

Raising Capital in Kansas

If you're considering an offering of securities to raise capital for your business, the following information highlights a few alternatives and suggestions to help you comply with state and federal securities laws. There are various types of securities to consider for raising capital, but most development stage and growth companies issue equity securities, such as stock or LLC interests rather than debt securities.

Issues to Consider

As with any major business decision, it's important to research alternatives and to consider the legal and accounting requirements before offering securities to any investors (even family and friends).

You should consider the following aspects of selling part of your company to investors:

- The cost of equity capital can be expensive and issuance of debt may not be feasible.
- The regulatory requirements for securities offerings are complex.
- New investors will be “looking over your shoulder” as you manage “their” company.
- Accountability and access to high quality information will become even more important with serious consequences for errors.
- Many entrepreneurs have discovered that complying with complicated state and federal laws is not the most challenging aspect of conducting a securities offering—the process of finding appropriate investors and selling to them is very hard work!
- Officers must ordinarily offer and sell securities of small companies themselves because broker-dealers are rarely interested in underwriting small offerings, and no compensation can be paid for offering & selling unless registered as an agent.
- Before spending the time and expense, entrepreneurs should carefully determine whether securities of their company are reasonably marketable.

Regulation of Securities

Once you've decided to offer securities to new investors in your company, it is important to determine how you will comply with both state and federal securities laws and regulations. The Office of the Kansas Securities Commissioner (“KSC”) regulates securities offerings and persons who sell securities in Kansas and has been doing so since 1911 when the Kansas Legislature enacted the first securities law in the United States. Before that, many Kansans were victims of fraudulent speculative schemes that were described back then as having “no more substance than so many cubic feet of Kansas blue sky”. The Kansas law served as a nationwide model for other states and since then, all state securities laws have been referred to as “Blue Sky” laws. Many of the modern versions of Blue Sky Laws are based on a Uniform Securities Act that was developed in 2002 by the National Conference of Commissioners on Uniform State Laws, including the current laws in Kansas, Missouri and other Midwestern states.

Federal securities laws were not enacted until more than 20 years after the first Blue Sky Laws and include the Securities Act of 1933 and the Securities Exchange Act of 1934. Those federal laws are administered and enforced by the U.S. Securities and Exchange Commission (the "SEC"). Small or local securities offerings are regulated primarily at the state level, but entrepreneurs and their professional advisers must also be aware of exemption requirements and anti-fraud provisions under the federal laws.

Securities Registration or Exemption Alternatives

Public offerings involve advertising or other methods of general solicitation to attract investors and must ordinarily be registered before any offers or sales of securities. If you want to avoid the complexities and documentation requirements of registration, then you must carefully comply with the conditions for an exemption from registration.

KANSAS LIMITED OFFERING EXEMPTION

Section 17-12a202(14) of the Kansas Uniform Securities Act (KUSA) provides a self-executing exemption for private offerings if all of the following conditions are met:

- ✓ There are no more than 25 purchasers in Kansas in any 12-month period other than "institutional investors" (as defined under KUSA);
- ✓ No advertising or other general solicitation methods are used (you must know the investors through business or personal relationships);
- ✓ No commissions are paid to anyone other than a Kansas-registered broker-dealer or agent for solicitation of investors; and
- ✓ The issuer reasonably believes that all purchasers other than institutional investors are purchasing for investment purposes (rather than resales).

INVEST KANSAS EXEMPTION (IKE)

IKE is an exemption that became effective in August, 2011 in order to reduce the regulatory hurdles for small businesses and organizations based in Kansas. This exemption is intended to save entrepreneurs, especially in rural Kansas, thousands of dollars and substantial time that it takes to register an offering with KSC. The exemption is specified under Kansas Administrative Regulation 81-5-21 which was adopted by the Commissioner based on authority provided by K.S.A. 17-12a203. The most significant requirements for the exemption are:

- ✓ The issuer must be based in Kansas and organized under Kansas law by registration with the Kansas Secretary of State;
- ✓ All offers and sales must occur within Kansas to Kansas residents, and any resales within 9 months after the offering must be limited to Kansas residents;
- ✓ The aggregate offering is limited to \$1,000,000 less the amount of other securities sold within the previous 12 months;
- ✓ The investment amount per investor is limited to \$5,000 unless they qualify as an "Accredited Investor" as defined under Regulation D, Rule 501;
- ✓ The issuer must comply with SEC Rule 147 for an intrastate offering; and
- ✓ Form IKE must be filed with the KSC before use of any general solicitation to attract potential investors.

Other conditions are specified by K.A.R. 81-5-21 which should be reviewed carefully, and persons considering an IKE offering are encouraged to confer with KSC staff.

No specific form of disclosure document is required for the exemptions above. However, the exempt offerings are still subject to the anti-fraud provisions of state and federal laws. Therefore, complete and accurate information should be provided to investors. KSC staff can provide further information regarding preparation of disclosure documents.

Other exemptions from registration with limitations on the number of securities transactions or types of investors are available under KUSA and Regulations and can be explained further by KSC staff. The KUSA and Regulations are on the KSC website.

What's the SCOR?

“SCOR” refers to Small Company Offering Registration. SCOR was originally developed by state securities regulators as a simpler (but still not simple) type of registration for small business offerings. SCOR offerings are exempt from federal registration at the SEC if the issuer complies with Rule 504 under Regulation D for offerings up to \$5 million or Rule 147 for an offering within a single state where the Company is based. That intrastate offering exemption may be more difficult to comply with in the KC area. The SEC requires notice filings for exemptions under Regulation D.

SCOR provides a question-and-answer or “do-it-yourself” type of format for the disclosure document (prospectus) on Form U-7. However, we suggest a team approach to preparing the U-7 with the involvement of company owners/managers, an attorney and an independent CPA, along with assistance from KSC staff. An extensive Issuer’s Manual with explanations of SCOR is available with guidance and suggestions for preparing the Form U-7. Both the manual and Form U-7 are available on the website of the North American Securities Administrators Association, Inc. (NASAA) at: www.nasaa.org by selecting “Corporation Finance” and “SCOR Overview” under the drop-down menu for “Industry Resources”. A “Midwest Regional Review Program” (MRRP) is available which enables a uniform and coordinated review of SCOR filings in two or more of eleven Midwestern states. MRRP information is available on the KSC website at www.ksc.ks.gov by selecting “Registration of Securities” and “Registration by Qualification” under the drop-down menu for “Capital Formation” on the homepage.

NOTE: This brief overview does not include a thorough explanation of all regulatory requirements for offering securities, and it does not constitute legal or financial advice. You should consult with a securities attorney and contact KSC staff when planning a securities offering in Kansas.

Other Securities and Business Information Links

North American Securities Administrators Association at: www.nasaa.org

Coordinated Review Program at: www.coordinatedreview.org

SEC Information for Small Businesses at: <http://www.sec.gov/info/smallbus.shtml>