

LIMITED AND PRIVATE OFFERING EXEMPTIONS  
UNDER TEXAS SECURITIES LAW

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- I. Introduction.** The Texas Securities Act (“Act”) and the Rules and Regulations of the State Securities Board (“Rules”) are available on the Texas State Securities Board web site ([www.ssb.state.tx.us](http://www.ssb.state.tx.us)) or for purchase from the Agency at:

Texas State Securities Board  
P.O. Box 13167  
Austin, Texas 78711-3167  
512/305-8300 (voice)  
512/305-8310 (facsimile)  
[www.ssb.state.tx.us](http://www.ssb.state.tx.us)

- II. Overview of Exemptions and Exemptive Authority.** Six separate, but related, provisions of the Act and the rules adopted by the State Securities Board (“Board”) provide exemptions from securities registration for issuers engaged in limited offerings in Texas: Sections 5.I(a), 5.I(c) and 5.Q of the Act, and Rules 109.13(k), 109.13(l) and 109.14(c). Sections 5.I and 5.Q of the Act are also interpreted in Rules 109.13(a)-(j), and 109.14(a)-(b), respectively. Additionally, the National Securities Markets Improvement Act of 1996 (“NSMIA”), Public Law 104-290, enacted by the 104th Congress, created an exemption from state registration for offerings of “covered securities.”

- A. Private offerings.** Section 5.I(a) of the Act exempts sales by issuers made without public solicitation or advertisements so long as the total number of security holders does not exceed 35. Section 5.I(c) permits sales to 15 persons in a 12-month period, in addition to sales made pursuant to registered offerings or pursuant to other exemptions contained in the Act, other than Section 5.I(a) and (b), Rule 109.13(k) and (l), and, for oil and gas offerings, Section 5.Q, Rule 109.14(a)-(b) and Rule 109.14(c).

- 1. History.** These exemptions have developed over the years through Board interpretation by rule, and, to a lesser extent, court cases. Initially, these exemptions were available to small entrepreneurs who raised capital from close personal friends, relatives, and business associates. Eventually, the concept of the “sophisticated investor” changed the character of the exemptions and dispensed with the need for the issuer to have a special relationship with the purchaser.
- 2. Agency interpretation by rule.** Rules 109.13(a)-(e) and (h)-(j) define the terms and concepts used in Section 5.I(a) and (c). These provisions are described in more detail in Part III.A of this Outline.

**B. Intrastate offerings.** Rule 109.13(l), the Intrastate Limited Offering Exemption, was adopted pursuant to the authority vested in the Board by Section 5.T of the Act. The rule provides an exemption from the securities registration requirements of the Act for any offer or sale of any securities by the issuer itself or by a registered dealer acting on the issuer's behalf, provided all offers and sales are made pursuant to an offering made and completed solely within Texas. The rule is self-contained for ease of use by oil and gas operators who have no need to refer to federal law for their Texas-only offerings.

**1. Additional requirements.** Some of the significant conditions of the exemption follow.

**a. Public solicitation prohibited.** The use of public solicitation or advertisements is prohibited.

**b. Who may purchase.** Sales may be made to not more than 35 new security holders who are well-informed and sophisticated or who are well-informed and have a relationship with the issuer. Sales also may be made to other well-informed investors who are "accredited investors" as defined in Rule 109.13(l)(11). The definition of "accredited investor" in Rule 109.13(l)(11) differs from that set forth in Rule 501 of the Securities and Exchange Commission's ("SEC") Regulation D and incorporated in Rule 109.13(k), the Uniform Limited Offering Exemption; the Rule 109.13(l) definition is patterned after a predecessor version of SEC Rule 501. The retention of this self-contained definition better serves nonlawyers who avail themselves of the exemption.

**c. Disqualifications.** Neither the issuer nor the registered dealer (as those terms are defined in Rule 109.13(l)(4)) may:

1. currently be subject to any administrative order issued by state or federal authorities within five years of the expected offer and sale of securities in reliance on the exemption, if the order:

A. is based on a finding that such person engaged in fraudulent conduct; or

B. has the effect of enjoining such person from activities subject to federal or state statutes designed to protect investors or consumers against unlawful or deceptive practices involving securities, insurance, commodities or commodity futures, real estate, franchises, business opportunities, consumer goods, or other goods and services;

2. have been convicted within five years prior to commencement of the offering of any felony or misdemeanor of which fraud is an essential element, or which is a violation of the securities laws or regulations of Texas or of any other state of the United States, or of the United States, or any foreign jurisdiction; or which is a crime involving moral turpitude; or which is a criminal violation of statutes designed to protect consumers against unlawful practices involving insurance, securities, commodities or commodity futures, real estate, franchises, business opportunities, consumer goods, or other goods and services; or
  3. be subject to any order, judgment, or decree entered within five years prior to commencement of the offering by any court of competent jurisdiction which temporarily or permanently restrains or enjoins such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or involving any false filing with any state; or which restrains or enjoins such person from activities subject to federal or state statutes designed to protect consumers against unlawful or deceptive practices involving insurance, commodities or commodity futures, real estate, franchises, business opportunities, consumer goods, or other goods and services.
- d. Filing.** A filing is required under Rule 109.13(l) only if sales are made, other than by and through a dealer registered in Texas, to investors in those classes of accredited investors which may include natural persons as opposed to only businesses. The filing must be made on Form 133.29. A filing fee of one-tenth of 1.0% of the aggregate amount of securities described as being offered for sale, but in no case more than \$500, must accompany the filing.
- 2. Effect of the rule.** The rule permits sales to be made on an intrastate basis to an unlimited number of accredited investors who do not have to be “counted” in the 35 limitation on nonaccredited investors. The requirements of Rule 109.13(a)-(j) must be met. For a discussion of those provisions, see Part III.A of this Outline.
- C. Interstate offerings.** Rule 109.13(k), the Uniform Limited Offering Exemption (“ULOE”), was adopted by the Board in 1985. Formulated by the North American Securities Administrators Association (“NASAA”) in conjunction with the SEC and the American Bar Association (“ABA”), ULOE represents a uniform approach to limited offerings. ULOE is, in essence, a state law addendum to SEC Regulation D that adds requirements not found in the federal exemption. The primary focus of ULOE was on Rule 505 offerings. Many states, however, have

included Rule 506 offerings within their ULOE exemption as well. ULOE is static; it is tied to specific SEC releases, thereby giving the states an opportunity to accept or reject future changes to SEC Regulation D. ULOE is set out at Rule 109.13(k) of the Board's rules and is discussed in more detail in Part III.C of this Outline.

**D. Oil and gas limited offerings.** The sale of fractional interests in oil and gas leases has been, and continues to be, a large segment of exempt offerings in Texas. Section 5.Q of the Act exempts the sale of such interests if the total number of sales by any one owner of those interests does not exceed 35 within a period of 12 consecutive months and no use is made of advertisements or public solicitation.

1. **Agency interpretation by rule.** To a large extent, Section 5.Q is interpreted in a manner similar to Section 5.I. Indeed, Rule 109.14(a) states that Rule 109.13(a)-(c) and (j) apply to Section 5.Q transactions. Thus, the terms defined in Rule 109.13(a)-(c) and (j) have the same meanings for purposes of Section 5.Q as they do for Section 5.I. For a discussion of Rule 109.13(a)-(c) and (j), see Part III.A of this Outline.

2. **Who may sell.** Rather than using the term "issuer" as does Section 5.I, Section 5.Q uses the term "owner." Section 5.Q also provides that if sales are made by an agent for such owner or owners, such agent shall be licensed pursuant to the Act. Registration of such agents is necessary because they are acting on their own behalf, as paid sales personnel engaged in sales activity, rather than acting on behalf of the owner. By rule, however, the Board has clarified that certain employees of the owner are not required to be registered under the Act. An employee of an owner may, without being registered, assist the owner in selling interests in an oil, gas, or mineral lease, fee, or title if:

- a. the employee was not hired for the purpose of offering or selling such securities;
- b. the employee's activity involving the offer and sale of such securities is strictly incidental to the employee's bona fide primary nonsecurities related work duties; and
- c. the employee's compensation is based solely on the performance of nonsecurities related work duties; *i.e.*, the employee does not receive any compensation for offering for sale, selling, or otherwise aiding in the sale of securities.

3. **Rule 109.14(c).** Rule 109.14(c), adopted by the Board pursuant to Section 5.T of the Act, serves as a bridge between Section 5.Q and Rule 109.13(k) and (l), giving Section 5.Q the same relationship to Rule 109.13(k) and (l) as has Section 5.I. Thus, as Rule 109.14(c) itself states, its purpose is "to

provide a mechanism which will allow for sales of [oil and gas interests] to accredited investors” if the conditions of Rule 109.13(k) or (l) are met.

- E. **Federal covered securities.** The National Securities Markets Improvement Act of 1996 (“NSMIA”), Public Law 104-290, created a new category of classification for securities -- a covered security. The treatment of the various types of federal covered securities is discussed in greater detail in the author’s paper presented in 1999 at the 21st Annual Conference on Securities Regulation and Business Law Problems.

### III. Texas Exemptions Compatible with SEC Regulation D.

- A. **SEC Rule 504 and Section 5.I private offerings.** As one commentator has stated, the SEC “defers to the states for regulation of offerings meeting the conditions of Rule 504. Both the [SEC] and NASAA have concluded that greater emphasis on state blue sky laws is appropriate for Rule 504 transactions in view of (1) the small amount of the offering and (2) the likelihood that Rule 504 sales will occur in a limited geographic area.” Hicks, *Limited Offering Exemptions: Regulation D* §1:23 (Thomson West 2004-2005 ed.) (citations omitted). Accordingly, the Texas version of ULOE does not encompass SEC Rule 504 and issuers must look to other exemptions or register securities offered pursuant to the rule. In 1999 the SEC significantly changed Rule 504. In its current form, there are restrictions on transferability of the securities purchased under the rule and general advertising and general solicitation are prohibited, except in very limited circumstances set out in Part III.B of this Outline. Persons seeking to rely on SEC Rule 504 at the federal level in connection with interstate offerings are often able to rely on the private offering exemptions set forth in Section 5.I(a) and (c) of the Act. There is no filing requirement for use of these exemptions; they are self-executing. Significant aspects of Section 5.I(a) and (c) follow.

#### 1. Manner of sale.

- a. **Public solicitation prohibited.** Section 5.I(a) and (c) prohibit the use of public solicitation or advertisements. Similarly, SEC Rule 504 also contains a prohibition against general solicitation and general advertising. Indiscriminate offers to persons who do not fall within the classes of purchasers described in Rule 109.13(a) also will render the exemptions unavailable. This prohibition against indiscriminate offers encompasses the practices of mass mailings, cold calls, and other mass or random solicitations. Similarly, it is safe to assume that any pronouncement designed to reach the public generally, indicating that securities are for sale, will be regarded as advertising. Under Rule 109.13(b), controlled disseminations to prospective investors of the type of material through which persons may become “well-informed” do not constitute advertisements.

- b. Who may sell.** The exemption provided by Section 5.I is available to issuers. The staff takes the position that the exemption is available even if certain officers and/or directors engaged in the daily decision-making of the issuer make offers and sales without being registered, on the theory that the “issuer” can act only through individuals. These officers and/or directors may not receive any special remuneration for selling because they then cannot be said to be acting on behalf of the issuer, but rather on their own behalf as paid sales personnel engaged in sales activity. Other persons offering and selling the securities, regardless of the payment of commissions, will be “dealers” or “agents” who must be registered.
- c. Who may purchase.** Only those persons described in Rule 109.13(a) may purchase securities offered as part of a transaction exempt under either Section 5.I(a) or (c). The purchaser must be either well-informed and sophisticated or well-informed and have a relationship with the issuer or its principals, executive officers, or directors, evincing trust between the parties. The following factors should be considered in determining who is sophisticated:
1. the investor’s financial capacity -- the amount invested must not be material when compared with the investor’s total financial capacity. If the amount invested is not more than 20% of the investor’s net worth, the amount will be presumed not to be material;
  2. the investor’s knowledge of finance, securities, and investments generally; and
  3. the investor’s experience and skill in investments, based on actual participation.
- d. Well-informed purchasers.** Purchasers must receive adequate disclosure to make a well-informed investment decision. The requirement that investors be well informed may be satisfied through full and factual disclosure of the following:
1. the issuer’s plan of business;
  2. the issuer’s history;
  3. financial statements of the issuer; and
  4. other material facts necessary to make the statements made, in light of the circumstances under which they are made, not misleading.

e. **Purchaser representatives.** The factors specified in Part III.A.1.c.2 and c.3 of this Outline may be met by the purchaser’s representative. The conditions placed on a purchaser representative under Rule 109.13(a)(2) are somewhat different from those of SEC Regulation D. Thus, for example, while Regulation D requires only disclosure of most material relationships between the purchaser representative and the issuer, the Texas rule relating to Section 5.I(a) and (c) requires that the purchaser representative:

1. have no business relationship with the issuer;
2. represent only the investor and not the issuer; and
3. be compensated only by the investor.

2. **Number of “persons” or “security holders.”**

a. **Section 5.I(a).** Section 5.I(a) exempts sales by issuers, so long as the total number of *security holders* does not exceed 35. It does not matter how or where persons become security holders; all security holders, regardless of where they are domiciled, must be included in the count to 35. Sales made pursuant to almost all other exemptions contained in the Act and Board rules count toward the total. However, a sale to an accredited investor who becomes a security holder under Rule 109.13(l) would not count toward the total number of security holders for purposes of Section 5.I(a).

b. **Section 5.I(c).** Section 5.I(c) permits sales to not more than 15 *persons* in any 12 month period. Excluded from the 15 person limitation are sales made pursuant to a registered offering and/or any other exemption contained in the Act and Board rules, other than Section 5.I(a) and Rule 109.13(k) and (l) (for oil and gas offerings, see Part II.D of this Outline). For example, Rule 139.7 exempts from the securities registration provisions of the Act, offers and sales made by an issuer and its selling agents to non-Texas residents not present in Texas when the offer is made. Consequently, sales to non-Texas residents made in compliance with Rule 139.7 need not be counted in determining the number of purchasers for purposes of Section 5.I(c). To calculate the allowable number, the issuer must count the number of all sales made within one year before the date of the proposed sale in reliance on exemptions, listed above, which are exclusive by their own terms. Assuming the other conditions of the exemption are met, if the number is less than 15, the sale may be made in reliance on Section 5.I(c).

- c. Counting.** Not all persons are counted as “security holders” or “persons” for purposes of Section 5.I(a) and (c). Rule 109.13(c) contains various guidelines for determining who is counted as one or more purchaser(s) or security holder(s). Thus, Rule 109.13(c) provides that two or more persons or entities count as only one security holder or person when, for example, the persons reside in the same home and are related to either the security holder or his or her spouse. Under Rule 109.13(h), a noncontributory employees’ stock ownership plan or employees’ stock ownership trust that holds securities of the employer company for the benefit of that company’s employees is counted as one security holder. Employee participants in such a plan or trust are not deemed security holders of the employer company for counting purposes solely because of their participation in the plan or trust. However, employee participants receiving distributions of securities from the plan or trust will be deemed security holders of the employer on receipt of securities of the employer from the plan or trust.
- 3. Investment intent.** Purchasers under 5.I(a) and (c) must acquire securities as an investment for their own account and not for distribution. Accordingly, the issuer must exercise reasonable care to assure the purchasers’ investment intent. Rule 109.13(j) sets out certain actions indicative of such reasonable care. Thus, for example, the rule states that reasonable care should include, but not be limited to, the following:
- a. making reasonable inquiry to determine if the purchaser is acquiring the securities for his or her own account or on behalf of other persons;
  - b. placing a legend on the document evidencing the securities to the effect that the securities have not been registered and setting forth or referring to the restrictions on transferability and sale of the securities;
  - c. issuing stop transfer instructions to the issuer’s transfer agent, if any, with respect to the securities, or, if the issuer transfers its own securities, making a notation in the appropriate records of the issuer;
  - d. obtaining from the purchaser a signed, written agreement to the effect that the securities will not be sold without registration under applicable securities laws or exemptions therefrom; and
  - e. disclosing in writing, prior to sale, that the purchaser must bear the economic risk of the investment for an indefinite period of time because the securities have not been registered and therefore cannot be sold unless they are subsequently registered or an exemption from

registration is available and that the securities are subject to the limitations set forth in (b)-(d) above.

**B. SEC Rule 504 and public offerings.** Although generally securities issued under Rule 504 may not be marketed using general solicitation or general advertising, if any of three conditions are met, the issuer may use general solicitation and advertising and the securities received by purchasers in such an offering will be unrestricted.

- 1. Registered with a prospectus.** The first situation occurs when the issuer registers its offering in a state that requires it to file a registration statement and to deliver a prospectus to investors before sale. The Board has recommended that Form U-7 be used in Texas for making small public offerings pursuant to Section 7.A of the Act. Form U-7, a uniform form for Small Company Offerings Registration (“SCOR”), devised by NASAA in collaboration with the ABA, is a simplified, uniform disclosure document using a question and answer format. Agency staff are available to assist issuers with questions pertaining to SCOR. Certain issuers who propose to use Form U-7 to register small business offerings may be permitted to submit reviewed, rather than audited, financial statements if the criteria set forth in Rule 113.5(b)-(e) are satisfied.
- 2. Register and disclose elsewhere.** The second situation occurs when the issuer wishes to register and sell its securities in a state that requires registration and disclosure delivery and also sell its securities in a state without those requirements, as long as the issuer provides investors with the prospectus that is required by the state where the securities are registered.
- 3. Utilize state accredited investor exemption.** The final situation is presented when the issuer sells its securities exclusively according to state law exemptions that permit general solicitation and advertising, as long as it sells only to accredited investors. In Release No. 33-7644, effective April 7, 1999, the SEC gave the NASAA model accredited investor exemption (adopted in Texas as Rule 139.19) as an example of this kind of state exemption. Presumably, Rules 139.16 and 109.3 and Section 5.H of the Act would also meet this criteria.
  - a. Individual accredited investor exemption.** Rule 139.16, adopted in 1995, exempts from the securities registration requirements of the Act, the sale of securities, by the issuer itself or by a registered dealer, to individual accredited investors. The rule was adopted by the Board as part of its continuing effort to facilitate small business capital formation. The salient features of the rule are provisions concerning who may sell, who may purchase, when and how a seller may advertise, and when and how a seller may use other exemptions after using the rule. Although the rule is designed to stand alone, it

coordinates with a variety of exemptions on the federal level. It will likely be used most often in conjunction with SEC Rule 504. (There is a certain degree of overlap between this exemption and the new uniform accredited investor exemption discussed in Part III.B.3.b of this Outline.)

1. **Who may sell.** The issuer itself or a registered dealer may offer and sell securities pursuant to Rule 139.16. For purposes of the rule, an issuer does not have to register as a dealer to make sales. The term “issuer” includes directors, officers, or employees of an issuer provided all the following conditions are satisfied:
  - A. the director, officer, or employee was not hired for the purpose of offering or selling such securities;
  - B. the director’s, officer’s, or employee’s activity involving the offer and sale of such securities is strictly incidental to his or her bona fide primary nonsecurities related work duties; and
  - C. the director’s, officer’s, or employee’s compensation is based solely on the performance of other such duties; *i.e.*, the director, officer, or employee does not receive any compensation for offering for sale, selling, or otherwise aiding in the sale of securities.
  
2. **Disqualifications.** Certain “bad person” issuers and registered dealers are disqualified from using the exemption. The “bad person” disqualification provisions are similar to, but narrower than, those contained in ULOE. Under the rule, no exemption is available for the securities of any issuer if the issuer or registered dealer:
  - A. within the last five years, has filed a registration statement which is the subject of a currently effective registration stop order entered by the SEC or any state securities administrator;
  - B. within the last five years, has been convicted of any felony in connection with the offer, purchase, or sale of any security or any felony involving fraud or deceit;
  - C. is currently subject to any state or federal administrative enforcement order, entered within the

last five years, finding fraud or deceit in connection with the purchase and sale of any security; or

- D. is currently subject to any order, judgment, or decree of any court of competent jurisdiction, entered within the last five years, permanently restraining or enjoining such party from engaging in or continuing to engage in any conduct or practice involving fraud or deceit in connection with the purchase and sale of any security.

**3. Exceptions from disqualification.** The disqualifications are rendered inoperative if:

- A. the party subject to the disqualification is duly licensed or registered to conduct securities related business in the state in which the order, judgment, or decree creating the disqualification was entered against such party; or
- B. before the first offer under the rule, the Securities Commissioner, or the court or regulatory authority that entered the order, judgment, or decree, waives the disqualification on a showing of good cause.

**4. Provision of information furnished to offerees and record-keeping.** On the Securities Commissioner's written request, an issuer relying on the exemption is required to furnish to the Securities Commissioner the information furnished to offerees. In addition, the rule requires that issuers must retain, for a period of at least three years, evidence of the basis for the belief that all purchasers were accredited investors at the time of purchase.

**5. Who may purchase.** For purposes of the rule, the term "individual accredited investor" means any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his or her purchase exceeds \$1 million, or any 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. Thus, the definition of "individual accredited investor" is patterned after Rule 501(a)(5) and (6) of SEC Regulation D as currently written. The term also embraces self-directed employee

benefit plans with investment decisions made solely by persons that are “individual accredited investors” as defined above, and the individual retirement accounts of any such individual accredited investors.

- A. **Issuer’s reasonable belief.** Sales under the rule may be made only to purchasers who are actually individual accredited investors or to purchasers who the issuer has reasonable grounds to believe, and after making reasonable inquiry shall believe, to be individual accredited investors.
  - B. **Sophistication.** The rule contains no sophistication requirement, nor does it specify that the investment must be a suitable one. Issuers and registered dealers should keep in mind, however, that the antifraud provisions of the Act would be applicable to transactions falling within the rule and that certain provisions, such as those set out in Section 14 of the Act, may operate to require that persons engaged in selling securities determine that the investment is suitable for the purchaser based on the information the purchaser reveals about his or her financial situation and needs.
  - C. **Investment Intent.** Presently, Rule 139.16 does not contain an express requirement that investors purchase with “investment intent” (as opposed to investing in order to resell), although such was implied when the rule was adopted. At its meeting in September 2004, the Board proposed an amendment to the rule to expressly require that purchasers purchase with investment intent and note that resales within 12 months are not allowed.
6. **Limited use advertisements.** One of the most salient features of the rule permits “limited use advertisements,” as specified, in connection with offerings under the rule. Thus, although the rule generally prohibits the use of advertising, should an issuer desire to reach a broad group of appropriate investors, it need only comply with the restrictions set out in subsection (e) of the rule.
- A. **Dissemination.** After careful consideration, the Board determined to permit an issuer to disseminate a limited use advertisement by any means, direct or

indirect. Since the rule states that a limited use advertisement that results in an offer to a person who is not an individual accredited investor will not alone result in loss of the exemption, an issuer may advertise through a wide variety of media.

**B. Filing requirement.** Limited use advertisements must be filed with the Securities Commissioner ten days prior to use in Texas. The filing of the advertisement does not mean that it or the securities to which it refers have been approved by the Securities Commissioner.

**C. Required content.** Limited use advertisements *must* contain:

- i. a brief description of the securities to be offered;
- ii. the name, address, and telephone number of the person to contact for additional information;
- iii. the address where offering material may be obtained; and
- iv. the following statement: “The securities have not been registered with or approved by the Texas Securities Commissioner and are being offered and sold pursuant to the exemption provided by §139.16 of the Rules and Regulations of the State Securities Board. This advertisement was filed with the Texas Securities Commissioner on or about (fill in date). The securities are being offered to, and may be purchased by, only those natural persons whose individual net worth, or joint net worth with that person’s spouse, at the time of purchase of the securities, exceeds \$1 million or natural persons who have 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 who have a reasonable expectation of reaching that same income level in the current year.”

- D. Permitted content.** A limited use advertisement *may* also include:
- i. the name and address of the issuer;
  - ii. a brief description of the issuer’s business;  
and
  - iii. the name and address of the registered dealer(s) acting on the issuer’s behalf in connection with the offering.
- E. Safe harbor.** Because the rule permits dissemination of limited use advertisements, the use of such advertisements in connection with an offering made in reliance on the rule could result in the unavailability of other exemptions (such as those discussed in Parts II, III.A, III.C, and V of this Outline) which prohibit public solicitation and advertisements. The rule attempts to address this issue in two ways. First, it cautions issuers or registered dealers who use the exemption to take all necessary steps to document that any sales to persons who are not individual accredited investors were not made in response to a limited use advertisement. In the same vein, it urges users of the section to consult with experienced securities counsel, especially if the user anticipates selling securities, within six months of the last sale made under the rule, to persons who are not individual accredited investors. Second, the rule provides a six-month safe harbor. The rule specifies that the use of a limited use advertisement in compliance with the rule and in connection with sales under the rule will not render exemptions that prohibit public solicitation or advertisements unavailable for other sales that are made more than six months after the use of the limited use advertisement.
- F. Combining exemptions.** The rule specifies that transactions exempt under the rule may be combined with offers and sales exempt under the Act, Section 5.H and Rule 109.3(c), which exempt sales to certain institutional investors. These exemptions are discussed in greater detail in Part III.B.3.c of this Outline.

**G. Deviations from terms and conditions of rule.** Should an offer and sale of securities fail, for any reason, to comply with all the terms and conditions for use of the exemption, the rule specifies that the issuer may claim the availability of any other applicable exemption.

**b. Model Accredited Investor Exemption.** Rule 139.19, adopted in 1997, is a model exemption developed by NASAA, and is similar to Texas Rule 139.16 (discussed in Part III.B.3.a of this Outline). The rule provides an exemption from the securities registration requirements of the Act for the sale of securities by an issuer to accredited investors.

**1. Who may sell.** The issuer itself may offer and sell securities pursuant to Rule 139.19. For purposes of the rule, an issuer does not have to register as a dealer to make sales. The exemption is not available to an issuer that is in the development stage that either has no specific business plan or purpose or 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. As with Rule 139.16, the term “issuer” includes directors, officers, or employees of an issuer satisfying certain conditions, namely:

- A. the director, officer, or employee was not hired for the purpose of offering or selling such securities;
- B. the director’s, officer’s, or employee’s activity involving the offer and sale of such securities is strictly incidental to his or her bona fide primary nonsecurities-related work duties; and
- C. the director’s, officer’s, or employee’s compensation is based solely on the performance of other such duties; *i.e.*, the director, officer, or employee does not receive any compensation for offering for sale, selling, or otherwise aiding in the sale of securities.

**2. Disqualifications.** Certain issuers that are “bad persons” or that are affiliated with certain “bad persons” are disqualified from using the exemption. No exemption is available for the securities of an issuer if the issuer, the issuer’s predecessors, any affiliated issuer, any of the issuer’s directors, officers, general partners, beneficial owners of 10% or more of any class of its equity securities, any of the issuer’s promoters

presently connected with the issuer in any capacity, any underwriter of the securities to be offered, or any partner, director, or officer of such underwriter:

- A. within the last five years, has filed a registration statement which is the subject of a currently effective registration stop order entered by any state securities administrator or the SEC;
- B. within the last five years, has been convicted of any criminal offense in connection with the offer, purchase, or sale of any security or involving fraud or deceit;
- C. is currently subject to any state or federal administrative enforcement order or judgment, entered within the last five years, finding fraud or deceit in connection with the purchase or sale of any security; or
- D. is currently subject to any order, judgment, or decree of any court of competent jurisdiction, entered within the last five years, temporarily, preliminarily, or permanently restraining or enjoining such party from engaging in or continuing to engage in any conduct or practice involving fraud or deceit in connection with the purchase or sale of any security.

**3. Exceptions from disqualification.** The disqualifications are rendered inoperative if:

- A. the party subject to the disqualification is licensed or registered to conduct securities related business in the state in which the order, judgment, or decree creating the disqualification was entered against such party; or
- B. before the first offer under the rule, the state securities administrator, or the court or regulatory authority that entered the order, judgment, or decree, waives the disqualification; or
- C. the issuer establishes that it did not know and in the exercise of reasonable care, based on a factual inquiry, could not have known that the disqualification existed.

4. **Who may purchase.** Sales of securities shall be made only to persons who are “accredited investors.” Accredited investor has the same definition as that contained in SEC Regulation D, set forth at 17 Code of Federal Regulations §230.501(a).
  - A. **Issuer’s reasonable belief.** Sales under the rule may be made only to purchasers who are actually accredited investors or to purchasers who the issuer reasonably believes are accredited investors.
  - B. **Sophistication.** Like Rule 139.16, this rule contains no sophistication requirement, nor does it specify that the investment must be a suitable one. However, the antifraud provisions of the Act are applicable to transactions falling within the rule and certain provisions, such as those set out in Section 14 of the Act, may operate to require that persons engaged in selling securities determine that the investment is suitable for the purchaser based on the information the purchaser reveals about his or her financial situation and needs.
  - C. **Investment intent.** The issuer must reasonably believe that all purchasers are purchasing for investment and not with the view to or for sale in connection with distribution of the security. Any resale of a security sold in reliance on this exemption within 12 months of the sale is presumed to be with a view to distribution and not for investment. Excepted from this presumption is a resale pursuant to a registration statement effective under Section 7, or to an accredited investor pursuant to an exemption available under the Act or Board rules.
5. **General announcement.** The rule permits the use of a published announcement in connection with offerings under the rule.
  - A. **Dissemination.** The general announcement of the proposed offering may be disseminated by any means. The rule states that dissemination of the general announcement to a person who is not an accredited investor does not disqualify the issuer from claiming the exemption.

**B. Filing requirement.** A notice of the transaction, a consent to service of process, and a copy of the general announcement must be filed with the Texas Securities Commissioner within 15 days after the first sale in Texas.

**C. Required content.** The general announcement *must* contain:

- i. the name, address, and telephone number of the issuer of the securities;
- ii. the name, a brief description, and price (if known) of any security to be issued;
- iii. a brief description of the business of the issuer, in 25 words or less;
- iv. the type, number, and aggregate amount of securities being offered;
- v. the name, address, and telephone number of the person to contact for additional information; and
- vi. a statement that:
  - I. sales will be made only to accredited investors;
  - II. no money or other consideration is being solicited or will be accepted by way of this general announcement; and
  - III. the securities have not been registered with or approved by any state securities agency or the SEC and are being offered and sold pursuant to an exemption from registration.

**6. Additional information.** The issuer, in connection with an offer, may provide information in addition to the general announcement, if that information:

- A. is delivered through an electronic database that is restricted to persons who have prequalified as accredited investors (such as a designated matching service, discussed in Part VI.A of this Outline); or
    - B. is delivered after the issuer reasonably believes that the prospective purchaser is an accredited investor.
  - 7. **Telephone solicitation.** No telephone solicitation is permitted unless, prior to placing the call, the issuer reasonably believes that the prospective purchaser to be solicited is an accredited investor.
- c. **Section 5.H and Rule 109.3 sales to institutional investors.** Rule 109.3 and Section 5.H cover transactions with financial institutions and certain other institutional investors specifically named in those exemptions.
  - 1. **Capacity.** The exemptions in Section 5.H and Rule 109.3(c) are available to exempt sales to an institutional investor acting for its own account or as a bona fide trustee of a trust organized and existing other than for the purpose of acquiring the specific securities for which the seller is claiming the exemption. Similarly, the exemptions are not available if the institutional investor is in fact acting only as agent for another purchaser that is not named in the exemption.
  - 2. **Applicable to Dealers and Investment Advisers.** In 1998, Rule 109.9(e) was amended to provide that a dealer or investment adviser dealing solely with such institutional customers is not required to register. This amendment formalized a longstanding agency policy that provides an exemption from registration for dealers, investment advisers, agents and investment adviser representatives when such persons are engaging in the offer or sale of securities and/or the rendering of investment advisory services to certain institutional investors.
- C. **SEC Rules 505 and 506 and ULOE.** Most states now have registration exemptions coordinated with Rule 505 of SEC Regulation D. Most, like Texas, have adopted ULOE as their method of coordination and have included Rule 506 in their coordinating exemption. As an initial matter, compliance with all of the conditions of SEC Rule 505 or Rule 506 is a condition for claiming ULOE. As of October 11, 1996, when Title I of NSMIA became effective, securities offered in a Rule 506 offering are “covered securities” and are not subject to registration in Texas; however, a notice filing and fee are still required. Another effect of

NSMIA was to make certain parts of Rule 109.13(k) inapplicable to Rule 506 offerings. NASAA is working on uniform revisions to ULOE to update the exemption.

1. **Rule 505 offerings.** Under ULOE, the following further conditions and limitations, among others, must be observed.

a. **“Bad Person” disqualifications.** Rule 505 of SEC Regulation D contains certain bad person disqualifications. ULOE contains certain disqualification provisions applicable to offerings made in reliance on the state exemption. The ULOE bad person exclusions are similar to those contained in SEC Regulation A (as incorporated in SEC Rule 505), but are adapted to state, rather than federal, actions. There are certain “escape hatches” from bad person disqualifications, as set forth in Rule 109.13(k)(3) and (4). The bad person disqualifications, set out in Rule 109.13(k)(2)(A)-(E), include:

1. having filed a registration statement which is subject to a currently-effective stop order entered pursuant to any state’s securities law within five years prior to filing the notice required under ULOE;
2. having been convicted, within five years prior to filing the required notice, of any felony or misdemeanor in connection with the offer, purchase, or sale of any security or of any felony involving fraud or deceit;
3. currently being subject to any state’s administrative enforcement order or judgment entered by that state’s securities administrator within five years prior to the filing of the required notice, or being subject to any state’s administrative enforcement order or judgment, entered within five years prior to the filing of the required notice, in which fraud or deceit was found;
4. being subject to any state’s administrative order or judgment prohibiting, denying, or revoking the use of any exemption from registration in connection with the offer, purchase, or sale of securities; or
5. currently being subject to a court order, judgment, or decree, entered within five years prior to the filing of the required notice, which temporarily or permanently restrains or enjoins the party from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security, or involving a false filing with the state.

- b. Filing requirements.** Timely filing is a condition of Rule 109.13(k). Accordingly, the issuer should carefully note the following requirements.
- 1. Form D filing.** A completed Form D must be filed no later than 15 days after the receipt of consideration or the delivery of a subscription agreement by an investor in Texas, and at such other times and in the form required by SEC Regulation D.
  - 2. Undertaking.** The initial notice must contain an undertaking by the issuer to furnish to the Securities Commissioner, on written request, the information furnished to offerees.
  - 3. Consent to service.** The issuer must file a consent to service of process, unless one has already been filed with the Securities Commissioner by the same issuer.
  - 4. Filing fee.** A filing fee must accompany the notice. The fee is one-tenth of 1.0% of the aggregate amount of securities described as being offered for sale, but in no case more than \$500. The fee is calculated on the basis of the entire offering, not just the portion to be offered in Texas.
  - 5. Staff review.** The staff reviews Form D filings for completeness within five days of receipt. If the Form D is incomplete, the issuer will be notified by letter and will have 30 days to correct the deficiency.
- 2. Rule 506 offerings.** NSMIA made certain parts of Rule 109.13(k) inapplicable in Rule 506 offerings coordinated with ULOE (most notably, the bad person disqualifiers). The Board adopted rules (particularly the addition of paragraph (16) to Rule 109.13(k) and new Rule 114.4(b)(1)) to address how Rule 506 offerings would be conducted in Texas. ULOE fee and certain filing requirements were not changed by NSMIA. Timely filings are required in this context, the same as they are with Rule 505 offerings coordinated with Rule 109.13(k). Accordingly, the issuer should carefully note the following requirements.
- a. Form D filing.** Rule 114.4(b) requires that a completed Form D be filed at the time the Form D is filed with the SEC, but no later than 15 days after the first sale of the issuer's securities in Texas.
  - b. Consent to service.** Generally, a non-Texas issuer must file a consent to service of process. Rule 114.3 details when a consent to service must be filed in an offering of federal covered securities.



Section 7.A of the Act, including the requirement that audited financial statements be provided. However, Rule 113.5 does allow a “small business issuer” to submit reviewed financial statements, if those statements are submitted in connection with a “small business offering” not exceeding \$500,000.

- B. No testing-the-waters.** The “test-the-waters” provisions of SEC Regulation A do not mesh with the requirements of the Act. Thus, in Texas, issuers are not permitted to offer securities using the solicitation of interest documents described in Rule 254 of SEC Regulation A. In like fashion, if the SEC rule proposal allowing issuers contemplating initial public offerings to “test-the-waters” before filing a federal registration statement is adopted (Rel. No. 33-7188, July 10, 1995), the current requirements of the Texas Securities Act would not permit an issuer to engage in such solicitations of interest before filing an application in Texas. Issuers should note, however, that once an application for registration has been filed, and while it is pending, Section 22 of the Act permits an issuer to engage in certain specified informational advertising. Both Rule 139.16 and Rule 139.19 permit certain kinds of advertisements. Both are described in more detail in Part III.B.3 of this Outline.

**V. Texas Exemptions Compatible with SEC Rule 701.**

- A. In general.** To a large extent, Section 5.I(b) of the Act coordinates with SEC Rule 701, which exempts offers and sales of securities pursuant to certain employee benefit plans. Section 5.I(b) exempts the sale or distribution by an issuer or its participating subsidiary, if any, of a security under a written benefit or compensatory plan or written compensation contract established by the issuer or its subsidiary for the benefit of certain eligible persons. Unlike SEC Rule 701, Section 5.I(b) limits neither the types of issuers that can avail themselves of the exemption nor the aggregate offering price of the securities.
- B. Conditions of the exemption.**
- 1. Public solicitation prohibited.** The sale or distribution of securities exempt under Section 5.I(b) must be made without any public solicitation or advertisements. In addition to those rules regarding public solicitation and advertisements discussed above, Rule 109.13(f) provides that no public solicitation or advertisement occurs by the distribution to eligible persons of a prospectus filed under the Securities Act of 1933 (“1933 Act”) with the SEC for the plan or any other material required or permitted to be distributed by the 1933 Act in connection with such plans when the securities under the plan are sold or distributed in a transaction otherwise meeting the requirements of Section 5.I(b).
  - 2. Employer and participating subsidiary.** Section 5.I(b) is available to an “issuer” or its “participating” subsidiary. The staff takes the position that the

term “participating” subsidiary means a subsidiary whose employees or directors are participating in a plan covered by the exemption. As set out in Rule 109.13(g), only the employer and its participating subsidiaries, parents, or subsidiaries of such parents, if any, may offer or sell securities in connection with the employee plan without registration as dealers. A general partner of a limited partnership is not required to be registered as an agent with respect to a security sold or distributed by the limited partnership in a transaction that otherwise meets the requirements of Section 5.I(b), as long as the general partner receives no commissions for the sales activity. An employee of the issuer or its participating subsidiary who aids in offering or selling such securities in connection with an employee plan is not required to be registered as an agent provided that such person meets all of the following conditions:

- a. the employee was not hired for the purpose of offering or selling such securities;
  - b. the employee’s activity involving the offer and sale of such securities is strictly incidental to his or her bona fide primary nonsecurities related work duties; and
  - c. the employee’s compensation is based solely on the performance of such other duties; *i.e.*, no compensation is received for offering for sale, selling, or otherwise aiding the sale of securities.
3. **Eligible participants.** Eligible participants include employees, directors, general partners, managers, or officers of the issuer or its subsidiary, trustees, if the issuer or subsidiary is a business trust; and consultants or advisors who provide bona fide services, unrelated to the offer or sale of securities in a capital-raising transaction, to the issuer or its subsidiary.
4. **Types of plans.** The exemption covers a thrift, savings, stock purchase, retirement, pension, profit-sharing, option, bonus, appreciation right, incentive, and similar written compensation plan or written compensation contract. The concept of employee plans is construed broadly to include, among other things, employee stock option plans, employee stock purchase plans, and unfunded deferred compensation plans. The plan must, however, be bona fide. Thus, even if sales are limited to employees, if the offering of securities is only coincidentally being made to employees, Section 5.I(b) is not available.
5. **Consultants and advisors.** SEC Rule 701 includes a definition of “consultants and advisors.” This definition includes a three prong test:
- a. they are natural persons;

- b. they provide bona fide services to the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parent; and
- c. the services provided are not in connection with the offer or sale of securities in a capital-raising transaction, and do not directly or indirectly promote or maintain a market for the issuer's securities.

## VI. Board Initiatives to Facilitate Internet Offerings in Texas.

**A. Designated matching services rule.** Rule 109.15 carves out a narrow exception from the ban on public solicitation and advertisements in the context of exempt limited offerings by providing that the use of a designated matching service facility by an issuer member does not constitute public solicitation or advertisement within the meaning of certain specified exemptions. It also provides that a designated matching service is not deemed a dealer subject to registration within the meaning of the Act or Board rules. The rule is utilized by on-line services and provides a balanced framework for regulating those services. Application to become a designated matching service is made on Form 133.35.

**1. Conditions for use.** A person owning, operating, sponsoring, or conducting a computer system, seminar, or meeting limited to providing investor members with certain information regarding investment opportunities may apply to the Securities Commissioner for designation as a matching service.

**a. In general.** To be designated, the applicant must demonstrate that it limits its facility to providing investor members with the summary business plans and identities of issuer members.

**1. Investor member.** The term "investor member" is defined as an investor who has been properly qualified by and uses a designated matching service. Any of the following investors, among others, may be properly qualified:

- A. any institutional investor described in the Act, Section 5.H or Rule 109.3(c);
- B. any individual accredited investor as defined in Rule 139.16;
- C. any sophisticated investor, as defined in Rule 109.13(a)(2); or
- D. any person who is engaged in the same business, or in the practice of a profession or discipline directly

related to that business, as is the issuer member whose identity and summary business plan is provided to that person.

- 2. Summary business plan.** The term “summary business plan” is defined to mean a brief statement specifically describing the issuer, its management, its products or services, and the market for those products or services. Other information, including, specifically, financial projections, must not be included in a summary business plan.
  - 3. Issuer member.** The term “issuer member” is defined simply to be an issuer who uses a matching service facility. Thus, although the rule is designed primarily to benefit small business issuers, any issuer -- even large, well-established entities -- may use a designated matching service.
- b. Character of entity.** The applicant must also demonstrate that it is a governmental entity, a quasi-governmental entity, an institution of higher education, or a domestic (Texas) nonprofit corporation that is associated with a governmental or quasi-governmental entity or an institution of higher education.
- c. Other conditions.** Other conditions for designation are intended to ensure, among other things, that the applicant will not be involved in any manner in the sale, offer for sale, solicitation of a sale or offer to buy a security other than as specifically allowed. Those conditions include:
1. a prohibition on employing any person required to be registered under the Act as a dealer, investment adviser, agent or investment adviser representative -- because of activities on or off their job with the facility -- and required disclosure of past securities-related activities of any employees, officers, directors or control persons;
  2. required disclosure of any officer’s, director’s, or control person’s disqualification as set out in Rule 109.13(k)(2)(A)-(E) of the Board’s rules. See Part III.C.1.a of this Outline for a discussion of Rule 109.13(k)(2)(A)-(E). Such disqualification might be a basis for the Securities Commissioner to deny the application or to impose additional conditions under Rule 109.15(c)(9) which permits the Securities Commissioner to require that the applicant meet conditions the Securities Commissioner considers appropriate for the protection of investors and consistent with the

purposes fairly intended by the policy and provisions of the Act and Board rules;

3. a limitation on fees that can be charged for use of the facility; and
4. an agreement on the part of the applicant not to use any advertisement of its matching service facility that advertises any particular issuer or any particular securities or the quality of any securities or that is false or misleading or otherwise likely to deceive a reader thereof.

2. **Safeguards.** The rule has been narrowly crafted in an attempt to avoid abuses. By limiting the scope of the rule to those facilities operated by certain governmental or quasi-governmental entities, institutions of higher education, or associated Texas nonprofit corporations, the Board has attempted to forge a balanced approach toward easing regulation of matching service facilities. Designation is expressly not available to any matching service formed in a manner that constitutes part of a scheme to violate or evade the provisions of the Act or Board rules. The Securities Commissioner is vested with authority to withdraw a designation if the standards for designation are not maintained.

**B. Internet rule.** Rule 139.17, made effective in 1996, was designed to provide a way for persons to use the Internet for securities offerings and avoid inadvertently violating the Act. Persons who use the Internet to offer securities to Texas residents or to sell securities from Texas are held to the same standards and registration requirements as persons engaging in such activities in a more traditional manner.

1. **Operation of the rule.** Rule 139.17 exempts from the securities registration requirements of the Act -- and, under certain circumstances, the Act's dealer registration requirements -- offers of securities disseminated through the Internet if:

- a. the offer indicates that the securities are not being offered for sale to any person in Texas;
- b. an offer is not otherwise specifically directed to any person in Texas by, or on behalf of, the issuer; and
- c. no sales of the issuer's securities are made to any person in Texas as a result of the offer.

2. **Statement.** The offer must contain a statement indicating that the securities are not being offered for sale to any person in Texas. The statement must be the same or substantially similar to one of the following:
    - a. “These securities are not being offered or sold in Texas.”
    - b. “These securities are being offered or sold in (fill in names of states other than Texas).”
    - c. “This is neither a solicitation to buy nor an offer to sell to persons in Texas.”
  3. **Enforcement.** The agency has issued several emergency cease and desist orders against persons who failed to meet the criteria of this rule and neglected to register in this state.
- C. **Other Rules.** Both the Rule 139.16 individual accredited exemption and the Rule 139.19 model accredited investor exemption can be used for internet offerings of securities because the limited advertisement permitted under the exemptions can be disseminated through any means, including the internet. Both of these provisions are described in more detail in Parts III.B.3.a and III.B.3.b of this Outline, respectively.