

RESOLUTION 10-01-2012

DIGEST

Securities: Sale of LLC Securities to Qualified Purchasers

Amends Corporations Code section 25102 to exempt from certain securities laws full-voting LLC securities sold to qualified investors.

RESOLUTIONS COMMITTEE RECOMMENDATION

APPROVE IN PRINCIPLE

History:

No similar resolutions found.

Reasons:

This resolution amends Corporations Code section 25102 to exempt from certain securities laws full-voting LLC securities sold to qualified investors. The resolution should be approved in principle because it allows limited liability companies issuing shares to statutorily-defined "qualified investors" to have the same exemption from certain securities laws that corporations currently enjoy.

It is not clear why the current statute distinguishes between corporations and limited liability companies on this point. The author of the resolution suggests that the difference is either oversight (the law creating limited liability companies and the law creating the exemption were enacted the same day), or a desire to ensure that the exemption only applies to securities issued with full voting rights. This resolution addresses the latter concern by defining a class of LLC securities that are the equivalent of full voting shares of stock.

TEXT OF RESOLUTION

RESOLVED, that the Conference of California Bar Associations recommends that legislation be sponsored to amend Corporations Code section 25102 as follows:

- 1 § 25102
- 2 The following transactions are exempted from the provisions of Section 25110:
- 3 (a) Any offer (but not a sale) not involving any public offering and the execution and
- 4 delivery of any agreement for the sale of securities pursuant to the offer if (1) the agreement
- 5 contains substantially the following provision: "The sale of the securities that are the subject of
- 6 this agreement has not been qualified with the Commissioner of Corporations of the State of
- 7 California and the issuance of the securities or the payment or receipt of any part of the
- 8 consideration therefore prior to the qualification is unlawful, unless the sale of securities is
- 9 exempt from the qualification by Section 25100, 25102, or 25105 of the California Corporations
- 10 Code. The rights of all parties to this agreement are expressly conditioned upon the qualification
- 11 being obtained, unless the sale is so exempt"; and (2) no part of the purchase price is paid or
- 12 received and none of the securities are issued until the sale of the securities is qualified under this
- 13 law unless the sale of securities is exempt from the qualification by this section, Section 25100,
- 14 or 25105.

15 (b) Any offer (but not a sale) of a security for which a registration statement has been
16 filed under the Securities Act of 1933 but has not yet become effective, or for which an offering
17 statement under Regulation A has been filed but has not yet been qualified, if no stop order or
18 refusal order is in effect and no public proceeding or examination looking towards an order is
19 pending under Section 8 of the act and no order under Section 25140 or subdivision (a) of
20 Section 25143 is in effect under this law.

21 (c) Any offer (but not a sale) and the execution and delivery of any agreement for the sale
22 of securities pursuant to the offer as may be permitted by the commissioner upon application.
23 Any negotiating permit under this subdivision shall be conditioned to the effect that none of the
24 securities may be issued and none of the consideration therefore may be received or accepted
25 until the sale of the securities is qualified under this law.

26 (d) Any transaction or agreement between the issuer and an underwriter or among
27 underwriters if the sale of the securities is qualified, or exempt from qualification, at the time of
28 distribution thereof in this state, if any.

29 (e) Any offer or sale of any evidence of indebtedness, whether secured or unsecured, and
30 any guarantee thereof, in a transaction not involving any public offering.

31 (f) Any offer or sale of any security in a transaction (other than an offer or sale to a
32 pension or profit-sharing trust of the issuer) that meets each of the following criteria:

33 (1) Sales of the security are not made to more than 35 persons, including persons not in
34 this state.

35 (2) All purchasers either have a preexisting personal or business relationship with the
36 offeror or any of its partners, officers, directors or controlling persons, or managers (as appointed
37 or elected by the members) if the offeror is a limited liability company, or by reason of their
38 business or financial experience or the business or financial experience of their professional
39 advisers who are unaffiliated with and who are not compensated by the issuer or any affiliate or
40 selling agent of the issuer, directly or indirectly, could be reasonably assumed to have the
41 capacity to protect their own interests in connection with the transaction.

42 (3) Each purchaser represents that the purchaser is purchasing for the purchaser's own
43 account (or a trust account if the purchaser is a trustee) and not with a view to or for sale in
44 connection with any distribution of the security.

45 (4) The offer and sale of the security is not accomplished by the publication of any
46 advertisement. The number of purchasers referred to above is exclusive of any described in
47 subdivision (i), any officer, director, or affiliate of the issuer, or manager (as appointed or elected
48 by the members) if the issuer is a limited liability company, and any other purchaser who the
49 commissioner designates by rule. For purposes of this section, a husband and wife (together with
50 any custodian or trustee acting for the account of their minor children) are counted as one person
51 and a partnership, corporation, or other organization that was not specifically formed for the
52 purpose of purchasing the security offered in reliance upon this exemption, is counted as one
53 person. The commissioner may by rule require the issuer to file a notice of transactions under
54 this subdivision.

55 The failure to file the notice or the failure to file the notice within the time specified by
56 the rule of the commissioner shall not affect the availability of this exemption. An issuer who
57 fails to file the notice as provided by rule of the commissioner shall, within 15 business days
58 after discovery of the failure to file the notice or after demand by the commissioner, whichever
59 occurs first, file the notice and pay to the commissioner a fee equal to the fee payable had the
60 transaction been qualified under Section 25110.

61 (g) Any offer or sale of conditional sale agreements, equipment trust certificates, or
62 certificates of interest or participation therein or partial assignments thereof, covering the
63 purchase of railroad rolling stock or equipment or the purchase of motor vehicles, aircraft, or
64 parts thereof, in a transaction not involving any public offering.

65 (h) Any offer or sale of voting common stock by a corporation incorporated in any state
66 if, immediately after the proposed sale and issuance, there will be only one class of stock of the
67 corporation outstanding that is owned beneficially by no more than 35 persons, provided all of
68 the following requirements have been met:

69 (1) The offer and sale of the stock is not accompanied by the publication of any
70 advertisement, and no selling expenses have been given, paid, or incurred in connection
71 therewith.

72 (2) The consideration to be received by the issuer for the stock to be issued consists of
73 any of the following:

74 (A) Only assets (which may include cash) of an existing business enterprise transferred to
75 the issuer upon its initial organization, of which all of the persons who are to receive the stock to
76 be issued pursuant to this exemption were owners during, and the enterprise was operated for, a
77 period of not less than one year immediately preceding the proposed issuance, and the ownership
78 of the enterprise immediately prior to the proposed issuance was in the same proportions as the
79 shares of stock are to be issued.

80 (B) Only cash or cancellation of indebtedness for money borrowed, or both, upon the
81 initial organization of the issuer, provided all of the stock is issued for the same price per share.

82 (C) Only cash, provided the sale is approved in writing by each of the existing
83 shareholders and the purchaser or purchasers are existing shareholders.

84 (D) In a case where after the proposed issuance there will be only one owner of the stock
85 of the issuer, only any legal consideration.

86 (3) No promotional consideration has been given, paid, or incurred in connection with the
87 issuance. Promotional consideration means any consideration paid directly or indirectly to a
88 person who, acting alone or in conjunction with one or more other persons, takes the initiative in
89 founding and organizing the business or enterprise of an issuer for services rendered in
90 connection with the founding or organizing.

91 (4) A notice in a form prescribed by rule of the commissioner, signed by an active
92 member of the State Bar of California, is filed with or mailed for filing to the commissioner not
93 later than 10 business days after receipt of consideration for the securities by the issuer. That
94 notice shall contain an opinion of the member of the State Bar of California that the exemption
95 provided by this subdivision is available for the offer and sale of the securities. The failure to file
96 the notice as required by this subdivision and the rules of the commissioner shall not affect the
97 availability of this exemption. An issuer who fails to file the notice within the time specified by
98 this subdivision shall, within 15 business days after discovery of the failure to file the notice or
99 after demand by the commissioner, whichever occurs first, file the notice and pay to the
100 commissioner a fee equal to the fee payable had the transaction been qualified under Section
101 25110. The notice, except when filed on behalf of a California corporation, shall be accompanied
102 by an irrevocable consent, in the form that the commissioner by rule prescribes, appointing the
103 commissioner or his or her successor in office to be the issuer's attorney to receive service of any
104 lawful process in any noncriminal suit, action, or proceeding against it or its successor that arises
105 under this law or any rule or order hereunder after the consent has been filed, with the same force
106 and validity as if served personally on the issuer. An issuer on whose behalf a consent has been

107 filed in connection with a previous qualification or exemption from qualification under this law
108 (or application for a permit under any prior law if the application or notice under this law states
109 that the consent is still effective) need not file another. Service may be made by leaving a copy
110 of the process in the office of the commissioner, but it is not effective unless (A) the plaintiff,
111 who may be the commissioner in a suit, action, or proceeding instituted by him or her, forthwith
112 sends notice of the service and a copy of the process by registered or certified mail to the
113 defendant or respondent at its last address on file with the commissioner, and (B) the plaintiff's
114 affidavit of compliance with this section is filed in the case on or before the return day of the
115 process, if any, or within the further time as the court allows.

116 (5) Each purchaser represents that the purchaser is purchasing for the purchaser's own
117 account, or a trust account if the purchaser is a trustee, and not with a view to or for sale in
118 connection with any distribution of the stock.

119 For the purposes of this subdivision, all securities held by a husband and wife, whether or
120 not jointly, shall be considered to be owned by one person, and all securities held by a
121 corporation that has issued stock pursuant to this exemption shall be considered to be held by the
122 shareholders to whom it has issued the stock.

123 All stock issued by a corporation pursuant to this subdivision as it existed prior to the
124 effective date of the amendments to this section made during the 1996 portion of the 1995-96
125 Regular Session that required the issuer to have stamped or printed prominently on the face of
126 the stock certificate a legend in a form prescribed by rule of the commissioner restricting transfer
127 of the stock in a manner provided for by that rule shall not be subject to the transfer restriction
128 legend requirement and, by operation of law, the corporation is authorized to remove that
129 transfer restriction legend from the certificates of those shares of stock issued by the corporation
130 pursuant to this subdivision as it existed prior to the effective date of the amendments to this
131 section made during the 1996 portion of the 1995-96 Regular Session.

132 (i) Any offer or sale (1) to a bank, savings and loan association, trust company, insurance
133 company, investment company registered under the Investment Company Act of 1940, pension
134 or profit-sharing trust (other than a pension or profit-sharing trust of the issuer, a self-employed
135 individual retirement plan, or individual retirement account), or other institutional investor or
136 governmental agency or instrumentality that the commissioner may designate by rule, whether
137 the purchaser is acting for itself or as trustee, or (2) to any corporation with outstanding
138 securities registered under Section 12 of the Securities Exchange Act of 1934 or any wholly
139 owned subsidiary of the corporation that after the offer and sale will own directly or indirectly
140 100 percent of the outstanding capital stock of the issuer, provided the purchaser represents that
141 it is purchasing for its own account (or for the trust account) for investment and not with a view
142 to or for sale in connection with any distribution of the security.

143 (j) Any offer or sale of any certificate of interest or participation in an oil or gas title or
144 lease (including subsurface gas storage and payments out of production) if either of the following
145 apply:

146 (1) All of the purchasers meet one of the following requirements:

147 (A) Are and have been during the preceding two years engaged primarily in the business
148 of drilling for, producing, or refining oil or gas (or whose corporate predecessor, in the case of a
149 corporation, has been so engaged).

150 (B) Are persons described in paragraph (1) of subdivision (i).

151 (C) Have been found by the commissioner upon written application to be substantially
152 engaged in the business of drilling for, producing, or refining oil or gas so as not to require the

153 protection provided by this law (which finding shall be effective until rescinded).

154 (2) The security is concurrently hypothecated to a bank in the ordinary course of business
155 to secure a loan made by the bank, provided that each purchaser represents that it is purchasing
156 for its own account for investment and not with a view to or for sale in connection with any
157 distribution of the security.

158 (k) Any offer or sale of any security under, or pursuant to, a plan of reorganization under
159 Chapter 11 of the federal bankruptcy law that has been confirmed or is subject to confirmation
160 by the decree or order of a court of competent jurisdiction.

161 (l) Any offer or sale of an option, warrant, put, call, or straddle, and any guarantee of any
162 of these securities, by a person who is not the issuer of the security subject to the right, if the
163 transaction, had it involved an offer or sale of the security subject to the right by the person,
164 would not have violated Section 25110 or 25130.

165 (m) Any offer or sale of a stock to a pension, profit-sharing, stock bonus, or employee
166 stock ownership plan, provided that (1) the plan meets the requirements for qualification under
167 Section 401 of the Internal Revenue Code, and (2) the employees are not required or permitted
168 individually to make any contributions to the plan. The exemption provided by this subdivision
169 shall not be affected by whether the stock is contributed to the plan, purchased from the issuer
170 with contributions by the issuer or an affiliate of the issuer, or purchased from the issuer with
171 funds borrowed from the issuer, an affiliate of the issuer, or any other lender.

172 (n) Any offer or sale of any security in a transaction, other than an offer or sale of a
173 security in a rollup transaction, that meets all of the following criteria:

174 (1) The issuer is (A) a California corporation or foreign corporation that, at the time of
175 the filing of the notice required under this subdivision, is subject to Section 2115, or (B) any
176 other form of business entity, including without limitation a partnership or trust organized under
177 the laws of this state. The exemption provided by this subdivision is not available to a "blind
178 pool" issuer, as that term is defined by the commissioner, or to an investment company subject to
179 the Investment Company Act of 1940.

180 (2) Sales of securities are made only to qualified purchasers or other persons the issuer
181 reasonably believes, after reasonable inquiry, to be qualified purchasers. A corporation,
182 partnership, or other organization specifically formed for the purpose of acquiring the securities
183 offered by the issuer in reliance upon this exemption may be a qualified purchaser if each of the
184 equity owners of the corporation, partnership, or other organization is a qualified purchaser.
185 Qualified purchasers include the following:

186 (A) A person designated in Section 260.102.13 of Title 10 of the California Code of
187 Regulations.

188 (B) A person designated in subdivision (i) or any rule of the commissioner adopted
189 thereunder.

190 (C) A pension or profit-sharing trust of the issuer, a self-employed individual retirement
191 plan, or an individual retirement account, if the investment decisions made on behalf of the trust,
192 plan, or account are made solely by persons who are qualified purchasers.

193 (D) An organization described in Section 501(c)(3) of the Internal Revenue Code,
194 corporation, Massachusetts or similar business trust, or partnership, each with total assets in
195 excess of five million dollars (\$5,000,000) according to its most recent audited financial
196 statements.

197 (E) With respect to the offer and sale of one class of voting common stock or one class of
198 non-preferred voting securities of an issuer or of preferred stock or preferred securities of an

199 issuer entitling the holder thereof to at least the same voting rights as the issuer's one class of
200 voting common stock or the issuer's class of voting securities with the greatest voting rights,
201 provided that the issuer has only one class of voting common stock or non-preferred voting
202 securities outstanding upon consummation of the offer and sale, a natural person who, either
203 individually or jointly with the person's spouse, (i) has a minimum net worth of two hundred fifty
204 thousand dollars (\$250,000) and had, during the immediately preceding tax year, gross income in
205 excess of one hundred thousand dollars (\$100,000) and reasonably expects gross income in
206 excess of one hundred thousand dollars (\$100,000) during the current tax year or (ii) has a
207 minimum net worth of five hundred thousand dollars (\$500,000). "Net worth" shall be
208 determined exclusive of home, home furnishings, and automobiles. Other assets included in the
209 computation of net worth may be valued at fair market value. "Non-preferred securities" means
210 securities which have no preference over any other securities with respect to distribution of
211 assets on liquidation or with respect to payment of dividends.

212 Each natural person specified above, by reason of his or her business or financial
213 experience, or the business or financial experience of his or her professional adviser, who is
214 unaffiliated with and who is not compensated, directly or indirectly, by the issuer or any affiliate
215 or selling agent of the issuer, can be reasonably assumed to have the capacity to protect his or her
216 interests in connection with the transaction. The amount of the investment of each natural person
217 shall not exceed 10 percent of the net worth, as determined by this subparagraph, of that natural
218 person.

219 (F) Any other purchaser designated as qualified by rule of the commissioner.

220 (3) Each purchaser represents that the purchaser is purchasing for the purchaser's own
221 account (or trust account, if the purchaser is a trustee) and not with a view to or for sale in
222 connection with a distribution of the security.

223 (4) Each natural person purchaser, including a corporation, partnership, or other
224 organization specifically formed by natural persons for the purpose of acquiring the securities
225 offered by the issuer, receives, at least five business days before securities are sold to, or a
226 commitment to purchase is accepted from, the purchaser, a written offering disclosure statement
227 that shall meet the disclosure requirements of Regulation D (17 C.F.R. 230.501 et seq.), and any
228 other information as may be prescribed by rule of the commissioner, provided that the issuer
229 shall not be obligated pursuant to this paragraph to provide this disclosure statement to a natural
230 person qualified under Section 260.102.13 of Title 10 of the California Code of Regulations. The
231 offer or sale of securities pursuant to a disclosure statement required by this paragraph that is in
232 violation of Section 25401, or that fails to meet the disclosure requirements of Regulation D (17
233 C.F.R. 230.501 et seq.), shall not render unavailable to the issuer the claim of an exemption from
234 Section 25110 afforded by this subdivision. This paragraph does not impose, directly or
235 indirectly, any additional disclosure obligation with respect to any other exemption from
236 qualification available under any other provision of this section.

237 (5)(A) A general announcement of proposed offering may be published by written
238 document only, provided that the general announcement of proposed offering sets forth the
239 following required information:

240 (i) The name of the issuer of the securities.

241 (ii) The full title of the security to be issued.

242 (iii) The anticipated suitability standards for prospective purchasers.

243 (iv) A statement that (I) no money or other consideration is being solicited or will be
244 accepted, (II) an indication of interest made by a prospective purchaser involves no obligation or

245 commitment of any kind, and, if the issuer is required by paragraph (4) to deliver a disclosure
246 statement to prospective purchasers, (III) no sales will be made or commitment to purchase
247 accepted until five business days after delivery of a disclosure statement and subscription
248 information to the prospective purchaser in accordance with the requirements of this subdivision.

249 (v) Any other information required by rule of the commissioner.

250 (vi) The following legend: "For more complete information about (Name of Issuer) and
251 (Full Title of Security), send for additional information from (Name and Address) by sending
252 this coupon or calling (Telephone Number)."

253 (B) The general announcement of proposed offering referred to in subparagraph (A) may
254 also set forth the following information:

255 (i) A brief description of the business of the issuer.

256 (ii) The geographic location of the issuer and its business.

257 (iii) The price of the security to be issued, or, if the price is not known, the method of its
258 determination or the probable price range as specified by the issuer, and the aggregate offering
259 price.

260 (C) The general announcement of proposed offering shall contain only the information
261 that is set forth in this paragraph.

262 (D) Dissemination of the general announcement of proposed offering to persons who are
263 not qualified purchasers, without more, shall not disqualify the issuer from claiming the
264 exemption under this subdivision.

265 (6) No telephone solicitation shall be permitted until the issuer has determined that the
266 prospective purchaser to be solicited is a qualified purchaser.

267 (7) The issuer files a notice of transaction under this subdivision both (A) concurrent with
268 the publication of a general announcement of proposed offering or at the time of the initial offer
269 of the securities, whichever occurs first, accompanied by a filing fee, and (B) within 10 business
270 days following the close or abandonment of the offering, but in no case more than 210 days from
271 the date of filing the first notice. The first notice of transaction under subparagraph (A) shall
272 contain an undertaking, in a form acceptable to the commissioner, to deliver any disclosure
273 statement required by paragraph (4) to be delivered to prospective purchasers, and any
274 supplement thereto, to the commissioner within 10 days of the commissioner's request for the
275 information. The exemption from qualification afforded by this subdivision is unavailable if an
276 issuer fails to file the first notice required under subparagraph (A) or to pay the filing fee. The
277 commissioner has the authority to assess an administrative penalty of up to one thousand dollars
278 (\$1,000) against an issuer that fails to deliver the disclosure statement required to be delivered to
279 the commissioner upon the commissioner's request within the time period set forth above.
280 Neither the filing of the disclosure statement nor the failure by the commissioner to comment
281 thereon precludes the commissioner from taking any action deemed necessary or appropriate
282 under this division with respect to the offer and sale of the securities.

283 (o) An offer or sale of any security issued by a corporation or limited liability company
284 pursuant to a purchase plan or agreement, or issued pursuant to an option plan or agreement,
285 where the security at the time of issuance or grant is exempt from registration under the
286 Securities Act of 1933, as amended, pursuant to Rule 701 adopted pursuant to that act (17 C.F.R.
287 230.701), the provisions of which are hereby incorporated by reference into this section,
288 provided that (1) the terms of any purchase plan or agreement shall comply with Sections
289 260.140.42, 260.140.45, and 260.140.46 of Title 10 of the California Code of Regulations, (2)
290 the terms of any option plan or agreement shall comply with Sections 260.140.41, 260.140.45,

291 and 260.140.46 of Title 10 of the California Code of Regulations, and (3) the issuer files a notice
292 of transaction in accordance with rules adopted by the commissioner no later than 30 days after
293 the initial issuance of any security under that plan, accompanied by a filing fee as prescribed by
294 subdivision (y) of Section 25608. The failure to file the notice of transaction within the time
295 specified in this subdivision shall not affect the availability of this exemption. An issuer that fails
296 to file the notice shall, within 15 business days after discovery of the failure to file the notice or
297 after demand by the commissioner, whichever occurs first, file the notice and pay the
298 commissioner a fee equal to the maximum aggregate fee payable had the transaction been
299 qualified under Section 25110.

300 Offers and sales exempt pursuant to this subdivision shall be deemed to be part of a
301 single, discrete offering and are not subject to integration with any other offering or sale, whether
302 qualified under Chapter 2 (commencing with Section 25110), or otherwise exempt, or not subject
303 to qualification.

304 (p) An offer or sale of nonredeemable securities to accredited investors (Section 28031)
305 by a person licensed under the Capital Access Company Law (Division 3 (commencing with
306 Section 28000) of Title 4). All nonredeemable securities shall be evidenced by certificates that
307 shall have stamped or printed prominently on their face a legend in a form to be prescribed by
308 rule or order of the commissioner restricting transfer of the securities in the manner as the rule or
309 order provides.

310 (q) Any offer or sale of any viatical or life settlement contract or fractionalized or pooled
311 interest therein in a transaction that meets all of the following criteria:

312 (1) Sales of securities described in this subdivision are made only to qualified purchasers
313 or other persons the issuer reasonably believes, after reasonable inquiry, to be qualified
314 purchasers. A corporation, partnership, or other organization specifically formed for the purpose
315 of acquiring the securities offered by the issuer in reliance upon this exemption may be a
316 qualified purchaser only if each of the equity owners of the corporation, partnership, or other
317 organization is a qualified purchaser. Qualified purchasers include the following:

318 (A) A person designated in Section 260.102.13 of Title 10 of the California Code of
319 Regulations.

320 (B) A person designated in subdivision (i) or any rule of the commissioner adopted
321 thereunder.

322 (C) A pension or profit-sharing trust of the issuer, a self-employed individual retirement
323 plan, or an individual retirement account, if the investment decisions made on behalf of the trust,
324 plan, or account are made solely by persons who are qualified purchasers.

325 (D) An organization described in Section 501(c)(3) of the Internal Revenue Code,
326 corporation, Massachusetts or similar business trust, or partnership, each with total assets in
327 excess of five million dollars (\$5,000,000) according to its most recent audited financial
328 statements.

329 (E) A natural person who, either individually or jointly with the person's spouse, (i) has a
330 minimum net worth of one hundred fifty thousand dollars (\$150,000) and had, during the
331 immediately preceding tax year, gross income in excess of one hundred thousand dollars
332 (\$100,000) and reasonably expects gross income in excess of one hundred thousand dollars
333 (\$100,000) during the current tax year or (ii) has a minimum net worth of two hundred fifty
334 thousand dollars (\$250,000). "Net worth" shall be determined exclusive of home, home
335 furnishings, and automobiles. Other assets included in the computation of net worth may be
336 valued at fair market value.

337 Each natural person specified above, by reason of his or her business or financial
338 experience, or the business or financial experience of his or her professional adviser, who is
339 unaffiliated with and who is not compensated, directly or indirectly, by the issuer or any affiliate
340 or selling agent of the issuer, can be reasonably assumed to have the capacity to protect his or her
341 interests in connection with the transaction.

342 The amount of the investment of each natural person shall not exceed 10 percent of the
343 net worth, as determined by this subdivision, of that natural person.

344 (F) Any other purchaser designated as qualified by rule of the commissioner.

345 (2) Each purchaser represents that the purchaser is purchasing for the purchaser's own
346 account (or trust account, if the purchaser is a trustee) and not with a view to or for sale in
347 connection with a distribution of the security.

348 (3) Each natural person purchaser, including a corporation, partnership, or other
349 organization specifically formed by natural persons for the purpose of acquiring the securities
350 offered by the issuer, receives, at least five business days before securities described in this
351 subdivision are sold to, or a commitment to purchase is accepted from, the purchaser, the
352 following information in writing:

353 (A) The name, principal business and mailing address, and telephone number of the
354 issuer.

355 (B) The suitability standards for prospective purchasers as set forth in paragraph (1) of
356 this subdivision.

357 (C) A description of the issuer's type of business organization and the state in which the
358 issuer is organized or incorporated.

359 (D) A brief description of the business of the issuer.

360 (E) If the issuer retains ownership or becomes the beneficiary of the insurance policy, an
361 audit report of an independent certified public accountant together with a balance sheet and
362 related statements of income, retained earnings, and cashflows that reflect the issuer's financial
363 position, the results of the issuer's operations, and the issuer's cashflows as of a date within 15
364 months before the date of the initial issuance of the securities described in this subdivision. The
365 financial statements listed in this subparagraph shall be prepared in conformity with generally
366 accepted accounting principles. If the date of the audit report is more than 120 days before the
367 date of the initial issuance of the securities described in this subdivision, the issuer shall provide
368 unaudited interim financial statements.

369 (F) The names of all directors, officers, partners, members, or trustees of the issuer.

370 (G) A description of any order, judgment, or decree that is final as to the issuing entity of
371 any state, federal, or foreign country governmental agency or administrator, or of any state,
372 federal or foreign country court of competent jurisdiction (i) revoking, suspending, denying, or
373 censuring for cause any license, permit, or other authority of the issuer or of any director, officer,
374 partner, member, trustee, or person owning or controlling, directly or indirectly, 10 percent or
375 more of the outstanding interest or equity securities of the issuer, to engage in the securities,
376 commodities, franchise, insurance, real estate, or lending business or in the offer or sale of
377 securities, commodities, franchises, insurance, real estate, or loans, (ii) permanently restraining,
378 enjoining, barring, suspending, or censuring any such person from engaging in or continuing any
379 conduct, practice, or employment in connection with the offer or sale of securities, commodities,
380 franchises, insurance, real estate, or loans, (iii) convicting any such person of, or pleading nolo
381 contendere by any such person to, any felony or misdemeanor involving a security, commodity,
382 franchise, insurance, real estate, or loan, or any aspect of the securities, commodities, franchise,

383 insurance, real estate, or lending business, or involving dishonesty, fraud, deceit, embezzlement,
384 fraudulent conversion, or misappropriation of property, or (iv) holding any such person liable in
385 a civil action involving breach of a fiduciary duty, fraud, deceit, embezzlement, fraudulent
386 conversion, or misappropriation of property. This subparagraph does not apply to any order,
387 judgment, or decree that has been vacated, overturned, or is more than 10 years old.

388 (H) Notice of the purchaser's right to rescind or cancel the investment and receive a
389 refund pursuant to Section 25508.5.

390 (I) The name, address, and telephone number of the issuing insurance company, and the
391 name, address, and telephone number of the state or foreign country regulator of the insurance
392 company.

393 (J) The total face value of the insurance policy and the percentage of the insurance policy
394 the purchaser will own.

395 (K) The insurance policy number, issue date, and type.

396 (L) If a group insurance policy, the name, address, and telephone number of the group,
397 and, if applicable, the material terms and conditions of converting the policy to an individual
398 policy, including the amount of increased premiums.

399 (M) If a term insurance policy, the term and the name, address, and telephone number of
400 the person who will be responsible for renewing the policy if necessary.

401 (N) That the insurance policy is beyond the state statute for contestability and the reason
402 therefor.

403 (O) The insurance policy premiums and terms of premium payments.

404 (P) The amount of the purchaser's moneys that will be set aside to pay premiums.

405 (Q) The name, address, and telephone number of the person who will be the insurance
406 policy owner and the person who will be responsible for paying premiums.

407 (R) The date on which the purchaser will be required to pay premiums and the amount of
408 the premium, if known.

409 (S) A statement to the effect that any projected rate of return to the purchaser from the
410 purchase of a viatical or life settlement contract or a fractionalized or pooled interest therein is
411 based on an estimated life expectancy for the person insured under the life insurance policy; that
412 the return on the purchase may vary substantially from the expected rate of return based upon the
413 actual life expectancy of the insured that may be less than, equal to, or may greatly exceed the
414 estimated life expectancy; and that the rate of return would be higher if the actual life expectancy
415 were less than, and lower if the actual life expectancy were greater than the estimated life
416 expectancy of the insured at the time the viatical or life settlement contract was closed.

417 (T) A statement that the purchaser should consult with his or her tax adviser regarding the
418 tax consequences of the purchase of the viatical or life settlement contract or fractionalized or
419 pooled interest therein and, if the purchaser is using retirement funds or accounts for that
420 purchase, whether or not any adverse tax consequences might result from the use of those funds
421 for the purchase of that investment.

422 (U) Any other information as may be prescribed by rule of the commissioner.

(Proposed new language underlined; language to be deleted stricken.)

PROPONENT: Alameda County Bar Association

STATEMENT OF REASONS

Existing Law: In a Corporations Code section 25102(n) securities offering, only a corporation can use the class of investors described in subpart (n)(2)(E) (“Full Voting Rights Investors”). Subpart (n)(1) states that all types of California business entities may use the 25102(n) exemption.

But an opinion issued by the California Commissioner of Corporations in 1999 (Commissioner’s Opinion 99/1C, Nov. 22, 1999) stated that only corporations could sell to Full Voting Rights Investors. The Commissioner based this on subpart (n)(2)(E)’s use of the word “stock” rather than “securities”.

This Resolution: Would amend Corporations Code section 25102(n)(2)(E) to add language allowing offerings of other types of securities beyond “stock” while keeping the same voting and investor requirements that currently exist in that subpart.

The amendment basically adds the phrases “non-preferred voting securities” along with the existing “voting common stock”, and also adds the words “preferred voting securities” along with the existing “preferred stock”. For clarity it also defines “non-preferred securities” by tracking the definition of “common shares” found in Corporations Code Section 159. (Common stock has full voting rights; preferred stock has limited voting rights.)

The Problem: Unlike corporations, California limited liability companies (LLC’s) making a Corporations Code section 25102(n) securities offering cannot use the subpart (2)(E) class of investors. Allowing the same exemption for LLC’s perhaps doubles the number of qualified potential investors. Given the ongoing credit crisis, taking this step will help California businesses, both startups and established businesses having trouble getting loans, to raise money. (For tax reasons, many small businesses must form as an LLC as opposed to a corporation. A “C” corporation has two levels of taxation: It pays income tax on its profits and its owners/investors pay income taxes on their profit distributions. Both a Subchapter “S” corporation and a limited liability company avoid most of this problem, at least for federal income taxes. But a Subchapter “S” corporation is not allowed if even one investor is an entity as opposed to an individual or is a foreign resident.)

The bill creating limited liability companies in California (SB 469) and the bill creating the 25102(n) exemption (SB 1951) were passed on the same day: August 30, 1994. The analyses of the latter do not discuss differences between corporations and other types of business entities.

It is not clear why the legislature used “stock” in subpart (n)(2)(E) rather than “securities”. (Instead of stock, an LLC uses either “units” or percentages to track ownership.) It may have been accidental or it may be because subpart (n)(2)(E) stresses full voting rights for this class of investors. The Legislature may not have realized that an LLC – which was being adopted as a business entity at the same time -- could be organized to meet the voting requirements of subpart (n)(2)(E).

Assuming that an LLC has the required voting rights, it does not make any sense to allow a

corporation to use the Full Voting Rights Class of investors but bar an LLC from doing so.

IMPACT STATEMENT

This resolution does not affect any other law, statute or rule.

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