Existing Businesses Using Private Placements to Raise Money.

Given the economy, even business that have been operating for many years find it hard to get loans from financial institutions. While it's possible in some cases to factor invoices, that generally carries a high price.

There is another option: Raising money from customers, vendors, other businesses with an interest in your continued operations, or even the public. This can be in the form of loans, equity or loans convertible to equity. If equity, the company raising the money can retain buyback options at set prices or by formula.

An offering is easiest if limited to a single state (a so-called intrastate offering) because then federal securities law does not apply. Generally, the offering company must be formed in that state, have its principal place of business in that state, and have 80%+ of its assets, revenues and expenditures in/from that state.

Full Public Advertising Approaches

In California, there are advantages to using the qualification by permit procedure, since full public advertising is allowed and there are minimal requirements for investors, though the State must approve the offering in advance. If the offering is for $5 million or less and if certain low-level income and asset requirements are used for investors, California will not conduct a merit (fairness) review of the offering, which makes it very likely that the offering will be approved. To avoid merit review, the minimum qualifications must be as follows:

> The investor (or husband and wife) must either (1) have a minimum net worth of at least $75,000 and minimum gross income of $50,000 or (2) have a minimum net worth of $150,000, provided that in either case (a) net worth must be determined exclusive of homes, home furnishings and automobiles and (b) the investment must not exceed 10 percent of the net worth of the investor.

Alternatively, the investor must be investing less than $2,500 total in the company, including any investments made during the prior 12 months. This can be useful if the company has many customers and wants them to be able to invest small amounts regardless of their financial qualifications.

If state lines need to be crossed to get investors, there are several possibilities.

One multi-state approach is a SCOR (small company offering registration) offering. This requires prior approval by one or more securities regulators. Most states participate in regional approval (there are five regions). California requires its own separate registration via qualification by permit. The big advantage is that full public advertising is allowed. The disadvantages are that the amount is limited to $1 million and a merit (fairness) review will be conducted.

Tombstone Ad Approaches

If it's expected that all the investors will be accredited investors, then the offering can be made in approximately 30 states that have adopted the Model Accredited Investor Exemption. Full public advertising is not allowed, but a brief "tombstone" ad giving the bare bones of the offering is. Again, the offering must be limited to $1 million (due to federal Rule 504). No prior approval by securities regulators is needed though there must be filings with the SEC and each state where there are investors.

Roughly, accredited investors are entities with more than $5 million in assets and individuals with net worth of at least $1 million or at least $200,000 in annual income individually or at least $300,000 annually including the spouse's income. As of summer of 2010 equity in the personal residence cannot be counted in calculating net worth.

California's counterpart to the Model Accredited Investor Exemption is the 25102(n) offering. Again, a brief "tombstone" ad can be used and no prior approval by securities regulators is required. If the offering is an intrastate offering, then an unlimited amount can be raised. Interestingly, a non-California entity can use this exemption if the investors are all in California and $5 million or less is being raised. Generally all the investors must be accredited, but if the offering company is a California corporation (not an LLC or limited partnership) and there is only a single class of stock, lower investor standards can be used:

> Individuals with net worth of at least $500,000 (versus $1 million for accredited investors) or at least $100,000 in annual income individually (versus $200,00 for an accredited investor) but also minimum net worth of $250,000. In each case, homes, home furnishings and automobiles must be excluded in calculating net worth.

Individual Contact and General Information Approaches

If the offering needs to cross state lines and more than $1 million needs to be raised, generally a Rule 506 offering is used. An unlimited number of accredited investors and up to 35 non-accredited but sophisticated investors are allowed. No public advertising is permitted, but individual communications with potential investors believed to meet the qualifications are allowed. Also, general information about the company can be made public (for example, on a web site or through seminars). No specifics may be given publicly, though; potential investors must show they qualify via investor questionnaires in order to receive any specifics about an offering. An unlimited amount may be raised. While no prior approval by securities regulators is needed, filings must be made with the SEC and each state where there are investors.

The California-only counterpart to this is the 25102(f) offering. It's very similar to a Rule 506 offering except it also allows friends, family and business colleagues to invest (without being accredited or sophisticated) if they have a substantive prior relationship with one of the principals of the company. That can be useful if the offering company wants to allow friends, family or business colleagues to invest who would not meet the qualifications for another type of offering.

Obviously an existing company looking to raise money has a number of options, depending on the type of advertising needed, whether the offering will cross state lines, and the amount to be raised.

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