

- **Private Placements**

Section 1707.03(Q) of the Act provides an exemption for transactions not involving a public offering pursuant to section 4(2) of the federal Securities Act of 1933. The “3(Q)” exemption is available where: there is compliance with section 4(2); sales commissions are limited to 10% and paid only to securities dealers and salespersons licensed in Ohio; a Form 3-Q is filed with the Division within 60 days of the date of sale in Ohio; and a filing fee of \$100 (\$50 for subsequent filings within the same calendar year) is paid to the Division.

Section 1707.03(X) of the Act provides an exemption for transactions not involving a public offering that are within the “safe harbor” of federal Rule 506. In order to qualify for the “3(X)” exemption: there must be compliance with federal Rule 506; a federal Form D must be filed with the Division within 15 days of the date of sale in Ohio; and a filing fee of \$100 must be paid to the Division.

- **Private Offerings of Commercial Paper Paper and Promissory Notes**

Section 1707.02(G) of the Act provides an exemption for the sale of commercial paper and promissory notes that are not offered directly or indirectly to the public. This exemption is very narrow in scope and has limited applicability. An administrative rule adopted by the Division provides that there is no offering “directly or indirectly to the public” where the commercial paper or promissory notes are sold: to officers, directors or partners of the issuer; to persons who control the management of the issuer; or to not more than ten persons in a twelve month period. No filing with the Division is required to perfect this exemption.

- **Private Offerings Up To \$5,000,000**

Section 1707.03(W) of the Act provides an exemption for private offerings up to \$5,000,000 pursuant to federal Rule 505. In order to qualify for the “3(W)” exemption: there must be compliance with the conditions of Rule 505; sales commissions must be limited to 12% and may be paid only to securities dealers and salespersons licensed in Ohio; a Form 3-W must be filed with the Division at least five business days prior to the first use of offering materials; and a filing fee of \$100 must be paid to the Division.

- **Offerings Only to “Accredited Investors”**

Section 1707.03(Y) of the Act provides an exemption for offerings to “accredited investors,” who are persons that have a certain high level of net worth or income. A general announcement is permitted, but it may only contain certain information. A Form 3-Y, including a copy of the general announcement and a \$100 filing fee, must be filed with the Division within 15 days of when the general announcement is made in Ohio.

- **Coordination With Federal Exemptions**

Keep in mind that all securities sold in Ohio also must be properly registered or exempted under federal law. Like the Act, the federal securities laws contain certain exemptions from securities registration. Following is a list of the Ohio registration or exemption provisions that may correspond to the federal exemptions most commonly used by start-up or small businesses:

- **Section 3(a)(11)/Rule 147**

Section 1707.03(O) of the Act is the most commonly used exemption for small (ten or fewer purchasers) intra-state offerings exempt federally pursuant to section 3(a)(11) of the

Securities Act of 1933 or Rule 147 promulgated thereunder. Intra-state offerings under Section 3(a)(11) or Rule 147 with more than ten purchasers generally must be registered with the Division.

- **Regulation A**

Like all other states, Ohio does not have an exemption that directly corresponds to the federal Regulation A exemption. As a result, Regulation A offerings not otherwise exempted must be registered with the Division.

- **Section 4(2)**

Section 1707.03(Q) of the Act generally provides a companion exemption for transactions by an issuer not involving a public offering pursuant to Section 4(2) of the Securities Act of 1933.

- **Rule 504**

An issuer relying on the federal Rule 504 exemption that wishes to advertise its offering and issue freely transferable stock must register the offering with the Division and deliver a disclosure document to potential investors.

- **Rule 505**

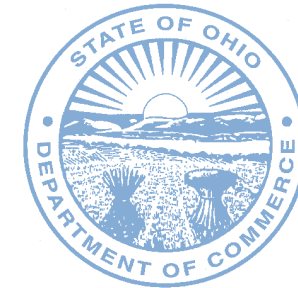
Section 1707.03(W) of the Act generally provides a companion exemption for an offering up to \$5,000,000 pursuant to federal Rule 505.

- **Rule 506**

Section 1707.03(X) of the Act generally provides a companion exemption for private offerings pursuant to federal Rule 506.

The Ohio Department of Commerce is an Equal Opportunity Employer and Service Provider.

## AN INTRODUCTION TO THE OHIO SECURITIES LAWS FOR START-UP AND SMALL BUSINESSES



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There are many legal considerations in the start-up and operation of a small business. For example, decisions must be made regarding the legal structure of the entity (corporation, partnership, etc.), there are tax considerations, and filings must be made with various government agencies. In Ohio, the One Stop Business Permit Center (800-248-4040) provides Start-Up Business Kits that contain information regarding many of these legal requirements.

When a business or venture issues ownership interests (such as stock or partnership interests), debt obligations (such as bonds or promissory notes) or otherwise seeks to raise money by promising a return to investors, the federal and state securities laws apply. This brochure provides some basic information about the Ohio securities laws. Additional information may be obtained by contacting the Ohio Division of Securities at the address, telephone number or website listed on the front of this brochure. Information about the federal securities laws may be obtained from the federal Securities and Exchange Commission, (202) 942-8088, <http://www.sec.gov>.

This brochure provides only a basic introduction to the Ohio securities laws, and is not intended, and should not be construed, to be a substitute for consultation with competent legal counsel. State and federal securities laws apply to all transactions in and dispositions of securities, and violations of applicable laws can lead to civil and criminal liability. As a result, transactions in and dispositions of securities should be carried out only after consultation with competent legal counsel.

### **An Overview of the Ohio Securities Act**

The Ohio Securities Act (the “Act”) is set out in Ohio Revised Code Chapter 1707. The Act is administered and enforced by the Ohio Division of Securities (the “Division”) and

applies to all “sales” of “securities” in Ohio. *Sale* is broadly defined to include every disposition, and every attempt to dispose, of a security. *Security* is broadly defined to include typical instruments like stocks, bonds, options and promissory notes, and also includes instruments that constitute “*investment contracts*.” Ohio courts have held that an *investment contract* exists anytime that: (i) an offeree furnishes initial value to an offeror; (ii) a portion of this initial value is subjected to the risks of the enterprise; (iii) the furnishing of the initial value is induced by the offeror’s promise or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise; and (iv) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise. As a result, the concept of *security* includes a wide range of investment opportunities and business plans.

If the Act applies, there are three basic aspects: (i) the person selling the securities must be *licensed with the Division or properly exempted from licensure*; (ii) the securities being sold *must be registered with the Division or properly exempted from registration*; and (iii) *anti-fraud standards* apply and prohibit fraudulent tactics, including false representations and omissions, in the sale of securities. Keep in mind that similar aspects of the federal securities laws also apply.

### **The Act’s Anti-Fraud Standards**

The fraud proscriptions of the Act are very broad and include prohibitions on, among other things: false representations, omissions, the filing of false information with the Division and the use of any device, scheme or artifice to defraud or obtain money or property by means of false pretenses. Violation of the anti-fraud standards can result in civil liability and severe criminal

punishment. Certain types of securities fraud constitute “predicate acts” under Ohio’s criminal “RICO” statute.

### **The Act’s Licensing Requirements**

The Act requires that all securities “*dealers*” and securities “*salespersons*” be licensed by the Division, or properly excepted from licensure. In general, a *dealer* is an individual or entity who is in the business of buying and selling securities for compensation. In general, a *salesperson*, commonly known as a stockbroker, is a natural person authorized to buy and sell securities on behalf of a dealer. Importantly, in most cases, an *issuer* of securities, including its officers, directors and employees, is excepted from the Act’s licensing requirements. As a result, a start-up or small business that wishes to sell its own securities may not have to comply with the Act’s licensing requirements. Competent legal counsel should be consulted to determine whether such an exception to the licensing requirements exists.

The Act also requires that “*investment advisers*” be licensed under federal or Ohio law, or be properly excepted from licensure. In general, an *investment adviser* is an individual or entity that is in the business of providing advice regarding securities. In most cases, employees of an investment adviser firm, known as “*investment adviser representatives*” must also be licensed by the Division. There is no exception for *issuers* from the investment adviser and investment adviser representative licensing requirements, although in many cases *issuers* will not be required to be licensed because they are not “in the business” of providing advice.

### **Securities Registration, and Exemptions from Registration, Under the Act**

Perhaps the most important consideration for a start-up or small business that wishes to issue securities is the fact that all securities sold

in Ohio must be registered with the Division, or properly exempted from registration.

### **Securities Registration**

In general, there are three ways to register securities with the Division under the Act. An issuer that is registering securities with the SEC under the Securities Act of 1933 can file a *registration by coordination* with the Division. An issuer that is making an offering that involves a limited number of purchasers or limited selling efforts can file a *registration by description* with the Division. Issuers that are not eligible for registration by coordination or registration by description pursue *registration by qualification* with the Division.

### **Exemptions from Securities Registration**

Because securities registration can be complicated and time consuming, issuers of securities often seek to fit within an exemption from the securities registration requirements. The Ohio securities laws contain over 40 different exemptions from the securities registration requirements. The exemptions commonly available to start-up and small businesses are:

#### **• Ten or Fewer Purchasers**

Section 1707.03(O) of the Act provides an exemption for the sale of equity securities by the issuer to ten or fewer purchasers in Ohio who the issuer reasonably believes are purchasing for investment. There is no limit on the dollar amount raised. No general advertising is permitted, and sales commissions are limited to 10% and may be paid only to securities dealers and salespersons licensed in Ohio. No filing with the Division is required to perfect this exemption, but the Division recommends that reliance on this exemption be memorialized in the corporate records.