for a DPO company to structure its offering to fall within an exemption, because like exemptions under the 1933 Act, exemptions from blue sky registration requirements are, for the most part, only available for offerings to a limited number or type of people and/or offerings below a certain total dollar amount. Thus, it is likely that a

93. UNIF. SEC. ACT, Blue Sky L. Rep. (CCH) ¶¶ 5500-5573 (June 1988); see also LOSS & SELIGMAN, supra note 16, § 1-B-2. In 1985, the National Conference of Commissioners on Uniform State Laws adopted a Revised Uniform Securities Act. Id. However, it was not approved by the ABA or the SEC, and the National Conference did not withdraw the 1956 Act when it approved the 1985 Act. Id.

94. LOSS & SELIGMAN, supra note 16, § 1-B-2.

95. Id. § 1-B-5.

96. Id. § 1-B-2.

97. One exemption that DPO companies do sometimes rely on is the exemption for offers or sales to no more than ten persons in a state (with various additional requirements). See UNIF. SEC. ACT § 402(b)(9) (June 1998). This exemption comes in handy when a person from a state in which the company is not actively marketing the offering finds out about the offering through the Internet or otherwise and wants to invest. However, because of the conditions required for general solicitation to be permissible in a Rule 504 offering, a DPO issuer relying on Rule 504 will likely not be able to rely on the § 402(b)(9) exemption. See supra note 71.

98. See, e.g., Uniform Limited Offering Exemption, NASAA Rep. (CCH) ¶ 6,201 at 6,101.
company will have to register its DPO in each state where it intends to make offers or sales.

1. Registration by Notification

Thirty-four jurisdictions permit registration under a streamlined procedure called registration by notification. To qualify for registration by notification under Section 302 of the Uniform Securities Act, a company must have been in continuous operation for at least five years; not have been in default on any principal, interest or dividend payments on its securities during the past three years; and must satisfy a net earnings test. If a DPO company meets these qualifications, generally all it then needs to do to register its offering is to provide the state with the following: (1) a statement demonstrating that it meets the qualifications; (2) basic information about the company, e.g., date of organization, address, etc.; (3) a description of the security being offered and the price at which it is being offered; (4) a description of the plan of distribution for the securities; (5) a description of any stock options outstanding or to be created in the offering; and (6) a copy of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature to be used in

(2000).

99. LOSS & SELIGMAN, supra note 16, § 1-B-4. Citations to the registration by notification provisions of jurisdictions that have adopted Section 302 are as follows: ALA. CODE § 8-6-5 (2000); ALASKA STAT. § 45.55.080 (Michie 2000); ARK. CODE. ANN. § 23-42-401 (Michie 2000); COLO. REV. STAT. ANN. § 11-51-303 (West 2000); IDAHO CODE §§ 30-1417, 30-1418, 30-1419 (Michie 2000); KAN. STAT. ANN. § 17-1256 (West 1999); KY. REV. STAT. ANN. § 292.350 (Michie 2000); ME. REV. STAT. ANN. tit. 32, § 10,402 (West 2000); MD. CODE ANN., CORPS. & ASS’NS § 11-502 (2000); MICH. COMP. LAWS ANN. § 451.702 (West 2000); MO. ANN. STAT. § 409.302 (West 1999); MONT. CODE ANN. § 30-10-203 (2000); NEB. REV. STAT. ANN. § 8-1105 (2000); NEV. REV. STAT. § 90.470 (2000); N.J. STAT. ANN. § 49:3-60 (West 2001); N.M. STAT. ANN. § 58-13B-21 (Michie 2000); N.C. GEN. STAT. § 78A-25 (2000); 10 P.R. LAWS ANN., § 872 (1998); R.I. GEN. LAWS § 7-11-302 (2000); S.C. CODE. ANN. § 35-1-820 (Law. Co-op. 2000); S.D. CODIFIED LAWS § 47-31A-303 (Michie 2000); UTAH CODE ANN. § 61-1-8 (2000); VA. CODE ANN. § 13.1-508 (Michie 2000); W. VA. CODE § 32-3-302 (2000); WYO. STAT. ANN. § 17-4-108 (Michie 2000). Hawaii, which has also adopted the Uniform Securities Act, has a more comprehensive registration by notification provision; it also exempts any offering registered with the SEC. HAW. REV. STAT. ANN. § 485-9 (Michie 2000). Although both Minnesota and New Hampshire have adopted the Uniform Securities Act, they have registration by notification requirements that are more restrictive than § 302 in that such registrations are limited to industrial revenue bonds and securities issued by not-for-profit organizations. MIII. STAT. ANN. § 80A.099 (West 2000); N.H. REV. STAT. ANN. § 421-B:12 (2000). California, Florida, Georgia, Louisiana, Texas and Vermont are among the jurisdictions that have not adopted the Uniform Securities Act, but each have a form of registration by notification. CAL. CORP. CODE § 25112 (West 2000); FLA. STAT. ANN. § 517.082 (West 2000); GA. CODE ANN. § 10-5-5(d) (2000); LA. REV. STAT. ANN. § 51:705(D) (West 2000); TEX. REV. CIV. STAT. ANN. art. 581-7(B) (West 2000); VT. STAT. ANN. tit. 9, § 4207 (2001).

100. UNIF. SEC. ACT § 302(a)(1), (Aug. 1997).
connection with the offering. The registration becomes effective automatically on the second full business day after filing unless the administrator accelerates effectiveness or pursues a stop order to deny effectiveness.

2. Registration by Coordination

Forty-three jurisdictions permit registration under a second streamlined procedure called registration by coordination. Under Section 303 of the Uniform Securities Act, registration by coordination is only available for offerings that have been registered with the SEC. To register by coordination, generally all a company needs to do is file with the state copies of the prospectus and any amendments thereto that it filed with the SEC. A state may also require that the company file copies of its organizational documents and any other documents filed with the SEC.

101. Id. §§ 302(b), 304(b)(8), 304(b)(10), 304(b)(12).
102. Id. § 302(c).


105. LOSS & SELIGMAN, supra note 16, § 1-B-4; Unif. Sec. Act § 303(b)(1).
under the 1933 Act. If specified conditions are met, the offering automatically becomes effective in the state at the same time that the federal registration becomes effective.

3. Registration by Qualification

A company that does not meet the requirements for registration by notification or coordination must file a full registration which many states label registration by qualification. Under Section 304 of the Uniform Securities Act, to register by qualification a company must file a registration statement with the state that includes data concerning: (1) the company and subsidiaries; (2) directors and officers; (3) aggregate remuneration of directors and officers; (4) stockholders owning 10% or more of the outstanding shares of any class of equity; (5) promoters; (6) sellers other than the company; (7) capitalization; (8) securities offered, price and underwriting data; (9) use of proceeds; (10) options; (11) material contracts; (12) litigation; (13) sales literature; (14) specimen of the security, articles of incorporation, and by-laws; (15) opinion of counsel that shares will be legally issued; (16) consents of experts; (17) financial statements; and (18) additional information specified by rule or order. This list of data was modeled, in part, on Schedule A of the 1933 Act and the then-effective registration Form S-1. Further, Section 305(d) requires information concerning: (1) the amount of securities to be offered in the state; (2) the other states in which a registration statement has been filed; and (3) any adverse order, judgment, or decree entered in connection with the offering by state securities administrators, a court, or the SEC. Finally, Sections 304(b) and 708(a) require the company to file a consent to service of process.

In all states but New York, the filed information is then reviewed by the state to verify whether it meets the state’s disclosure requirements and, in many states, fraud or merit standards. These standards vary widely. At one extreme are states with simple fraud standards, e.g., whether “the offering has worked or tended to work a fraud upon purchasers or would

---

106. LOSS & SELIGMAN, supra note 16, § 1-B-4; UNIF. SEC. ACT § 303(b)(2), (3).
107. LOSS & SELIGMAN, supra note 16, § 1-B-4; UNIF. SEC. ACT § 303(c).
108. LOSS & SELIGMAN, supra note 16, § 1-B-4.
109. UNIF. SEC. ACT § 304(b) (amended 1988).
110. LOSS & SELIGMAN, supra note 16, § 1-B-4 n.250 (citing Official Comment to Uniform Securities Act § 304(b)).
111. UNIF. SEC. ACT § 305(d) (amended 1988).
112. Id. §§ 304(b), 708(a).
113. LOSS & SELIGMAN, supra note 16, § 1-B-4.
114. Id.
so operate.”115 At the other extreme are states that have so-called merit standards,116 the purpose of which is to align the interests of the company with those of the public investor.117 The Kansas Securities Act provides a typical example of these standards.118 Under the Act, Kansas can deny registration of an offering if it concludes that the company’s “plan of business is unfair, inequitable, dishonest or fraudulent” or that “the securities offered . . . in payment for property, patents, formulae, goodwill, promotion or intangible assets, are in excess of the reasonable value thereof, or the offering has been, or would be, made with unreasonable amounts of options.”119 The largest number of states use the standard set

---


117.  GAO REPORT, supra note 3, at 25.


119.  See the following for other examples of merit standards: ARIZ. REV. STAT. §§ 44-1921(3), -1921(4) (2000) (specifying that state may deny registration of offering that is “unfair or inequitable to purchasers” or that is being made by a company “in an unsound financial condition”); ARK. CODE ANN. § 23-42-405(a)(2)(E)(i) (Michie 2000) (may deny registration if any aspect of the offering “is substantially unfair, unjust, inequitable or oppressive”); CAL. CORP. CODE § 25140(a)(2) (Deering 2000) (may deny registration unless the commissioner concludes that “the proposed plan of business of the applicant or the proposed issuance of securities is fair, just, and equitable, [and] that the issuer intends to transact its business fairly and honestly”); COLO. REV. STAT. § 11-51-306(b) (2000) (may deny registration if “offering, when viewed on its merits as an investment, is unfair, unjust, or inequitable”); FLA. STAT. § 517.111(1)(i) (1997) (may deny registration if offer or sale “would not be fair, just, or equitable”); IOWA CODE § 502.209(1)(h) (1999) (may deny registration if financial condition of company “afflicts or would affect the soundness of the securities”); ME. REV. STAT. ANN. tit. 32, § 10,406(1)(F) (West 1999) (may deny registration if offering made on terms which are “unfair, unjust or inequitable”); MICH. STAT. ANN. § 19.776(a)(5) (Michie 2000) (may deny registration if offering is on “unfair terms”); MINN. STAT. § 80A.13(1)(b)(6) (1999) (may deny registration if terms are “unfair and inequitable”); MO. REV. STAT. § 409.306(a)(2)(E)(ii), -(iii) (1990) (may deny registration if any aspect of offering is
forth in Uniform Securities Act Section 306(a)(2)(F), which falls between the two extremes by permitting “merit” regulation only insofar as “the offering has been or would be made with unreasonable amounts of underwriters’ and sellers’ discounts, commissions, or other compensation, or promoters’ profits or participation, or unreasonable amounts or kinds of options.”

Similar to the SEC review process, a state, upon completing its review, typically sends a comment letter to the company. A company then revises its registration statement in light of the comments and resubmits it to the state. At some point, either the state signs-off on the registration statement, or the company withdraws the registration statement and does not conduct the offering in that state.

---

substantially “unfair, unjust, inequitable or oppressive” or company’s enterprise is based upon “unsound business principles”; NEB. REV. STAT. ANN. § 8-1109.01(2) (Michie 1995) (may deny registration if company’s plan of business is “unfair, unjust, inequitable . . . oppressive”); N.H. REV. STAT. ANN. § 421-B:16(I)(b)(7) (1998) (may deny registration if terms of the securities are “unfair and inequitable”); N.D. CENT. CODE § 10-04-09(1) (1999) (may deny registration if offering is on “unfair terms” or the company’s plan of business is “unfair, unjust, or inequitable”); OHIO REV. CODE ANN. § 1707.13 (Anderson 1994) (may deny registration if offering is on “grossly unfair terms”); OR. REV. STAT. § 59.105(2)(b) (1998) (may deny registration if the company is in an “unsound financial condition”); S.D. CODIFIED LAWS § 47-31A-306(a)(2)(E) (Michie 2000) (may deny registration if offering is being made on terms that are “unfair, unjust and inequitable”); TEX. REV. CIV. STAT. ANN. art. 581-23(A) (Vernon 2000) (may deny registration if offering is not “fair, just or equitable”); VT. STAT. ANN. tit. 9, §§ 4211(a)(5), 4211(a)(7), 4211(a)(8) (2000) (may deny registration if the company is of “bad business repute,” its affairs are in “unsound condition,” or it is not based upon “sound business principles”).

4. Small Company Offering Registration

In 1989, in an effort to promote uniformity in regulation, simplify state registration of securities offerings and reduce associated costs, NASAA adopted the Small Corporate Offering Registration (SCOR).121 "As of February 2000, forty-six states have adopted the use of [SCOR], either formally or informally."122

To utilize SCOR a company must complete a Form U-7 which is a question-and-answer type of form designed to elicit "all material information about the company that a typical investor would want to know before making an investment" decision.123 The company then files the Form U-7 with the states in which it intends to offer its shares and pays certain registration fees.124 States then review the filing and send a comment letter to the company.125 Comments may include "requests for disclosure of additional information or" that the "terms of the offering be modified to comply with a particular state’s” merit regulations.126 A company must then either resolve the comments of each state or withdraw the offering from that state. Once comments are resolved, a state will declare the offering effective, and the company can then commence offers and sales in that state. All investors must be provided with a copy of the U-7 form.127 SCOR, as adopted by NASAA, is available for Rule 504 and Regulation A offerings.128 However, a number of states only make SCOR available for Rule 504 offerings and/or for offerings of $1 million or less.129
5. Coordinated Review Programs

In 1997, NASAA developed a uniform state registration procedure labeled Coordinated Equity Review (CER) in an effort to coordinate and expedite the state registration process. Currently, thirty-eight states participate in CER. NASAA designed CER for offerings of securities that are not “covered securities” as defined in Section 18(b)(1) of the 1933 Act. CER is only available for offerings registered with the SEC, and therefore, not for Regulation A offerings.

Under the program, a company files its federal registration statement accompanied by an Application for Coordinated State Review in each state where it intends to market the offering and with Pennsylvania, which serves as the program administrator. Pennsylvania then appoints two states in which the offering will be made to serve as lead states, one of which focuses on disclosure issues and the other on merit issues. Each of the participating states in which filings are made send their comments to the lead states. The lead states then combine the comments in a single comment letter and negotiate with the company to resolve the comments.

In addition to CER, states in five geographic regions of the United States participate in coordinated regional review programs. Six states participate in the Mid-Atlantic Regional Review Program, ten states...
participate in the Midwest Regional Review Program, six states participate in the New England Regional Review Program, three states participate in the Southwestern Regional Review Program and eleven states participate in the Western Regional Review Program. Under these programs, a company seeking to sell securities in multiple participating states within a covered region would still file with each state but would indicate on the filing that regional review is requested. One state is then appointed as lead examiner. Similar to CER, all applicable participating states in the region forward comments on the company’s filing to the lead examiner who then incorporates all comments into one comment letter. Thus, the company will only have to respond to one comment letter per region. Regional review is only available for SCOR offerings and Regulation A offerings using Offering Circular Model A of Regulation A.

C. Marketing an Internet DPO

The success or failure of a DPO is determined by how many shares the company sells, which is directly related to how well the offering is marketed to the public. Both federal securities laws and state securities laws restrict the marketing activities with respect to securities offerings. These restrictions essentially dictate how a DPO will be marketed over the Internet with some variations depending on whether the company is relying on Rule 504 or Regulation A or is registering the offering with the SEC and at what point the company is at in the registration process.

140. Participating states are Arkansas, Oklahoma and Texas. E-mail from John Veator, NASAA to William K. Sjostrom, Jr., Adjunct Professor of Law, William Mitchell College of Law (Jan. 31, 2001, 12:08 pm) (on file with author).
143. Id.
144. Id.
145. Id.
146. Id.
1. Federal Regulation of Marketing Activities

Marketing activities for Rule 504 offerings generally are not regulated at the federal level. This is because, in adopting Rule 504 in 1982, the SEC felt that the size and, at that time, local nature of the offerings did not warrant imposing extensive federal regulation. Thus, permissible marketing activities for Rule 504 DPOs are dictated by state regulations, as discussed below. Conversely, marketing activities for Regulation A and federally registered DPOs are heavily regulated at the federal level.

Permitted marketing activities for both a federally registered DPO and a Regulation A DPO vary depending on whether the company is in the pre-filing period, waiting period or post-effective period. The pre-filing period begins when the company decides to pursue a DPO and ends when it files its registration statement or offering statement with the SEC. The waiting period begins when the company files its registration statement or offering statement with the SEC and ends when the SEC declares the offering effective/qualified. The post-effective period starts when the SEC declares the offering effective/qualified and ends when offering document delivery requirements cease.

For both federally registered and Regulation A offerings, subject to certain exceptions discussed below, under federal law it is illegal to solicit offers during the pre-filing period. The 1933 Act defines the term “offer” as “every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.” The SEC has liberally construed this definition stating that

the publication of information and statements, and publicity efforts, generally, made in advance of a proposed financing, although not couched in terms of an express offer, may in fact contribute to conditioning the public mind or arousing public interest in the [company] or in the securities of [a company] in a manner which raises a serious question whether the publicity is not in fact part of the selling effort.

147. Rule 504 does condition the use of general solicitation on state registration of the offering. See supra note 71.
149. See infra Part II.C.2.
The SEC has provided some guidance on the issue, stating that during the pre-filing period a company “should maintain communications with the public as long as the subject matter of the communications is limited to ordinary-course business and financial information” including, among other things, advertisements for the company’s products and services and press releases concerning business and financial developments.  

In light of the “ordinary-course” qualification, can a company establish a website or begin posting company information on its website in anticipation of an Internet DPO? The answer is apparently not based on a recent SEC release. The release provides that since the company will not have established a history of ordinary-course business communications through its website, “its web site content may condition the market for the offering and, due to the unfamiliarity of the marketplace with the [company] or its business, investors may be unable to view the [company’s] communications in an appropriate context while the [company] is in registration.” Additionally, the SEC believes that potential investors may have difficulty distinguishing offers to sell a company’s securities through the company’s website from “product or service promotional activities or other business or financial information.”

There are several exceptions to the federal prohibition of offers during the pre-filing period. Pursuant to Rule 135(a) under the 1933 Act, a company may notify the public, including through a website posting or other electronic means, of a proposed registered public offering provided the notification states the offering will be made only by means of a prospectus and contains only certain limited information. Regulation A also allows a company to “test the waters” through written communications, including through electronic means, and scripted radio
and television broadcasts, to investors to determine if there is any interest in the offering before spending the time and money to prepare and file an offering statement with the SEC.\textsuperscript{160} The written document or script of the broadcast must include certain specified statements and information.\textsuperscript{161} Following filing of the written communication or scripted broadcast with the SEC, the company can engage in oral communications with prospective investors.\textsuperscript{162} The company may include with its written “test the waters” materials a coupon whereby a person would indicate her interest in the offering by filling in her name, address and telephone number and sending it to the company.\textsuperscript{163} The company must discontinue use of its “test the waters” solicitation materials once the company files its offering document with the SEC.\textsuperscript{164}

As discussed above, under federal law during the waiting period of a federally registered offering, a company may orally solicit offers, distribute its preliminary prospectus and publish a “tombstone” advertisement with respect to its offering.\textsuperscript{165} However, a company may not accept an offer during the waiting period.\textsuperscript{166} Likewise, under Regulation A, a company may orally solicit offers and distribute preliminary offering circulars\textsuperscript{167} but may not accept offers during the waiting period.\textsuperscript{168} The company may also solicit investors through printed advertisements or radio and television broadcasts if they state from whom a preliminary or final offering circular may be obtained and they contain only limited

\begin{itemize}
\item [160.] 17 C.F.R. § 230.254 (2001).
\item [161.] Rule 254(b)(2) provides:
\begin{quote}
The written document or script of the broadcast shall: (i) state that no money or other consideration is being solicited, and if sent in response, will not be accepted; (ii) state that no sales of the securities will be made or commitment to purchase accepted until delivery of an offering circular that includes complete information about the [company] and the offering; (iii) state that an indication of interest made by a prospective investor involves no obligation or commitment of any kind; and (iv) identify the chief executive officer of the [company] and briefly and in general its business and products.
\end{quote}
\item [162.] Id. § 230.254(b)(2).
\item [163.] Id. § 230.254(a).
\item [164.] Id. § 230.254(c).
\item [165.] See supra note 49 and accompanying text.
\item [168.] Id. § 230.255(d)(2).
\end{itemize}
factual information about the offering. Any of the above described documents could be posted on a website or distributed through other electronic means.

Once the SEC declares a registration statement effective, the company can accept offers and can solicit offers through use of a final prospectus, supplementary selling literature that is accompanied or proceeded by a final prospectus and tombstone advertisements, but may no longer use a preliminary prospectus. Under the “envelope theory,” supplementary selling literature posted on a website would be considered as accompanied by a final prospectus if a hyperlink to the sales literature is in close proximity to a hyperlink to the final prospectus on the same website menu or the sales literature contains a hyperlink to the final prospectus. Likewise, under Regulation A, after the SEC has qualified the offering statement, the company can solicit offers through supplementary selling literature provided such literature is accompanied or proceeded by a final offering circular.

---

169. Id. § 230.251(d)(1)(ii)(C).
170. With respect to posting a tombstone advertisement, see 1995 Release, supra note 157, at 53463. With respect to posting a preliminary prospectus see example nineteen in id. and with respect to Regulation A documents, see supra note 159.
172. A “final prospectus” is a prospectus that meets the requirements of Section 10(a) of the 1933 Act. Id. §§ 77(e)(b)(1), 77j(a).
173. The basic regulatory scheme for marketing securities through supplementary selling literature is as follows: Section 5(b)(1) of the 1933 Act prohibits the use of the mails or interstate facilities to transmit any prospectus that does not meet the requirements of § 10 of the 1933 Act. 15 U.S.C. § 77e(b)(1) (2001). As mentioned in note 49 supra, Section 2(a)(10) of the 1933 Act defines “prospectus” essentially as any written offer to buy or sell a security. Id. § 77b(a)(10). However, Section 2(a)(10)(a) provides that a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under subsection (b) of section 10) shall not be deemed a prospectus if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of subsection (a) of section 10 at the time of such communication was sent or given to the person to whom the communication was made.

Id. § 77b(a)(10)(a) (citations omitted). The use of supplementary selling literature is also referred to as “free writing.” 2000 Release, supra note 153, at 25847.
175. Id. § 230.430(a).
176. 2000 Release, supra note 153, at 25847. See also example fourteen in the 1995 Release, supra note 157, at 53463.
2. State Regulation of Marketing Activities

Similar to federal regulations, permitted marketing activities under state regulations generally vary depending on whether the company is in the pre-filing, waiting, or post-effective period with respect to state registration and also vary depending on whether the offering is federally registered. In most states, no marketing activities are permitted for DPOs during the pre-filing period because offers of securities are prohibited unless the offering is registered or is exempt from registration and no exemptions are generally applicable to DPOs. Thus, even though advertisements in compliance with Rule 135(a) or the “test the waters” provisions of Regulation A are permitted during the federal pre-filing period, they generally are not allowed during state pre-filing periods.

Section 402(b)(12) of the Uniform Securities Act provides an exemption from a state’s registration requirements for any offer (but not a sale) of a security for which registration statements have been filed with the state and the SEC. This exemption would allow marketing activities in the state during the waiting period of a federally registered offering but not a Regulation A or 504 offering because neither is registered with the SEC. Some states have a similar exemption which excludes the requirement that a registration statement be filed with the SEC. In these states, marketing activities are permitted for Regulation A and Rule 504 offerings during the state registration waiting period.

States do not generally have regulations specifically governing marketing activities during the post-effective period. However, Section 403 of the Uniform Securities Act does provide that a state “may by rule or order require the filing of any prospectus, pamphlet, circular, form letter, advertisement, or other sales literature or advertising communication addressed or intended for distribution to prospective investors.” Many states require that advertisements and sales literature...
be approved by the state prior to use.\textsuperscript{188} Some require merely filing prior to use.\textsuperscript{189} Others require filing concurrently with or after use.\textsuperscript{190} Others do not require any filing.\textsuperscript{191} In light of these varying requirements, instead of researching the various states, some counsel recommend filing all literature with each relevant state on the theory that this course is easier than trying to ascertain which states require filings.\textsuperscript{192}

Since state boundaries have no impact on the accessibility of a website, and considering the blanket prohibition against offers prior to state registration, marketing a DPO over the Internet raises the issue of whether a company is offering its securities in a particular state merely because residents of that state have accessed or can access the offering document through the Web.\textsuperscript{193} The Uniform Securities Act provides that an offer is made in a state, whether or not either party is then present in the state, when the offer is directed by the offeror to the state and received at the place to which it is directed.\textsuperscript{194} A state could thus take the position that since the offering document is accessible to its residents through the Web, the company is directing offers to the state. In January 1996, NASAA adopted a resolution addressing this issue.\textsuperscript{195} As of February 2001, thirty-nine states had adopted some form of the resolution.\textsuperscript{196} The resolution

\textsuperscript{188} Id. § 403 Official Code Comment.
\textsuperscript{189} Id.
\textsuperscript{190} Id.
\textsuperscript{191} Jurisdictions that do not require any filing include the District of Columbia, Georgia, Guam, Michigan, Mississippi, Nebraska, Nevada, New Jersey, New Mexico, Ohio, Oregon, Rhode Island, Utah, and Wyoming.
\textsuperscript{192} LOSS & SELIGMAN, supra note 16, § 1-B-4 n.282.
\textsuperscript{193} In fact, since the reach of the Internet is worldwide, the marketing activities of a company conducting an Internet DPO may also raise issues under the securities laws of foreign countries. Obviously, conducting a worldwide survey of securities laws is not practical for a DPO issuer, and the risk of prosecution is likely minimal in light of jurisdictional issues and uncertainty in this area. Thus, realistically, a DPO issuer should only concern itself with the securities laws of countries in which it is specifically directing its offering. See Brian J. Lane et al., Electronic Communications and Internet Offerings, ADVANCED SECURITIES LAW WORKSHOP 101, at 127-28 (Practising Law Institute Corporate Law & Practice Handbook Series, 2000).
\textsuperscript{194} UNIF. SEC. ACT § 414(c) (amended 1988).
\textsuperscript{195} NASAA Resolution Regarding Securities Offered on the Internet, NASAA Rep. (CCH) ¶ 7040, at 7046 (Jan. 1996).
\textsuperscript{196} The thirty-nine states are Alabama, Alaska, Arizona, California, Connecticut, Delaware, Florida, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, Montana, Nebraska, Nevada, New Jersey, New Mexico, New York, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming. Internet: Exemption (for Offers) and BD/IA Advertising, Blue Sky L. Rep. (CCH) ¶ 6481, at 2581 (July 2000). There are important differences in versions passed by the states. For example in some states, including California and New York, the exemption is only available for offers that originate outside the state. Offers of Securities Mode on the Internet, 1A Blue Sky L. Rep (CCH) California, CCH Blue Sky
generally exempts Internet offers from state registration requirements where: (1) the Internet offer indicates that the securities are not being offered to residents of the state, (2) the Internet offer is not specifically directed to any person in the state, and (3) no sales of the company’s securities are made in the state as a result of the Internet offer until such time as the securities being offered have been registered.197

3. Marketing Techniques

Marketing techniques for an Internet DPO vary and often include Web-based and traditional activities. Web marketing typically includes posting the offering document on the company’s website198 and placing advertisements that include a hyperlink to the final offering document on other websites.199 Traditional activities may include running a tombstone advertisement in newspapers (which could include a Web address where the offering document could be accessed),200 telephoning individuals the company thinks may be interested in the offering and meeting with and giving presentations to potential investors.201

The 1999 DPO of VillageFax.com, based in Tustin California, provides a good example of what can be involved in marketing an Internet DPO. In 1997 VillageFax decided to change its strategy from developing fax server software to providing Web-based business-to-business fax services.202 To finance this change, VillageFax elected to undertake a DPO in an effort to raise $3.7 million in reliance on Regulation A.203 VillageFax posted a notice of its offering on the website of Direct Stock Market, Inc., a site seeking to help companies raise capital through DPOs.204 The posting did not generate any offers.205

Frustrated, in early 1999 VillageFax elevated Mason Conner, its vice president of sales, to the post of chief executive officer.206 Mr. Conner realized that “[w]e needed to get our proposal in front of people who understood our business model. We needed eyeballs, and we realized that we had to reach out and find them—and that just posting our offering on

198. See 2000 Release, supra note 153, at 25856 (example 7).
199. See 1995 Release, supra note 157, at 23463 (example 15).
200. See id. (example 19).
201. See supra note 51.
203. Id.
204. Id.
205. Id.
206. Id.
the Web wouldn’t do it.”207 Thus, Conner established a board of advisors and recruited communications industry veterans to identify likely investors and brainstorm ways to get them interested in the VillageFax offering.208 VillageFax then placed advertisements of the offering on a number of websites frequented by investors, including sites operated by Bloomberg, Yahoo and Microsoft.209 VillageFax also produced a “virtual roadshow” and made it electronically available to investors on the Direct Stock Market website.210 Additionally, VillageFax tried to create a sense of urgency to the offering by increasing the minimum investment incrementally, from $1,000 to $5,000 to $10,000 and made sure that word of these increases made it onto as many investor websites as possible.211 Through these efforts, VillageFax raised $2.3 million from some 350 investors, $1.4 million short of its goal, and spent $140,000 on the offering.212

D. Closing an Internet DPO

To facilitate closing on the sale of shares, the Web page containing the company’s offering document should include a link to a subscription agreement containing blanks for the investor to fill in with the number and dollar amount of shares he desires to purchase. The investor would then print out the subscription agreement, sign it and mail it along with a check for the shares to an escrow agent retained by the company.213 Once the escrow agent has received and deposited checks aggregating the minimum amount required to close on the offering,214 or, thereafter as directed by the company, a closing will be held, the funds will be released to the company and sale confirmations and/or stock certificates will be sent to the investors.

Under federal law, both confirmations and stock certificates for Regulation A and federally registered DPOs must be accompanied or proceeded by a final offering circular/prospectus.215 A final offering

207. Id. (quoting Conner).
208. Id.
209. Id.
210. Id.
211. Id.
212. Id.
213. Many states can and often do require that the proceeds from a DPO be held by an escrow agent pending closing on the offering. UNIF. SEC. ACT § 305(g) (amended 1988); see also LOSS & SELIGMAN, supra note 16, § 1-B-4.
214. Many states can and often do require that a company raise a specified minimum amount in a DPO before it can close. See, e.g., UNIF. SEC. ACT § 305(g) (amended 1988); see also LOSS & SELIGMAN, supra note 16, § 1-B-4 n.281. If the company fails to raise the minimum amount, it has to return the funds it was able to raise to the investors.
circular/prospectus can be delivered electronically, provided three requirements are met; notice, access and evidence of delivery.\footnote{216} The SEC has established these requirements to ensure that information distributed through electronic means would result in investors receiving substantially equivalent information as they would have received had the information been delivered to them in paper form.\footnote{217}

To meet the notice requirement, investors must receive timely and adequate notice that a document has been delivered electronically.\footnote{218} A company generally can satisfy this condition by providing an electronic document such as a computer disk, CD-ROM or e-mail.\footnote{219} However, a company cannot satisfy this condition by merely posting the document on the Web absent evidence that the investor has actually accessed the document.\footnote{220}

To meet the access requirement, the electronic delivery must provide investors with access to the document similar to the access they would have if the document were delivered to them through the mail.\footnote{221} Specifically, “the use of a particular medium should not be so burdensome that intended recipients cannot effectively access the information provided.”\footnote{222} Additionally, investors should be able to retain the document, for example by downloading or printing it, or have ongoing access equivalent to personal retention.\footnote{223} Further, the company must keep the document continually accessible on the Web during the period in which it is required to be delivered.\footnote{224}

To meet the evidence of delivery requirement, companies delivering the documents electronically must have reason to believe that the means used will actually result in delivery as required by the 1933 Act.\footnote{225} A company can accomplish this by: (1) obtaining an investor’s informed

\footnotesize{Offerings see \textit{supra} note 64 with respect to confirmations and 15 U.S.C. § 77e(b)(2) (2000) with respect to stock certificates.}

\footnote{216}{2000 Release, \textit{supra} note 153, at 25845.}
\footnote{217}{1995 Release, \textit{supra} note 157, at 53460.}
\footnote{218}{\textit{Id.}}
\footnote{219}{\textit{Id.}}
\footnote{220}{\textit{Id.}}
\footnote{221}{\textit{Id.}}
\footnote{222}{\textit{Id.} A SEC example of a burdensome medium is one where “an investor must proceed through a confusing series of ever-changing menus to access a required document so that it is not reasonable to expect that access would generally occur.” \textit{Id.} at 53460 n.24. The SEC does not view the use of portable document format (PDF) as too burdensome if the company informs recipients of the requirements necessary to download PDF documents when obtaining consent to electronic delivery, and provides recipients with any necessary software and technical assistance at no cost. See 2000 Release, \textit{supra} note 153, at 25846.}
\footnote{223}{1995 Release, \textit{supra} note 157, at 53460.}
\footnote{224}{\textit{Id.} at 53461 n.26.}
\footnote{225}{\textit{Id.} at 53461.}
226. *Id.* For a consent to be informed, the investor should be apprised (1) that information will be available through a specific electronic medium or source, (2) of the potential that the investor may incur costs (e.g., on-line time), and (3) of the period of time (which may be indefinite) and type of documents for which the consent will be effective (which can include a “global consent” with respect to all documents of a company, as provided in the 2000 Release, *supra* note 153, at 25845-46). 1995 Release, *supra* note 157, at 53461 n.29. An informed consent may be made through written, electronic or telephonic means. 2000 Release, *supra* note 153, at 25846.


228. *Id.* at 53461; *see also id.* at 53463 (example 15) and *id.* at 53465 (example 35).

229. *Id.* at 53461; *see also id.* at 53465 (examples 31, 32).

230. The subscription agreement should also advise an investor that does not have access to electronic mail or the Web not to consent. 2000 Release, *supra* note 153, at 25856 (example 3).


234. *Id.* § 78c(a)(4).
his employer’s DPO is “engaged in the business of effecting transactions in securities for the account of others” and therefore needs to register with the SEC as a broker-dealer.\textsuperscript{235} Analysis of the issue is fact specific and may include consideration of the following factors: (1) whether the individual is acting as an employee or an independent contractor; (2) whether the individual’s primary duties for the company involve something other than selling the company’s securities; (3) whether the individual receives compensation tied to selling securities; (4) whether the individual’s employment will continue beyond the end of the offering; and (5) whether the individual has previously been compensated for selling securities.\textsuperscript{236}

In an effort to provide guidance in this area, in 1985 the SEC adopted Rule 3a4-1 under the 1934 Act.\textsuperscript{237} The rule specifies a non-exclusive safe harbor under which “associated persons” of an issuer who participate in sales of that issuer’s securities will not be considered to be acting as a broker for purposes of the 1934 Act.\textsuperscript{238} Associated persons of an issuer include officers, directors and employees of the issuer or of persons controlling the issuer.\textsuperscript{239} However, in the DPO context, to fall within the safe harbor the associated person would need to meet each of the following six conditions. First, the person cannot have been barred from associating with a member of a self-regulatory organization, e.g., a brokerage house.\textsuperscript{240} Second, the person must not be a partner, officer, director or employee of a broker or dealer.\textsuperscript{241} Third, the person cannot be paid a commission or other remuneration based on sales of securities.\textsuperscript{242} Fourth, the person must primarily perform substantial duties for the company other than selling its securities.\textsuperscript{243} Fifth, the person cannot have been a broker-dealer or associated person of a broker-dealer during the preceding twelve months.\textsuperscript{244} Sixth, the person cannot have (with certain limited exceptions) participated in the sale of securities of any company during the preceding twelve months.\textsuperscript{245}

\textsuperscript{235} LOSS & SELIGMAN, supra note 16, § 8-A-2.

\textsuperscript{236} See id. at 2985 n.37 (citing Denis T. Rice, The Expanding Requirement for Registration as “Broker-Dealer” Under the Securities Exchange Act of 1934, 50 NOTRE DAME L. REV. 201, 203 (1974)).


\textsuperscript{238} Id. at 2940.

\textsuperscript{239} 17 C.F.R. §§ 240.3a4-1(a), 3a4-1(c)(1) (2000).

\textsuperscript{240} Id. § 240.3a4-1(a)(1).

\textsuperscript{241} Id. § 240.3a4-1(a)(3).

\textsuperscript{242} Id. § 240.3a4-1(a)(2).

\textsuperscript{243} Id. § 240.3a4-1(a)(4)(ii)(A).

\textsuperscript{244} Id. § 240.3a4-1(a)(4)(ii)(B).

\textsuperscript{245} Id. § 240.3a4-1(a)(4)(ii)(C).
Obviously, the rule is narrow. In particular, employees of a company that is constantly trying to raise money, which is probably more often than not the case for a company undertaking a DPO, will likely run afoul of the sixth condition. This is because the condition applies to all sales of securities, not just public offerings. Thus, if a person has solicited investors for a private offering during the preceding twelve months, that person cannot rely on the safe harbor. However, failing to fall within the safe harbor does not create a presumption that a person is a broker-dealer. A person involved in a DPO can still argue that her activities do not amount to being engaged in the business of selling securities based on her particular circumstances.

In addition, all states require the registration of broker-dealers. Like the 1934 Act, the Uniform Securities Act defines a broker-dealer as “any person engaged in the business of effecting transactions in securities for the account of others” but specifically excludes companies and agents from the definition. Thus, under the Uniform Securities Act, neither a DPO company nor its agents would have to register as broker-dealers. However, some states specifically include a company distributing its securities directly to the public without using a broker-dealer within the definition of dealer. Therefore, a company conducting a DPO in one of these states would have to register as a dealer. Registration generally involves filing an application with the state that requires various information such as the applicant’s form and place of organization, proposed method of doing business, qualifications and business history, and financial condition and history. Some states also require the partners and directors of a broker-dealer entity to pass a qualification examination.

246. Id. § 240.3a4-1(b).
247. See supra text accompanying notes 235-36. If Rule 3a4-1 is not available and the company wants to take the safe route, instead of having each employee register with the SEC, the company should form a subsidiary. All employees involved in marketing the DPO should become employees of the subsidiary, and the subsidiary should register as a broker and become a member of the National Association of Securities Dealers. This would avoid having to register the individual employees as brokers because an employee of a registered broker does not have to also register. 15 U.S.C. § 78o(a)(1) (2001). But the employees would have to take and pass the NASD Series 7 examination. See BLOOMENTHAL ET AL., supra note 45, § 26.19[1], at 1532.
248. LOSS & SELIGMAN, supra note 16, § 1-B-4.
249. UNIF. SEC. ACT § 401(c) (amended 1988).
250. LOSS & SELIGMAN, supra note 16, § 8-A-2. See, e.g., TEX. REV. CIV. STAT. art. 581-4(c) (2000) (stating that “[a]ny [company] other than a registered dealer of a security or securities, who, directly or through any person or company, other than a registered dealer, offers for sale, sells or makes sales of its own security or securities shall be deemed a dealer”).
252. LOSS & SELIGMAN, supra note 16, § 1-B-4-b(i).

254. LOSS & SELIGMAN, supra note 16, § 1-B-4.

255. The exclusions are:

an individual who represents [a company] in (1) effecting transactions in a security exempted by clause (1), (2), (3), (10), or (11) of section 402(a), (2) effecting transactions exempted by section 402(b), or (3) effecting transactions with existing employees, partners or directors of the [company] if no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state.

UNIF. SEC. ACT § 401(b) (amended 1988).

256. Id.