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BILL ANALYSIS



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Senate Bill 1108 (as enrolled)
Sponsor: Senator Mike Rogers
Senate Committee: Financial Services
House Committee: Commerce

PUBLIC ACT 529 of 1996

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RATIONALE

The Corporation and Securities Bureau, within the Department of Consumer and Industry Services, regulates various types of securities offered to investors within Michigan. Generally speaking, most securities offerors must register with the Bureau any securities offered to the public before they can be sold in the State. One form of security that has been permitted by administrative rule in Michigan is known as the "small corporate offering registration" (SCOR). A SCOR is often used by smaller companies for purposes of generating capital and is exempt from regulation by the Securities and Exchange Commission (SEC). Typically, the companies that rely on a SCOR are those that cannot afford a full-fledged initial public offering (IPO) or that do not need to raise large sums of money. The Bureau has permitted SCORs to be issued in Michigan, subject to certain limitations, based on an exemption granted under Federal regulations issued by the SEC. Some people believe, however that companies might be more willing to issue SCORs in Michigan if permission to use them is granted by statute rather than administrative rule. In addition, although SCORs can be issued in amounts up to \$1 million, Federal law allows the SEC to grant states exemptions for issues of up to \$5 million and California reportedly has already received that exemption. Some feel that Michigan law should authorize a SCOR to be issued at that amount, if a Federal exemption is awarded to this State.

CONTENT

The bill amended the Uniform Securities Act to provide for the registration of securities whose aggregate offering price is not more than \$1 million (which previously were exempt from registration under Federal regulations and were subject to State regulation under administrative rules). Securities whose offering price is up to \$5 million may be

registered under the bill if a Federal exemption is granted to Michigan under provisions of the Federal Securities Act.

Small Corporate Offering Registration

A registration under the bill is known as a "small corporate offering registration". An issuer eligible to register a SCOR must use a registration form approved by the "administrator" as the disclosure document for the offering. (Under the Act, "administrator" means the Corporation and Securities Bureau of the Department of Consumer and Industry Services.) An application for a SCOR must comply with the bill, but the administrator may waive provisions of the bill.

Application and Eligibility

An application for a SCOR is not available to an investment company subject to the Federal Investment Company Act or issuers subject to the reporting requirements of Title I of the Federal Securities Exchange Act.

Unless the administrator grants written permission based on a showing that adequate disclosure can be made to investors using the SCOR format, a SCOR may not be used by the following issuers and programs:

- Holding companies or companies whose principal purpose is owning stock in, or supervising the management of, other companies.
- Portfolio companies, such as real estate investment trusts.
- Issuers with complex capital structures.
- Commodity pools.
- Equipment leasing programs.
- Real estate programs.

A SCOR is available only to the issuer of the securities and not to any affiliate of that issuer or to any other person for resale of the issuer's securities. The issuer must be a domestic corporation or a foreign corporation organized under the laws of a state, territory, or possession of the United States. (The administrator may allow other entities to file a SCOR, however.) The offering may not be a blind pool or other offering for which the specific business to be engaged in or property to be acquired by the issuer cannot be specified. The offering price for common stock; the exercise price, if the securities offered are options, warrants, or rights for common stock; and the conversion price, if the securities are convertible into common stock, must be at least \$5 per share, unless the administrator authorizes a lower price per share.

The aggregate offering price of the securities offered, within or outside of Michigan, may not be more than \$1 million under the exemption set forth in Federal rules, or \$5 million, if a Federal exemption is granted to Michigan pursuant to Section 3(b) of the Securities Act, which allows the SEC to grant an exemption up to that level (15 U.S.C. 77c).

A SCOR is available for debt offerings only if the issuer can demonstrate a reasonable ability to service its debt.

A SCOR is not available if any of the following provisions apply to the issuer or to any of the issuer's officers, directors, 10% stockholders, promoters, or selling agent of the securities to be offered, or to any officer, director, or partner of the selling agent:

- The person has filed a registration statement that is the subject of a currently effective registration stop order entered pursuant to a Federal or state securities law within five years before the filing of the SCOR application.
- The person has been convicted of any felony or misdemeanor in connection with the offer, purchase, or sale of any security or any felony involving fraud or deceit, including forgery, embezzlement, obtaining money under false pretenses, larceny, or conspiracy to defraud, within five years before the filing of the SCOR application.
- The person is subject to either a state administrative enforcement order or judgment entered by a state securities administrator or the SEC within five years before the SCOR application's filing, or a

Federal or state administrative enforcement order or judgment in which fraud or deceit, including making untrue statements of material facts or failing to state material facts, was found and the order or judgment was entered within five years before the SCOR application's filing.

- The person is subject to a Federal or state administrative enforcement order or judgment that prohibits, denies, or revokes the use of any exemption for registration in connection with the offer, purchase, or sale of securities.
- The person is subject to a court order, judgment, or decree, entered within five years before the SCOR application is filed, that either 1) temporarily, preliminarily, or permanently restrains or enjoins the person from engaging in or continuing any conduct or practice in connection with the purchase or sale of securities, or 2) involves the making of a false filing with any state or with the SEC.

A person who is disqualified for any of the reasons listed above may not act in any capacity other than that for which the person is licensed or registered. A disqualification is automatically waived if the administrator or other state or Federal agency that created the basis for disqualification determines, on a showing of good cause, that it is not necessary to deny the exemption.

Except for being subject to a Federal or state administrative enforcement order prohibiting, denying, or revoking the use of any exemption for registration, the reasons for disqualification listed above do not apply if the person is licensed or registered to conduct securities-related business in the state in which the order or judgment was entered or if the employing broker-dealer is licensed or registered in Michigan and a form filed in this State discloses the order, conviction, judgment, or decree relating to that person.

Without prior written approval of the administrator, an applicant who files a SCOR application in Michigan may not split common stock or declare a stock dividend for any security issued under the bill for two years after the registration is effective.

Filing Requirements

In addition to a properly completed application form, an applicant for a SCOR must file all of the following exhibits with the administrator:

- The form of the selling agency agreement.

- The issuer's articles of incorporation or other charter documents and all amendments.
- The issuer's bylaws, as amended.
- Copies of any resolutions by directors setting forth terms and provisions of capital stock to be issued.
- Any indenture, form of note, or other contractual provision containing terms of notes or other debt or of options, warrants, or rights to be offered.
- A specimen of the security to be offered, including any legend restricting resale.
- Consent to service of process accompanied by an appropriate corporate resolution.
- Copies of all material directed or furnished to investors in the offering.
- Consent to inclusion in the disclosure document of an accountant's report.
- Consent to inclusion in the disclosure document of a tax advisor's opinion or a description of tax consequences.
- Consent to inclusion in the disclosure document of an evaluation by a licensed attorney of any pending or anticipated litigation or administrative action.
- The form of any subscription agreement for the purchase of securities in the offering.
- An opinion of a licensed attorney that the securities to be sold in the offering are duly authorized and binding on the issuer in accordance with the terms of the securities.
- A list of the residence street addresses of officers, directors, and principal stockholders.
- The form of escrow agreement for escrow of proceeds.

An escrow agreement must comply with all of the following:

- The administrator may require that the issuer impound the proceeds from the sale of a registered security in Michigan until the issuer receives a specified amount from the sale of that security that is sufficient to accomplish the stated purpose of the offering or until the issuer's stipulated requirements are met.
- The administrator may require that the issuer return to investors any impounded proceeds, together with any accrued interest, if the issuer fails to raise the specified amount while the registration is effective or within one year or if the issuer's stipulated requirements are not met.
- A bank or trust company may act as depositary or escrow agent for impounded proceeds. Checks, drafts, and money

orders must be made payable to the depositary. If a broker-dealer is acting as selling agent for the issuer, the broker-dealer promptly must remit to the depositary or escrow agent payments that are made directly to the broker-dealer.

- A request to release impounded funds must be in writing, confirm compliance with the registration, and be accompanied by a statement from the depositary or escrow agent setting forth the total amount on deposit.

Information provided to the administrator under these filing requirements is exempt from disclosure under the Freedom of Information Act.

Effectiveness, Fees, and Stop Orders

Effectiveness and Fees. An applicant for a SCOR must pay a filing fee of 1/10 of 1% of the maximum aggregate offering price at which a registered security is to be offered, subject to the minimum fee of \$100 and maximum fee of \$1,250. (This is the same as the filing fee that the Act requires for a registration statement.)

A SCOR statement will be effective for one year from its effective date, except during the time a stop order is in effect. A SCOR statement may be extended, however, by the administrator by rule or order. All outstanding securities of the same class as a registered security are considered to be registered for the purpose of any nonissuer transaction, as long as the SCOR statement is effective. A SCOR statement may not be withdrawn for one year from its effective date if any securities of the same class are outstanding. A SCOR statement maybe otherwise withdrawn only in the discretion of the administrator.

For the period of a SCOR statement's effectiveness, the administrator may, by rule or order, require the person who filed the SCOR statement to file reports, not more often than quarterly, to keep reasonably current the information contained in the SCOR statement and to disclose the progress of the offering.

A SCOR statement relating to a security may be amended after its effective date to increase the securities specified as proposed to be offered. As to securities not yet sold, an amendment becomes effective upon the administrator's order. In the case of securities that are sold in an amount in excess of the amount or number specified in an effective SCOR statement, as proposed to be offered, the person or persons who filed the SCOR statement may, pursuant to the rules promulgated

by the administrator as necessary or appropriate in the public interest and for the protection of investors, elect to have the SCOR of those securities considered effective as of the time of their sale. This may be accomplished upon payment to the administrator, within six months after the sale, of a registration fee equal to the difference between the registration fee previously paid and the amount of the fee that would have otherwise been applicable to those additional securities if they had been included in the SCOR statement, if any, plus a late registration fee of \$250. Upon the election and payment, the SCOR statement will be considered to have been in effect with respect to those shares. Every person filing an amendment must pay a filing fee with respect to the additional securities.

Fees, expense reimbursements, and fines received under the bill must be deposited in the State Treasury to the administrator's credit, to be used pursuant to legislative appropriation by the Corporation and Securities Bureau in carrying out those duties required by law. After the payment of the amounts appropriated by the Legislature for the necessary expenses incurred in the administration of the Uniform Securities Act, the money remaining must be credited to the General Fund of the State. Fees and fines received under the bill may not be spent for partisan political activity.

Stop Orders. The administrator may issue a stop order, denying effectiveness to, or suspending or revoking the effectiveness of, any SCOR statement, if the administrator finds that the order is in the public interest and any of the following apply:

- The SCOR statement or any amendment or report is incomplete in any material respect or contains any statement that was, in the light of the circumstances under which it was made, false or misleading with respect to any material fact.
- Any provision of the bill or any rule, order, or condition lawfully imposed under the bill has been violated in connection with the offering by the person filing the SCOR statement; any underwriter; or the issuer, any partner, officer, or director of the issuer, any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling or controlled by the issuer, but only if the person filing the SCOR statement is directly or indirectly controlled by or acting for the issuer.
- The security registered or sought to be registered is the subject of an administrative

stop order, or similar order, or a permanent or temporary injunction of any court entered under any other Federal or state act applicable to the offering. The administrator, however, may not institute a proceeding against an effective SCOR statement more than one year from the date of the order or injunction, and may not enter an order on the basis of an order or injunction entered under any other state act unless that order or injunction was based on facts that would currently constitute a ground for a stop order under the bill.

- The issuer's enterprise or method of business includes or would include activities that are illegal where performed.
- The offering has worked or has tended to work a fraud, deception, or imposition, or would operate to do so.

The administrator, by order, may summarily postpone or suspend the effectiveness of a SCOR statement pending final determination of any proceeding under the bill. Upon the entry of such an order, the administrator promptly must notify the applicant or registrant, the issuer, and the person on whose behalf the securities are to be or have been offered that the order had been entered, the reasons that it has been entered, and that within 15 days after a written request is received, the matter will be scheduled for hearing. If no hearing is requested and none is ordered by the administrator, the order will remain in effect until it is modified or vacated by the administrator. If a hearing is requested or ordered, the administrator, after notice and opportunity for hearing, may modify, vacate, or extend the order until final determination. A stop order may not be entered without the appropriate prior notice, opportunity for a hearing, and written findings of fact and conclusions of law.

The administrator may vacate or modify a stop order if it finds that the conditions that prompted entry of the stop order have changed or that it is otherwise in the public interest to vacate or modify the stop order.

MCL 451.304a et al.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The bill not only establishes in statute many of the current administrative rules governing issuance of

a small corporate offering registration, or SCOR, but also updates provisions contained in rule to reflect recent SEC action regarding the cap that applies to SCORs. Specifically, the bill will raise the maximum amount available through a SCOR from \$1 million to \$5 million, which is the amount currently allowed in California for SCORs, if the SEC grants Michigan an exemption at that level as allowed under Federal law (15 U.S.C. 77c).

In addition, the bill will encourage more investors to take advantage of SCORs because, under the bill, the Corporation and Securities Bureau will be limited in the kind of information it may require from an issuer to approve a SCOR, and certain proprietary information provided to it by an issuer will be exempt from the Freedom of Information Act's disclosure requirements. The bill should open the SCOR market in Michigan by encouraging a greater number of small businesses to raise capital with a minimal amount of regulatory interference, which should help these businesses to grow and create new jobs.

Supporting Argument

According to an article in the July 1996 *Small Business Journal*, "Michigan is rich in technology but poor in efforts to commercialize new technologies through entrepreneurial enterprises." By encouraging relatively small securities offerings, the bill can help to establish Michigan as an attractive location for venture capital activity and for the development of high-technology companies. These ventures typically carry relatively small capital requirements in their early stages of development but have relatively high investment risk levels. By making investment capital more readily available to small operators, the bill should help to spur this industry in Michigan. Doing so will improve the State's poor rate of commercializing technology.

Legislative Analyst: P. Affholter

FISCAL IMPACT

The bill codifies the existing rules for registering securities under the small corporate offering registration category while also including the exemption that has been granted to California, which allows applicants to offer up to \$5,000,000 in securities to the public. Although there is no way to predict the number of new applicants that there will be as a result of this exemption, the Department of Consumer and Industry Services estimates that the filing fee will adequately cover these administrative costs; therefore there will be no fiscal impact.

Fiscal Analyst: M. Tyszkiewicz

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.