

NOTICES OF EXEMPT RULEMAKING

The Administrative Procedure Act requires the *Register* publication of the rules adopted by the state's agencies under an exemption from all or part of the Administrative Procedure Act. Some of these rules are exempted by A.R.S. § 41-1005 or 41-1057; other rules are exempted by other statutes; rules of the Corporation Commission are exempt from Attorney General review pursuant to a court decision as determined by the Corporation Commission.

NOTICE OF EXEMPT RULEMAKING

TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS; SECURITIES REGULATION

CHAPTER 4. CORPORATION COMMISSION SECURITIES

PREAMBLE

- Sections Affected** **Rulemaking Action**
R14-4-140 New Section
- The specific authority for the rulemaking, including both the authorizing statute (general) and the statutes the rules are implementing (specific):**
Authorizing statute: A.R.S. §§ 44-1821(A) and 44-1845(B)(1)
Implementing statute: A.R.S. § 44-1845(B)(1)
Constitutional authority: Arizona Constitution Article 15, §§ 4, 6, and 13
- The effective date of the rule:**
August 14, 1995
- A list of all previous notices appearing in the Register addressing the exempt rule:**
Notice of Rulemaking Docket Opening:

<u>1</u>	<u>A.A.R.</u>	<u>170</u>	<u>March 10, 1995</u>
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Notice of Proposed Rulemaking:

<u>1</u>	<u>A.A.R.</u>	<u>418</u>	<u>May 5, 1995</u>
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- The name and address of agency personnel with whom persons may communicate regarding the rulemaking:**
Name: Richard M. Weinroth, General Counsel
Address: Corporation Commission, Securities Division
1300 West Washington, Third Floor
Phoenix, Arizona 85007
Telephone: (602) 542-4242
Fax: (602) 542-3583
- An explanation of the rule, including the agency's reasons for initiating the rule, including the statutory citation to the exemption from the regular rulemaking process:**

R14-4-140 (the "rule") provides an exemption from the registration requirements of A.R.S. §§ 44-1841 and 44-1842. The rule will allow issuers who rely on federal Rule 504 of Regulation D under the Securities Act of 1933 ("Rule 504") to offer and sell up to \$1 million of securities during any 12-month period to accredited investors, as defined in R14-4-126, provided certain conditions are met. The rule also provides an exemption under certain circumstances for resales of securities issued in compliance with the rule.

For an issuer to take advantage of the rule, the sale of securities may not exceed \$1 million in any 12-month period. In addition, the offers of securities must specify that sales will be made only to accredited investors, and sales of securities must be made exclusively to accredited investors. Since initial sales of securities can only be made to accredited investors, the only specific information required to be furnished by the issuer to investors is a warning legend specified by the rule. Accredited investors generally include certain types of institutional investors and individuals with substantial net worths or substantial incomes as defined in R14-4-126. Certain issuers are ineligible to use the rule. Under the rule, the issuer may not be a development stage company with no business plan or a plan to engage in a merger or acquisition of an unidentified entity. Moreover, under Rule 504, the issuer may not be subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 and may not be an investment company under the Investment Company Act of 1940. Additionally, the issuer, or any of its predecessors, affiliates, directors, officers, general partners, or beneficial owners of 10% or more of any class of its equity securities, or any underwriter of the securities, cannot fall within the disqualification provisions of A.R.S. § 44-1901(G)(1) through (6).

There are very detailed and specific steps that an issuer must follow to avail itself of the exemption provided in the rule. Issuers must file any offering documents with the Commission at least ten business days in advance of any sales of securities. Advertisements must be filed with the Commission at least five business days prior to use. The offering documents or subscription agreements must contain a legend warning that the securities may only be sold to accredited investors. The certificate representing the security issued in accordance with the rule must have a similar legend. The rule also requires the issuer to provide an opinion of counsel as to the validity of the issuance of the securities. In addition, the rule requires the issuer to file with the Commission a copy of the initial Form D filed

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with the SEC pursuant to Rule 504. Finally, within 30 business days following the completion of any offering of securities, at least two officers, partners, or authorized persons of the issuer must file with the Commission a certificate stating that, after making a reasonable investigation, they believe that the issuer has complied with the conditions of the rule.

Unless registered under the Arizona Securities Act, resales of securities issued in accordance with the rule are limited in Arizona to accredited investors for the earlier of a three-year period or until the issuer completes a public offering or registration of its securities. Advertisements must specify that such resales in Arizona are limited to accredited investors.

If any offer, sale, or resale fails to comply with the conditions of the rule, it may be an unregistered, unlawful offer or sale. Civil and administrative liabilities may attach under the Arizona Securities Act. In addition, the Director of Securities may revoke the availability of the rule with respect to a particular issuer, seller, or transaction if the Director determines that there is a reasonable likelihood that the sale of the securities would work or tend to work a fraud or deceit upon the purchasers thereof. If the Director makes such a determination, the seller of the securities may request a hearing in accordance with the provisions of Article 11 of the Arizona Securities Act.

The purpose of the rule is to aid small businesses by providing a new and significant alternative for issuers employing Rule 504. Thus, the rule is intended to stimulate capital formation and promote economic growth.

The rule is exempt from the Governor's Regulatory Review Council pursuant to A.R.S. § 41-1057. The rule is exempt from Attorney General certification pursuant to the Arizona Constitution Article 15, §§ 4, 6, and 13, and State ex rel. Corbin v. Arizona Corporation Commission, 174 Ariz. 216, 848 P.2d 301 (App. 1992).

7. A showing of good cause why the rule is necessary to promote a statewide interest if the rule will diminish a previous grant of authority of a political subdivision of this state:

The rule is desirable to assist small businesses in capital formation in a manner which does not impose unnecessary expenses. The rule significantly benefits issuers by allowing them to seek capital from accredited investors in a significantly more cost-effective manner than with an offering of securities registered under Article 6 or 7 of the Arizona Securities Act. At the same time, since initial offers and sales of securities are limited to accredited investors, the risk of substantial harm to the general investing public is limited. Moreover, the Commission retains anti-fraud jurisdiction over any offering under the rule. Thus, the significant statewide interest in promoting capital formation for small businesses should be advanced without any significant loss of authority to the Commission.

8. The summary of the economic, small business and consumer impact:

Pursuant to A.R.S. § 41-1055(D)(3), the agency is exempt from providing an economic, small business, and consumer impact statement.

9. A description of the changes between the proposed rules, including supplemental notices, and final rules (if applicable):

Not applicable.

10. A summary of the principal comments and the agency response to them:

A number of members of the State Bar of Arizona and the business community submitted written comments regarding R14-4-140. Two members of the State Bar of Arizona attended the hearing on R14-4-140 on June 20, 1995. All of the comments received by the Commission, both in writing and at the hearing, have been supportive of the rule. In particular, the letters noted that the flexibility of disclosure requirements to accredited investors was appropriate and that R14-4-140 should aid capital formation by minimizing the costs of offerings to accredited investors. In addition, the comments noted that, since a valid legal opinion was required, an attorney must be involved in a R14-4-140 offering and this increased the likelihood of compliance with the securities laws. The Commission has not received any comments in opposition to R14-4-140. The Commission made no changes to the rule in response to comments received.

11. Any other matters prescribed by statute that are applicable to the specific agency or to any specific rule or class of rules:

None.

12. Incorporations by reference and their location in the rules:

Form D of Regulation D (17 CFR 239.500 (1994)) and Rule 504 of Regulation D (17 CFR 230.504 (1994)) promulgated by the Securities and Exchange Commission under the Securities Act of 1933, are located in subsections (A)(3) and (A)(4), respectively, of the rule. The Code of Federal Regulations (CFR) is published by the Office of the Federal Register and is available from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.

13. Was this rule previously adopted as an emergency rule?:

No.

14. The full text of the rules follows:

TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS; SECURITIES REGULATION

CHAPTER 4. CORPORATION COMMISSION SECURITIES

ARTICLE 1. IN GENERAL RELATING TO THE ARIZONA SECURITIES ACT

Section R14-4-140. Exempt Public Offerings to Accredited Investors

ARTICLE 1. IN GENERAL RELATING TO THE ARIZONA SECURITIES ACT

R14-4-140. Exempt Public Offerings to Accredited Investors

A. Definitions and terms. As used in this rule, the following terms shall have the meaning indicated:

- 1. "Accredited investor" shall have the meaning provided in R14-4-126.
2. "Business Day" shall mean any day other than a Saturday, Sunday, or day which is a legal holiday in the state of Arizona.
3. "Form D" shall mean Form D of Regulation D (17 CFR 239.500(1994)) promulgated by the SEC under the Securities Act of 1933, which is incorporated by reference and is on file with the Office of the Secretary of State.

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4. "Rule 504" shall mean Rule 504 of Regulation D (17 CFR 230.504 (1994)) promulgated by the SEC under the Securities Act of 1933, which is incorporated herein by reference and is on file with the Office of the Secretary of State.
 5. "Securities Act" shall mean the Arizona Securities Act.
 6. "SEC" shall mean the United States Securities and Exchange Commission.
- B.** Initial offers and sales of securities by an issuer in reliance on Rule 504 shall be exempt from the registration requirements of A.R.S. §§ 44-1841 and 44-1842, subject to the satisfaction of all of the following conditions:
1. The exemption from A.R.S. § 44-1842 shall be available for offers of an issuer made only by its employees, officers, and directors who were not retained for the primary purpose of making offers on behalf of the issuer and shall not be available for third parties or dealers retained by an issuer in connection with offers of the issuer.
 2. The sale of securities shall not exceed \$1,000,000 in any 12-month period.
 3. The issuer shall not be a development stage company with no specific business plan or purpose or a development stage company that has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person.
 4. Offers of securities must specify that sales shall be made only to accredited investors. Sales of securities shall be made exclusively to accredited investors.
 5. Any prospectus, offering memorandum, subscription documents, or other offering documents used in connection with the offer or sale of securities shall be filed with the Commission at least ten business days prior to the initial sale of securities.
 6. An opinion of counsel as to the validity of the issuance of the securities and the filing fee required by A.R.S. § 44-1861(E) shall be filed with the Commission at least ten business days prior to the initial sale of securities.
 7. Any advertisement, communication, or sales literature of any kind, published, either manually or electronically, exhibited, or broadcast for radio or television must specify that sales shall be made only to accredited investors and shall be filed with the Commission at least five business days prior to the use thereof. All radio and television broadcasts must be scripted and all such scripts and a videotape of all scripted television broadcasts must be submitted to the Commission within the requisite time period.
 8. The following legend shall be set forth on the cover page of any offering documents, or any subscription documents if there are no other offering documents, printed in capital letters in bold-face Roman type at least as large as ten-point modern type and at least two points leaded:
"SUBJECT TO THE PROVISIONS OF ARIZONA ADMINISTRATIVE CODE R14-4-140, THESE SECURITIES MAY BE OFFERED AND SOLD BY THE ISSUER ONLY TO ACCREDITED INVESTORS AS DEFINED IN ARIZONA ADMINISTRATIVE CODE R14-4-126 AND MAY BE RE-OFFERED AND SOLD WITHIN ARIZONA FOR A THREE-YEAR PERIOD ONLY TO ACCREDITED INVESTORS. THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY
- THE SECURITIES AND EXCHANGE COMMISSION OR THE ARIZONA CORPORATION COMMISSION, NOR HAVE THEY PASSED UPON THE MERITS OF OR OTHERWISE APPROVED THIS OFFERING. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE."
9. The first sentence of the legend required by subsection (B)(8) shall be conspicuously set forth on the front of any certificate that represents a security issued or resold in accordance with this rule. Any certificate legend shall no longer be required upon the termination of any resale restrictions in accordance with subsection (F).
 10. A copy of any initial Form D required to be filed with the SEC shall be filed with the Commission within ten business days after filing the Form D with the SEC.
 11. At the time of sale, the issuer, or any of its predecessors, affiliates, directors, officers, general partners, or beneficial owners of 10% or more of any class of its equity securities, or any underwriter of the securities shall not fall within the disqualifications of A.R.S. § 44-1901(G)(1) through (6).
 12. No later than 30 business days following the completion of any offering of securities, the issuer shall file with the Commission a certificate, signed by at least two of its authorized officers, partners, or other authorized persons, stating that such authorized officers, partners, or other authorized persons, in their official capacities for the issuer and after undertaking a reasonable investigation, believe that the issuer has complied with all of the requirements of subsection (B).
- C.** The Director may, in the Director's discretion, waive any disqualification caused by subsection (B)(11).
- D.** Any disqualification caused by subsection (B)(11) shall cease to exist if any of the following occurs:
1. The basis for the disqualification has been removed by the jurisdiction creating it.
 2. The jurisdiction in which the disqualifying event occurred issues a written waiver of the disqualification.
 3. The jurisdiction in which the disqualifying event occurred declines in writing to enforce the disqualification.
- E.** Except for re-offers and resales registered under Articles 6 or 7 of the Securities Act, re-offers and resales of securities issued in accordance with subsection (B) shall be made in Arizona exclusively in accordance with subsection (E). Such re-offers and resales shall be exempt from the registration requirements of A.R.S. §§ 44-1841 and 44-1842, subject to satisfaction of all of the following conditions:
1. Re-offers of securities must specify that resales within Arizona shall be made only to accredited investors. Resales of securities within Arizona shall be made exclusively to accredited investors.
 2. The seller of securities shall reasonably believe that the initial sale of securities complied with subsection (B). A reasonable belief may be based on the certificate of the issuer filed in accordance with subsection (B)(12), provided that the seller of the securities did not know and in the exercise of reasonable care could not have known of any material misstatement or omission in such certificate.
 3. Any advertisement, communication, or sales literature of any kind, published, either manually or electronically, exhibited, or broadcast for radio or television must

specify that resales shall be made only to accredited investors.

F. Any restrictions on re-offers or resales of securities imposed by subsection (E) shall terminate upon the earlier of:

1. Three years after the date of the filing of the certificate of the issuer required by subsection (B)(12);

2. The registration, with the Commission under Articles 6 or 7 of the Securities Act or with the SEC under the Securities Act of 1933 or the Securities Exchange Act of 1934, of all or part of the same class of securities or any other class of the issuer's securities junior in rank to such class of securities.

G. The Director may revoke the availability of subsection (B) or (E) prior to any particular sale of securities under such subsections with respect to a particular issuer, seller, or transaction if the Director determines that there is a reasonable likelihood that the sale of the securities would work or tend to work a fraud or deceit upon the purchasers thereof. In the event the Director makes such a determination, the seller

of the securities may request a hearing in accordance with the provisions of Article 11 of the Securities Act by notifying the Commission within ten days after notice of the Director's determination described in this subsection (G).

H. No action or inaction on the part of the Commission or the Director with respect to any offer or sale of securities undertaken pursuant to this rule shall be deemed to be a waiver of any condition of this rule nor shall it be deemed to be a confirmation by the Commission of the availability of this rule or the approval of any offering.

Note. No specific information is required to be furnished to purchasers other than the legend required by subsection (B)(8). However, in view of the anti-fraud provisions of federal securities laws and the Securities Act, issuers of securities should consider carefully the advisability of written disclosure of all material information and risks respecting the securities being offered to investors.