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Securities Law

Federal Securities Laws

I. Introduction

- A. The federal securities laws were adopted in 1933 and 1934 to address the problems that led to the market failure of 1929. Prior to the enactment of these statutes, it was not uncommon for the stock markets to be manipulated and for corporate "insiders" to reap great profits at the expense of innocent members of the investing public.
- B. Federal securities laws are based on a policy of "**disclosure**". Anyone who buys or sells a security must disclose all material information known to the buyer or seller. This policy of requiring disclosure is intended to assure that investors receive full and fair disclosure for informed investment decisions. The federal securities do not provide, however, for the Securities and Exchange Commission ("SEC") to evaluate the merits of the securities offerings.
- C. Today's securities markets enjoy great integrity, to everyone's advantage, as a result of the vigorous enforcement of the federal securities laws by the SEC.

II. Publicly-Held Companies

- A. Overview of the Securities Act of 1933, §§ 77a-77aa
 1. The Securities Act of 1933 (the "33 Act") requires that unless a registration statement has been filed with the SEC regarding the common stock of a company (the "issuer"), no **public offer** of that security can be made.
 2. A company's registration statement becomes a public document on filing. Copies of the registration statement can be obtained through the SEC's EDGAR system at the SEC's web site: www.sec.gov.
 3. The SEC will review the registration statement and provide the company with comments on the registration statement.
 4. The registration statement contains detailed information on the company. The regulations of the SEC specify the information to be set forth in the

registration statement.

5. Unless the registration statement has been declared effective by the SEC, no *sale* of that security can be made.
6. The registration statement itself is not delivered to investors, but a "statutory prospectus" - drawn directly from the registration statement - must be. By means of the prospectus, a large body of information is made available to the potential investor, before the investor makes a final decision.
7. Under the 33 Act, the issuer has strict liability if it does not prepare the disclosure documents "diligently".

B. Small Business Public Offerings - 33 Act

1. On July 30, 1992, the SEC adopted substantial revisions to its rules and forms to facilitate capital raising by small businesses and reduce compliance burdens placed on these companies by the federal securities laws. (Securities Act Release No. 6949.)
2. A small business issuer is defined as an entity that meets the following criteria:
 - a. Has revenues of less than \$25,000,000;
 - b. Is a U.S. or Canadian issuer;
 - c. Is not an investment company; and,
 - d. If a majority-owned subsidiary, the parent corporation is also a small business issuer.

Provided however that the entity is not a small business issuer if it has a public float (the aggregate market value of the outstanding voting and non-voting common equity held by non-affiliates) of \$25,000,000 or more.

3. Small business issuers are allowed to register their securities using Forms SB-1 or SB-2, as appropriate.
 - a. While extensive disclosure is still required by these forms, the information required is somewhat reduced and simplified when compared to that which would normally be required.
 - b. One prime advantage of Forms SB-1 and SB-2 is that two years of audited financial statements are required, rather than three years. This can result in a significant savings for the small business issuer.

C. Overview of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll.

1. After the public offering of a company's common stock, disclosure obligations shift to emphasize the protection of investors in the secondary markets (i.e. resales of the security in the trading markets).

2. Public companies and companies with more than 500 shareholders and more than \$1 million in assets are required to file periodic reports under the Securities Exchange Act of 1934 (the "34 Act").
3. These mandated disclosures include an annual report on Form 10-K, quarterly reports on Form 10-Q, occasional reports on Form 8-K, proxy statements and annual reports to shareholders.
4. The regulations of the SEC specify the information to be contained in these reports. Unlike review of the registration statements under the '33 Act, there is relatively little review of '34 disclosure documents by the SEC.
5. Periodic reports filed by reporting companies are public documents and are available on line at the SEC's web site: www.sec.gov.

D. Small Business Issuers - 34 Act

1. As in the case of public offerings by small business issuers, discussed above, the requirements of the 34 Act have been modified to lessen the regulatory burden on small business issuers.
2. Small business issuers may utilize simplified forms to make their periodic reports. Thus, the small business issuer may use Form 10-KSB for its annual reports and Form 10-QSB for its quarterly reports.

This outline summarizes and highlights certain relevant federal statutes and regulations governing the sale of securities. The date of this outline is June 1998. Treaders should refer to the federal statutes and regulations as the definitive source of the contents of these statutes and rules. The contents of this outline should not be construed as legal advice. Readers should not act upon information contained in this outline without individual professional advice.