



**Your company needs money to ensure its future.
Bank financing is unavailable, and other
potential lenders seem unwilling to even discuss the matter.
What should you do?**

How To Secure Funding Without a Bank

By Michael I. Stolzar, Esq.



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potential lender will require at least a business plan which sets forth the objectives of your company, together with a budget outlining its projected income and expenses. The business plan would also include the amount of funding sought as well as an explanation of how the funds will be utilized.



Private Placement Offerings

Given the current economic environment and the lack of institutional lending, an excellent source of funding is the private investor. When soliciting an investor, you can offer equity interests in the company through a private placement offering. Federal and New York State laws permit private, non-public security offerings as long as specific rules and filing requirements are met.



Investors: Accredited Vs. Non-Accredited

Federal rules permit such sales to an unlimited number of "accredited investors." According to Federal Rule 501 under the current Securities Act of 1933, an individual accredited investor is "any natural person whose individual net

worth, or joint net worth with that person's spouse, at the time of this purchase exceeds \$1 million."

An accredited investor may also be any natural person whose individual income was in excess of \$200,000 in each of the two most recent years, or whose joint income with that person's spouse was in excess of \$300,000 in each of those years. The individual accredited investor must also have reasonable expectations of reaching the same income level in the current year.

Up to 35 non-accredited investors may also purchase in the offering, but their involvement increases the regulatory requirements and complicates the transaction. A non-accredited investor is an individual whose combined net worth with a spouse is less than \$1 million and who earned less than \$200,000 annually or \$300,000 with a spouse in the previous two years. A non-accredited investor must also demonstrate an understanding of the requirements that enable the evaluation of "the merits and risks of the prospective investment," according to Rule 506 of the Securities Act of 1933.

By limiting potential investors to "accredited investors," a company may sell its stock to an unlimited number of investors, and by doing so, would avoid many specific disclosure requirements. Instead, your company only needs to satisfy the investor and federal and state law filing requirements and endeavor to cause your investors to meet the limits on resale of their securities.



Other Types of Investors

Friends and relatives may also be sources of funding as long as they satisfy the aforementioned investor standards. If you do not know a sufficient number of people from whom to seek financing, a broker-dealer can facilitate an offering to its clients. But beware: utilizing broker-dealer services will require that you pay a commission of approximately seven percent of the sale proceeds.

Additionally, you may have to issue warrants to the broker-dealer to purchase a certain amount of company stock for a negotiated price. That price is often the price at which the stock is being sold in the private placement. As a result, the private placement purchasers and the broker-dealer are both gambling on the future price of your company's stock.



The Legal Ins and Outs of Private Placement

Federal rules limit the manner of the private placement as well as enforce restrictions on the securities purchasers. The principal requirement in selling is direct contact. Therefore, there is a bar against "any form of general solicitations or general advertising," including any advertisement, article or other published or broadcast communication. In other words, either you or your broker-dealer must be in direct contact with the potential investor—an easy requirement if the potential investors are your friends or relatives or clients of the broker-dealer.

The purchaser must hold the stock from between six months to one year to satisfy federal rules. Your company must attempt to enforce this rule in order to avoid potential federal legal problems. For example, if a non-affiliate buyer (one who is not an officer, director or other significant company shareholder) buys 100,000 shares, and your company reports to the SEC (Securities and Exchange Commission), the buyer may sell all of those shares after owning them for at least six months. If your company does not report to the SEC, the buyer may sell the shares after owning them for at least one year.

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However, prior to reselling the stock, company affiliates who purchase stock in the private placement are subject to different requirements. First, there must be adequate information about the company publicly available. This requirement is more easily met when the company reports to the SEC. Next, the amount of the stock sold during any rolling three-month period may not exceed one percent of the outstanding stock or its average weekly trading volume. The stock may only be sold in permitted manners and must have been fully-owned by the affiliate for at least six months if your company reports to the SEC or otherwise for one year. Finally, various other filing requirements should be met.

Satisfying these requirements is not the only way your company may legally accomplish a private placement, but doing so provides some assurance that future legal problems may be avoided.



Knowing and Understanding the Rules

Keep in mind that the biggest obstacles facing the seller are not the rules; the biggest obstacle is whether or not there are willing buyers to pay the price the seller wants. Of course, other restrictions apply. Be sure to carefully review the SEC filing requirements. For additional information, go to www.sec.gov and see *SEC Rule 144* and *Reg. D* under the *Securities Act of 1933*.

These rules may sound simple, but a company, and a securities buyer or seller relying on them, should contact a securities attorney. Additional notice provisions, restrictions and rules require compliance and can be explained in detail by an attorney with knowledge in this specific area of the law.

A successful private placement in compliance with federal and state rules may yield substantial proceeds for your company, with only limited restrictions on the buyers of its stock. ::