

# **SIMPLIFYING THE CAPITAL FORMATION PROCESS FOR SMALL BUSINESS VENTURES IN IDAHO**

## **STATE OF IDAHO**

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Recognizing the unique financial problems small companies face in raising venture capital, the Department has adopted the Small Company Offering Registration Form (Form U-7) for use by qualifying small businesses.

This action was taken to promote small business capital formation in Idaho and to encourage investment in small business ventures.

Without sacrificing protections afforded investors under the securities laws, the form provides a simplified registration procedure intended to minimize offering costs and maximize the amount of investor funds available for use by the company.

The form allows the company to raise up to \$10 million in offering proceeds from an unlimited number of investors using public advertising. The company may engage selling agents or sell the securities itself. Form U-7 filings will be given priority to allow the issuer to begin the offering as expeditiously as possible.

Prior to filing a U-7 Disclosure Document, the issuer may seek assistance from the Department in determining eligibility and appropriateness of using the form.

### **The Form U-7 Disclosure Document**

The Small Company Offering Registration Form (Form U-7) consists of a description of qualifying factors and detailed instructions; however, the core of Form U-7 registration is the Disclosure Document.

The Form U-7 Disclosure Document uses an easily readable question and answer format intended to elicit specific information about the company and its business objectives.

Use of the form affords a reduction of offering costs in that: the company may file a claim of exemption from registration under federal securities laws pursuant to SEC Rule 504, so registration with the SEC is not required; the question and answer format is easily understandable and may be used by companies whose attorneys and accountants are not securities experts; once declared effective, the form may be reproduced on an office copier and be used as the prospectus to solicit investors; within limitations, reviewed rather than audited financials may be used (if the conditions of section III (D) of the Statement of Policy Regarding Small Company Offering Registrations are met).

The form provides investors with substantial disclosure information comparable to that required in other registered securities offerings. The form also uses a unique approach of allowing investors to read both the questions and answers including “no” and “inapplicable” responses and provides a number of notes to help investors interpret the answers provided by the issuer.

In addition, by completing the form, the company must address certain aspects of its business usually included in a formal business plan. The form can help a company identify deficiencies and weaknesses in its business plan that represent potential risks. Such factors should be disclosed as investment risks to prospective investors.

### **General Qualifications**

Form U-7 has been adopted in the State of Idaho as an alternative form of registration by qualification for small company issuers who seek to raise seed capital through an offering of securities to the public.

The form may be used only by companies:

- (1) organized under the laws of one of the states or possessions of the United States;
- (2) who have filed a claim of exemption from registration with the Securities and Exchange Commission in reliance upon Rule 504 of federal Regulation D;
- (3) who have sufficient operating history to complete the required disclosure document.

Specifically, Form U-7 may not be used:

- By companies which engage in or propose to engage in petroleum exploration or production, or mining or other extractive industries.
- By “blind pool” companies (those without sufficiently identifiable properties or business objectives).
- By companies that seek to raise more than \$10,000,000 in an offering.
- By “penny stock” offerings (for which the stock price is less than \$1.00 per share).
- By partnerships.
- To register securities for resale on behalf of anyone other than the company, itself.
- If the company or its officers, directors, or majority stockholders (ownership interest of 10% or greater), are subject to current or past regulatory action in connection with the offer or sale of securities.
- If the company is an investment company (including mutual funds) or is a public company subject to the reporting requirements of Sections 13 or 15(d) of the Securities Act of 1934.
- By any type of company whose securities are subject to registration with a governmental agency other than the Securities and Exchange Commission or a state securities regulator. (For example, the securities of banks and other financial institutions are regulated by separate agencies.)

## **Offering Size and Price**

Up to \$10 million may be raised each 12 months using Form U-7. In calculating this limit, sales in all jurisdictions must be included together with any other securities sold under SEC Rule 504 or under Section 3(b) of the Securities Act of 1933, or in violation of the registration provisions of federal securities laws. The offering price must be at least \$1 per share, and the company may not split its stock or declare stock dividends for 2 years following effectiveness of the registration except with the permission of the Director of the Department of Finance.

Securities sold in a U-7 offering are freely transferable. However, because of its small size and the \$1 minimum price, a public trading market is unlikely to arise following a Form U-7 offering. Thus, a U-7 offering is in the nature of an early-stage venture financing, using public investors solicited by means of advertising or other general solicitation, which, if appropriate, may be followed at some later stage by a more conventional public offering that would result in the development of a public trading market for the company's securities.

## **Types of Securities**

Form U-7 may be used to register equity securities including common, preferred, and convertible preferred stock, and options, warrants, or rights to purchase stock; and debt offerings (including convertible debt) if the issuer can demonstrate reasonable ability to service its debt.

## **The Registration Process**

The Department will assist companies in determining whether they are eligible to use Form U-7 and will provide guidance in completing the form. The company may wish to arrange a pre-filing conference with the Securities Bureau staff to go over specific items in the form.

Filing is accomplished by submitting to the Department:

- (1) A copy of the Form D filed with the SEC;
- (2) Forms U-1 and U-2;
- (3) Notification of the registered selling agent or agents;
- (4) Form U-7 Disclosure Document completed and accompanied by exhibits; and
- (5) Filing fee of \$300.

The Form U-7 when properly filled in, signed and submitted, together with the exhibits required above, constitutes an application to register securities. When declared effective by the Director, Form U-7 constitutes the offering circular or prospectus to be delivered to prospective investors and may be reproduced by the company.

While giving due consideration to the need to minimize interference in capital formation by small issuers, Form U-7 registration filings will be reviewed for substantial compliance with Idaho law. Fairness rules will be applied on a case by case basis as deemed necessary for the protection of Idaho investors. The issuer may anticipate receiving comments from securities examiners if additional disclosure information is required. However, the Department will expedite the review process – generally completing the review within one week of filing.

## **Financial Statements**

Financial statements for the company's last fiscal year must be attached to Form U-7. Reviewed rather than audited statements may be used if:

- (1) the company has not previously sold securities by means of an offering involving the general solicitation of investors;
- (2) the company has not previously been required by law to provide audited financial statements in connection with the sale of its securities, and;
- (3) the aggregate amount of all previous sales of securities by the company (excluding debt financing with banks and other commercial lenders) does not exceed \$10 million.
- (4) the amount of the present offering does not exceed \$10 million.

Unaudited interim financial statements may also be required. Financial statements for acquired companies must be included if either a 20% asset or income test is met.

## **Selling the Offering**

Under Form U-7, the issuer may make offers to an unlimited number of investors using public solicitations including public meetings and advertisements. There are no restrictions on the type of investor or the amount any one investor may purchase.

Advertisements and supplemental selling literature should be filed and approved by the Director prior to publication or circulation to the public. The form's instructions provide a sample classified advertisement for newspaper publication.

Securities offered under U-7 may be sold directly by the company or by commissioned selling agents. Any person (including employees of the issuer) who offers to sell securities to prospective investors must be registered prior to making offers or sales. The Uniform Securities Act (2004) of the State of Idaho allows up to two officers of the company to register as salesmen without taking a securities examination or posting a salesman's bond.

In addition to the above requirements, proceeds of the offering must be placed in an impound with an independent bank or similar institution until the minimum amount necessary for the company to achieve its stated objectives is raised. The company may raise additional funds so long as their anticipated use is clearly disclosed.

## **Development of Form U-7**

The Small Company Offering Registration Form was developed in furtherance of the policies of the Small Business Incentive Act of 1980 (Section 19 of the Securities Act of 1933) which prescribes state and federal cooperation in reducing the costs and paperwork of raising investment capital, particularly by small business.

A Study Group of the State Regulation of Securities Committee of the American Bar Association was instrumental in developing Form U-7 for use by small business. The form has been adopted by the North American Securities Administrators Association.

The Department would like to thank Mike Liles, Jr. of the Seattle law firm of Bogle and Gates, and a principal draftsman of the Form U-7 Disclosure Document, for his cooperation and assistance in preparation of this booklet.

### **Other Sources of Information**

Copies of Form U-7 as well as the information brochures:

- (1) *Raising Small Business Capital Through Securities*
- (2) *A Consumers Guide to Making Venture Investments in Small Businesses*

are available from the Department of Finance.

Information on alternative sources of funding is available from the Idaho Department of Commerce at (208) 334-2470

Assistance in developing business plans is available from the six regional offices of the Idaho Small Business Development Center. For more information call in-state 1-800-225-3815 or (208) 426-3875.