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Thinking of Seeking Registration of Securities?

-by Neil E. Harl*

The rapid run-up in farmland values¹ and the continued expansion of farm size have led some of the larger operations to begin to raise the question of whether the time may be coming to consider soliciting outside equity capital. Some see that as assuring a more stable capital base but others are reluctant to move in that direction because of possible loss of control of the operation over time. This article discusses some of the more likely routes to follow if the interest has matured to the point of wanting to consider some options.

Securities regulation

Since the early 1930s, in response to the excesses that some believe may have contributed to the economic downturn beginning in 1929, both state governments in various enactments, and the federal government, primarily through the Securities and Exchange Commission, have legislated in an effort to assert more government oversight over the issuance and distribution of securities, primarily equity securities.²

State-level regulation. State legislative enactments governing the sale and distribution of securities have been popularly known as "Blue Sky Laws."³ The original purpose of such laws was to protect the public from fraudulent sales of securities involving speculative schemes having no more basis than so many square feet of "blue sky."⁴ Blue sky laws generally apply to all securities sold except for exempt securities or securities sold in exempt transactions.⁵

While the regulatory statutes vary from state to state (although the acceptance of the Uniform Securities Act has reduced the state-to-state differences) the provisions generally fall into three classifications – (1) anti-fraud provisions; (2) registration or licensing requirements for persons engaged in the securities business; and (3) registration and licensing of securities.⁶

Federal-level regulation. Federal securities regulation is governed by two major acts – the Securities Act of 1933⁷ and the Securities Exchange Act of 1934.⁸ The Securities Act is primarily concerned with the distribution of securities and imposes general standards of fair and adequate disclosure and prohibits fraud and misrepresentation in the sale of securities.⁹

The Securities Exchange Act of 1934, enacted as a supplement to the Securities Act of 1933, regulates and controls transactions in securities on securities exchanges and in over-the-counter markets, affords a measure of disclosure to persons who buy and sell securities, controls the amount of the nation's credit going into security markets and offers some protection from unfair practices in the sales and management of regulated securities.

Registration is required by issuers engaged in interstate commerce or businesses affecting interstate commerce or whose securities are traded by use of the mails or an instrumentality of interstate commerce.¹⁰

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The Securities and Exchange Commission in the past has been authorized to exempt issues of securities with an aggregate offering price to the public not in excess of \$5 million if the agency finds that the enforcement of the regulatory law is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering.¹¹ Legislation signed into law on April 5, 2012 has expanded the exempt amounts as noted below.¹²

Regulation A

Many small corporations are able to take advantage of the reduced requirements under Section 3(b) of the Securities Act.¹³ That statutory provision authorizes the S.E.C. to provide for special treatment of certain classes of securities which, because of the small amount involved or the limited character of the offering, as noted above, do not necessitate full registration to ensure protection of the public interest.¹⁴ This option has been limited to a maximum of \$5 million. When it was adopted, in 1936, Regulation A exempted certain offerings raising up to \$100,000; that limit was raised to \$300,000 in 1945, to \$500,000 in 1972 and to \$1.5 million in 1978.¹⁵ The 1992 “small business initiatives” included several amendments intended to make Regulation A more accessible to small businesses. The dollar ceiling for offerings was raised from \$1.5 million to \$5 million.¹⁶ The 2012 legislation boosted that exemption figure to \$50,000,000 over a 12-month period.¹⁷

To qualify for this registration option, the issuer must meet certain requirements –

- The entity must be organized in and have its principal place of business in the United States or Canada, or be an individual resident of any state or province;
- No fractional undivided interests in oil and gas or issues subject to the Investment Company Act of 1940 may be exempted;
- The issuer, its predecessors and affiliates, must be free of specified prior Securities Act violations; and
- The directors, officers, principal security holders and offerors involved in the sale of securities must not have been involved in crimes involving the sale of securities within the past 10-years.¹⁸

Regulation A has featured reduced reporting requirements if two conditions were met –

- At least 10 business days prior to the initial offering of any securities for which this option is desired, a notification (Form 1-A) had to be filed with the regional office of the S.E.C. (where the issuer’s principal place of business is located), signed by the issuer and any offerors on whose behalf shares are offered, and accompanied by a \$100 nonrefundable filing fee.¹⁹
- An offering circular (short form prospectus) had to be prepared containing the information on Schedule I to Form 1-A and given to each offeree before or at the time the offer is made.²⁰ Advertisements (by any media form) are restricted to certain basic information, but may be permitted.²¹ The offering circular had to be updated if the offering was not completed within nine months.²² It is not yet clear whether these requirements will be revised in light of the 2012 legislation.

New legislation

Legislation was passed by the U.S. House of Representatives on November 2, 2011 by a vote of 421 to 1 to allow a company to offer and sell up to \$50 million of its securities within a 12-month period under Regulation A.²³ The bill would also allow a limited

exemption from state regulation.²⁴ The proposed law would have required audited financial statements after the first year which is not now required of Regulation A registrations. The 2012 legislation, as enacted, includes that enlarged exemption and requires issuers “. . . to file audited financial statements . . . annually. . . .”²⁵ One of the justifications for the amendment was to encourage more small businesses to use Regulation A.²⁶

The 2012 legislation also contained authorization for “Emerging Growth Companies” with total annual gross revenues of less than \$1,000,000,000 to be eligible for a special exemption²⁷ if the first sale of “common equity securities” of the issuer occurred on or after December 8, 2011.²⁸

ENDNOTES

¹ See, e.g., Duffy, “Iowa Farmland Values,” Iowa State University, December, 2011 (average 32.5 percent increase for Iowa farmland values reported in late 2011).

² See 7 Harl, *Agricultural Law* § 52.04 (2011).

³ See 7 Harl, *supra* note 2, § 52.04[1].

⁴ Hall v. Geiger-Jones Co., 242 U.S. 539, 550 (1917) (dictum). See Note, “Blue Sky Legislation,” 23 Iowa L. Rev. 102 (1937).

⁵ E.g., Iowa Code § 502.202-204 (2011).

⁶ 7 Harl, *supra* note 2.

⁷ 48 Stat. 74, as amended, codified at 15 U.S.C. §§ 771 *et seq.*

⁸ 48 Stat. 881, as amended, codified at 15 U.S.C. §§ 78a *et seq.*

⁹ S.E.C., 10th Annual Report 14-15 (1945).

¹⁰ 15 U.S.C. § 77c(a); 17 C.F.R. § 240.12(g)-1.

¹¹ 15 U.S.C. § 77c(b).

¹² See Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 112th Cong., 2d Sess. (2012).

¹³ 15 U.S.C. § 77c(b). See 7 Harl, *supra* note 2, § 52.04[2][b].

¹⁴ *Id.*

¹⁵ 17 C.F.R. 230.251(b); Securities Act Release No. 5977, Fed. Sec. L. Rep. (CCH), ¶ 81,710 (September 11, 1978).

¹⁶ 17 C.F.R. § 230.251(b); Securities Act Release No. 6924, Fed. Sec. L. Rep. (CCH) ¶ 84,931 (March 11, 1992).

¹⁷ Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 401(a), amending 15 U.S.C. § 77c(b)(2).

¹⁸ 17 C.F.R. § 230.252(d), (e).

¹⁹ 17 C.F.R. § 230.255(a), (b).

²⁰ 17 C.F.R. § 230.256.

²¹ 17 C.F.R. § 230.256(c).

²² 17 C.F.R. § 230.256(e).

²³ “Small Company Capital Formation Act,” H.R. 1070, 112th Cong., 1st Sess. (2011).

²⁴ *Id.* See H. Rep. 112-206, 112th Cong., 1st Sess. (2011).

²⁵ Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 401, amending 15 U.S.C. § 77c(b)(2)(E).

²⁶ Between 1995 and 2004, companies have used Regulation A only 78 times; in 2010, only three times. H. Rep. 112-206, 112th Cong., 1st Sess. (2011).

²⁷ Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 101-107, 112th Cong., 2d Sess. (2012).

²⁸ *Id.*, § 101(d).