SECURITIES LAW FOR GENERAL COUNSEL

Corporate Counsel Forum
Association of Corporate Counsel, Iowa Chapter

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I. WHAT IS A SECURITY?

Any instrument offered in exchange for capital could be viewed as a "security" and its issuance may therefore raise securities law concerns. Section 2(1) of the United States Securities Act of 1933 (the "1933 Act") defines the term "security" as follows.

> The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.[1]

The term "investment contract" has become the catchall category and the focus of many courts considering whether a particular instrument is a security. An investment contract has been defined as **any contract or profit-making scheme whereby a person invests his or her money in a common enterprise and expects to make a profit solely from the efforts of others**. *S.E.C. v. W. J. Howey Co.*[2] This test remains a useful guide in determining whether, for example, an interest in a limited liability company should be considered a security.

Iowa law makes it clear that the term "security" includes "an interest in a limited liability company or in a limited liability partnership or any class or series of such interest, including any fractional or other interest in such interest, provided "security" does not include an interest in a limited liability company or a limited liability partnership if the person claiming that such an interest is not a security proves that all of the members of the limited liability company or limited liability partnership are actively engaged in the management of the limited liability company or limited liability partnership; provided that the evidence that members vote or have the right to vote, or the right to information concerning the business and affairs of the limited liability company or limited liability partnership, or the right to participate in management, shall not establish, without more, that all members are actively engaged in the management of the limited liability company or limited liability partnership.[3]"

Any transaction in which an outside investor is asked to furnish money to a business likely involves either a public offering or a private offering of securities. Raising money for companies that chose not to (or are unable to) tap public markets can range from a simple cash contribution by a founder to a complex public or private offering.

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[1] Securities Act of 1933, 15 U.S.C.A. § 77B.
[2] 328 U.S. 293 (1946).
[3] Iowa Code §502.102.28.e.

II. REGULATORY FRAMEWORK

The sale of securities to residents of Iowa is regulated by both state and federal law.

Federal Regulation

In the US, sales of securities are subject to federal and state registration. The 1933 Act, Congress' first entry into securities regulation, was prompted by the Wall Street crash of 1929. Subject to certain exemptions, the 1933 Act requires registration of all securities being sold and requires that the seller of securities "provide full and fair disclosure of the character of securities sold..."[4]

The Securities Exchange Act of 1934 (the "1934 Act") regulates trading of shares, regulates stock exchanges, specifies periodic reporting by public companies and regulates brokers and dealers in securities. Provided that a company has more than 500 shareholders and has above $10 million in assets, the 1934 Act requires that issuers regularly file company information with the SEC on specified forms.[5]

The Sarbanes–Oxley Act became effective on July 30, 2002. It established new or enhanced standards for all U.S. public company boards, management, and public accounting firms.

There are a number of other Federal Acts that regulate the securities industry, including:

The Public Utility Holding Company Act of 1935
The Trust Indenture Act of 1939
The Investment Company Act of 1940
The Investment Advisers Act of 1940

Securities Regulation in Iowa

The Iowa Uniform Securities Act[6] (the "Iowa Act") was enacted in 2004, became effective January 1, 2005, and is patterned largely on the 2002 version of the Uniform Securities Act. The Iowa Act is based upon a regulatory approach that is common to many other state securities statutes.

Under the Iowa Act securities sold to Iowa residents must be registered with the Iowa Securities Bureau unless: (i) the securities qualify as "federal covered securities"; or (ii) the securities, or the transaction through which the securities are sold, qualify for an exemption from registration under the Iowa Act.

The term "federal covered securities" includes securities sold under Rule 506 of Regulation D of the federal Securities Act of 1933. (Under Rule 506 an unlimited dollar amount

[4] Securities Act of 1933, 15 U.S.C.A. §§ 77 *et seq*., Preamble.
[5] Securities Exchange Act of 1934, Section 13.
[6] Iowa Code Chapter 502.

of securities can be sold to a maximum of 35 sophisticated and experienced investors and an unlimited number of accredited investors without federal review or registration, as long as the securities are sold without general solicitation and specific disclosure requirements are met if non-accredited investors are included in the offering.) Rule 191-50.14 (IAC) contains the notice filing procedures for Rule 506 offerings in Iowa. An issuer offering securities under Rule 506 must file a notice on SEC Form D, a consent to service of process on a form U-2, and pay a fee of $100 to the Iowa Securities Bureau no later than 15 days after the first sale of the federally covered security in Iowa.

There are a variety of exemptions under the Iowa Act that may apply to the offering of securities to Iowa residents. Once such exemption is the private placement exemption found in Iowa Code Chapter 502.202(14).

Persons and entities involved in the business of distributing and trading securities are required to be registered under the Iowa Act. The Iowa Act also contains the typical prohibitions against use of fraudulent practices in the issuance and distribution of securities.

Anti-Fraud

Regardless of whether the offering of securities is exempt from either Iowa law or US federal law regarding registration, no offering is ever exempt from the anti-fraud provisions of federal and state securities laws. All issuers and insiders must provide adequate disclosure to each prospective investor to assure that the investor has the information necessary to make an informed decision.

The 1933 Act imposes liability upon any person who includes in offering materials "an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.[7]" Under this test, even the literal truth can be misleading.[8]

One often-cited securities regulation is Rule 10b-5, promulgated pursuant to Section 10b of the 1934 Act. [9]

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[7] Securities Act of 1933, Section 12.

[8] *Miller v. Thane Int'l, Inc.*, 2007 WL 4147327 (9th Cir. Nov. 26, 2007).

[9] It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange -

> (a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
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> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance

Rule 10b-21, the naked short selling anti-fraud rule, is a recent addition by the SEC. The new rule, which became effective September 18, 2008, covers short sellers who deceive broker-dealers or any other market participants about their intention or ability to deliver securities in time for settlement. The rule makes clear that such persons are violating the law when they fail to deliver.

III. AN INFORMED INVESTMENT DECISION

Securities disclosure rules are relevant whenever a shareholder is asked to make an investment decision with regard to any shares held. Circumstances when that would be relevant would include offers to redeem shares of stock, mergers and similar circumstances that require a shareholder vote. It is that vote which constitutes the investment decision and requires the issuer to disclose all material information to the shareholders.

The discussion below relates to registration exemptions and disclosure requirements for raising capital in private markets. The disclosure principles discussed are equally relevant whenever equity holders are asked to make an investment decision regarding their holdings.

Raising Capital

The sale of, or the offer to sell, any instrument that is classified as a security requires either registration or an exemption from registration. If the requirements of the exemption are not met, companies are liable for securities sold in violation of the registration requirements. It is also important to note that securities acquired in a private offering are not immediately re-saleable by the investor. There are re-sale limitations on persons affiliated with the issuer that apply whether the offering was a registered public offering or a private offering.

Various types of instruments can be used to attract capital. Equity interests in a corporation may be sold as common stock, preferred stock, options, or warrants. Equity interests in other types of entities could be (by way of example) "units" in a limited liability company or "interests" in a limited partnership. Debt instruments can also be used to attract capital and provide investors the protection of guaranteed interest payments rather than the risk of uncertain dividends.

Rule 506

Many securities lawyers advise that private offerings should most often be made in reliance on Rule 506 of Regulation D[10]. Rule 506 is a safe harbor for the private offering exemption found in Section 4(2) of the Securities Act. Under Rule 506 you can raise an unlimited amount of capital. You can sell securities to an unlimited number of accredited investors and up to 35 other sophisticated purchasers, as long as no general solicitation is

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in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[10] 17 CFR, Part 230, §§501-508.

involved. The definition of "**accredited investor**" is stated below[11]. To be considered "**sophisticated**," investors must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment.

Securities sold under Rule 506 are exempt from state registration, but will require a notice filing in each state in which an investor resides. An issuer offering securities in Iowa under Rule 506 must file a notice on SEC Form D, a consent to service of process on a form U-2, and pay a fee of $100 to the Iowa Securities Bureau no later than 15 days after the first sale of the federally covered security in Iowa.

It is up to the issuer to decide what information to give to *accredited investors*, so long as it does not violate the antifraud prohibitions. Generally, the information provided must be sufficient to enable the offeree the opportunity to make a reasoned, informed investment decision.

If *non-accredited* investors are included in an offering, the disclosure burden increases significantly and information to be provided generally is the same as that required in registered offerings. Here are some specifics about the financial statement requirements applicable to this type of offering:

- Financial statements need to be certified by an independent public accountant;
- If a company cannot obtain audited financial statements without unreasonable effort or expense, only the company's balance sheet, to be dated within 120 days of the start of the offering, must be audited; and
- Regardless whether the issuer has included non-accredited investors, officers must be available to answer questions by prospective purchasers

[11] *An "**accredited investor**" is:*

- *a bank, insurance company, registered investment company, business development company, or small business investment company;*
- *an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million;*
- *a charitable organization, corporation or partnership with assets exceeding $5 million;*
- *a director, executive officer, or general partner of the company selling the securities;*
- *a business in which all the equity owners are accredited investors;*
- *a natural person with a net worth of at least $1 million;*
- *a natural person with income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; or*
- *a trust with assets of at least $5 million, not formed to acquire the securities offered, and whose purchases are directed by a sophisticated person.*

Rule 504

Offerings for $1 million and less are exempt from federal registration requirements, regardless of whether the investors are accredited. If you have an offering that falls within this category, you should also review individual state law requirements before finally determining whether any specific disclosure is required or whether there is an exemption from state registration requirements.

Iowa-Only Exemptions

There are a variety of exemptions under the Iowa Act that may apply to the offering of securities to Iowa residents. Under the private placement exemption found in Section 202 of the Code[12], an issuer may sell unregistered securities, as part of a single issue, to no more than 35 purchasers (plus an unlimited number of "institutional investors") in Iowa during any twelve consecutive month period. The term "institutional investor" under Iowa law has generally the same meaning as does the term "accredited investor" under federal law. The Securities Bureau has indicated that persons who purchase at different times should be counted as a separate "purchaser" for each such transaction. The owners of entities formed for the purpose of making an investment will each be counted as a separate "purchaser" for purposes of this exemption. No general solicitation is allowed and no commissions or other remuneration may be paid (other than to broker-dealers registered in Iowa) in order to qualify for this exemption. The issuer must have taken reasonable steps to ascertain that each purchaser is purchasing the securities for investment purposes, and not with an intent to distribute.

To fall within a private or limited offering exemption, the issuer cannot engage in any general solicitation or advertising to market the securities. Contact with potential investments must be personal. Offerees should be persons with whom the principals are acquainted or to whom they have been introduced. The issuer should have enough information about each such person to believe they are likely to be a qualified investor.

Section 4(2) of the 1933 Act

Regulation D provides safe-harbor rules under the 1933 Act. Failure to comply with all of the requirements of the rules does not necessarily defeat an exemption. Section 4(2) of the 1933 Act exempts "transactions by an issuer not involving any public offering." Without the safe harbor protection, the issuer is left to make its own determination whether the offering involves a "public offering."

Frequently Asked Questions and General Tips

There is no blanket disclosure disclaimer that will be applicable to all offerings. The issuer should, however, tailor a "forward-looking statement" disclaimer for each offering. That statement should say something to the effect that the disclosure material being provided will contain forward-looking statements that involve risks and uncertainties. The actual results of the

[12] Iowa Code Chapter 502.202(14).

issuer will depend upon a number of factors beyond your control and could differ materially from those anticipated in the forward looking statements. You should caution readers to carefully read the financial statements and the notes thereto (if any), as well as the "risk factors" described in the disclosure documents. Here is a sample from one offering:

> "Much of the discussion in this memorandum regarding the company or its anticipated operations, contains forward-looking statements, not statements relating to historical results. Actual results will likely differ from our forward-looking statements and are dependent upon a number of risk factors beyond our control. The risks of investing in the shares of common stock include, without limitation: no operating history; lack of public market; lack of liquidity; lack of control over management, purchase price dilution; restrictions on transfer; arbitrary determination of the offering price for the shares; absence of a feasibility or marketing study; strong competition from _____; general economic conditions; absence of dividends; uncertainty regarding the retention and hiring of experienced management employees as the business of the company expands; _____ ; and _____."

Some states require specific legends to alert investors that the securities being offered are not registered and are subject to certain restrictions. Here is one example of such a legend:

> "This information is distributed pursuant to an exemption for small offerings under the rules of the Colorado Securities Division. The Securities Division and the United States Securities and Exchange Commission have neither reviewed nor approved its form or content. The securities described may only be purchased by "accredited investors" as defined by Rule 501 of SEC Regulation D and the rules of the Colorado Securities Division."

Although there is no specific legend required by Iowa, you should review requirements in each other state in which your offerees reside.

There are no different standards for individual and institutional investors as long as they are all accredited investors. If you have any investors who are non-accredited, your disclosure requirements will increase.

You should obtain information reasonably calculated to determine that the investment is suitable for the investor. We recommend using a Questionnaire along with the Subscription Agreement.

Always verify the state of residence and the taxpayer identification number for each investor. The forms for the Subscription Agreement and the Questionnaire should solicit this information.

IV. REVISED FORM D AND DEADLINE FOR ELECTRONIC FILING

Last spring, the Securities and Exchange Commission adopted rules intended to modify the Form D Notice of Sale of Securities Pursuant to Regulation D and to provide for the mandatory electronic filing of the form. The rules revising Form D became effective September 15, 2008. The rules providing for mandatory electronic filing of Form D are scheduled to become effective March 15, 2009.[13]

Form D is a safe-harbor filing for persons conducting an offering in compliance with Regulation D. To take advantage of the safe harbor, Form D notice should be filed within 15 days after the first sale of securities. In most states, a copy of the Form D must also be filed with the state securities regulator in compliance with state securities laws.

When adopting the new rules, the SEC provided for a generous transition period. Until March 15, 2009, issuers will have three options when filing a Form D. First, issuers may continue to file paper copies of the old Form D. Second, issuers may file paper copies of the newly revised Form D. Finally, issuers may elect to file the Form D electronically using the SEC's electronic filing system. Electronic filings are based on the revised Form D.

Revised Form D

Issuers should be aware that all electronically filed Form Ds are publicly available documents via the SEC website. Therefore, during the interim period ending on March 15, 2009, many issuers will likely find paper filings of the revised Form D to be the most attractive option. We are not aware of any states that have waived paper filing requirements for issuers that file the Form D electronically with the SEC.

For the most part, the revised Form D will be easier for issuers to prepare than the old Form D. A copy of the revised Form is attached to this article for informational purposes. The revised Form D does away with some of the more cumbersome requirements of the old Form D and requires relatively little new information. The new information that is required by the revised Form D should be fairly easy for issuers to provide. Relevant changes reflected in the revised Form D include:

1) the revised Form D eliminates the requirement to identify 10% owners of a class of the issuer's equity securities;

2) the revised Form D simplifies the Use of Proceeds disclosure by requiring an issuer to provide only the amount of the proceeds from the offering paid as sales commissions, finders' fees or payments to related persons (including directors or officers);

3) the revised Form D requires an issuer to choose a description of its industry from a list provided in the form instead of writing in its own description;

[13] Thanks to John Long for this summary of the new Form D rules.

4) the revised Form D requires an issuer to indicate whether it expects the duration of the offering to exceed one year;

5) the revised Form D requires an issuer to provide the number of investors who have already purchased securities in the offering (if any) and the number of such investors who are not accredited investors;

6) the revised Form D allows the inclusion of information regarding multiple issuers if the offering involves more than one issuer;

7) the revised Form D requires an issuer to provide the date of the first sale if any sales have occurred;

8) the revised Form D requires an issuer to provide additional information regarding any recipients of commissions or finders' fees including the name, states of solicitation and CRD number (if such recipient is a registered broker/dealer) of such recipients;

9) the revised Form D asks an issuer to provide its revenue range but allows an issuer to elect to answer "Decline to Disclose"; and

10) the revised Form D simplifies signature requirements by providing a single signature block for both the state and federal portions of the form.

Electronic Filing Deadline of March 15, 2009

Beginning March 16, 2009; a Form D must be filed electronically with the SEC; after the March 15, 2009 deadline, paper Form D filings will no longer be accepted by the SEC. All issuers should be aware that however they file a Form D with the SEC, they must still comply with state filing requirements.

Electronic Form D filings are made using the SEC's EDGAR system. An issuer that has already made EDGAR filings will use its current Central Index Key ("CIK") and CIK Confirmation Code ("CCC") to file a Form D. An issuer that has not previously filed using the EDGAR system will need to obtain CIK and CCC codes before it can electronically file a Form D. The SEC has posted guidance regarding procedures for filing electronically and obtaining CIK and CCC codes on its website at http://www.sec.gov/divisions/corpfin/formdfiling.htm. Issuers that have not previously filed with the EDGAR system should review this information in preparation for the March 15, 2009 deadline and allow time to obtain the required codes. Businesses that occasionally use newly formed entities for offerings related to specific projects should also become familiar with this information in advance of the deadline.

Finally, all issuers must continue to attend to state filing requirements, both before and after the March 15, 2009 deadline. The SEC hopes eventually to turn the electronic filing system into a one stop filing solution for Regulation D offerings. Currently, the states have not responded to the SEC's new electronic filing system by eliminating state filing requirements. Until the states adapt to the SEC's new system, electronic filers are not relieved of state filing

requirements and must print and mail copies of their electronic Form D filings in accordance with state securities laws.

V. LIMITATION ON THE RESALE OF RESTRICTED SECURITIES

Purchasers in private offerings receive "**restricted**" securities and certificates representing those securities should be marked with a restrictive legend. Consequently, purchasers may not freely trade the securities in the secondary market after the offering. Investors should be required to make an investment representation at the time of purchase (i.e. that they are purchasing for the own account, for purposes of investment, and not with the intent to distribute the securities). If they need to sell the securities in the future, they should have an opinion of company counsel that the sale is a private transaction, or is otherwise exempt from the registration requirements.

Federal Rule 144 provides a safe harbor for the re-sale of restricted securities. Effective February 15, 2008, the SEC has revised Rule 144 relating to the resale of restricted securities. These amendments to Rule 144 should enhance liquidity for affiliate and non-affiliate holders of restricted securities. Generally, the holding period for restricted securities of companies that report to the SEC under the Securities Exchange Act of 1934 will be shortened to *six months*, after which securities held by non-affiliates will, in most cases, be freely saleable. Securities held by affiliates will be saleable subject to other requirements of Rule 144.

Non-affiliates of a reporting company: As of that date, a person who is not an affiliate (and has not been an affiliate for the preceding three months) of an issuer that has met reporting requirements for at least 90 days, may resell the securities after a six-month holding period. If the issuer has not filed all required reports for at least twelve months prior to the sale (or for a shorter period if the issuer has been subject to reporting requirements for less than twelve months), the holding period is extended to one year.

Non-affiliates of a non-reporting company: If the issuer is not subject to reporting requirements, a minimum of one year must elapse prior to resale of the securities.

Affiliates of a reporting company: If the issuer has met reporting requirements for at least 90 days and has filed all required reports for at least twelve months prior to the sale (or for a shorter period if the issuer has been subject to reporting requirements for less than twelve months), an affiliate can resale securities after the expiration *six months, subject to certain other conditions:*

- The number of securities to be resold must fall within specified volume limitations;
- The resale must comply with the revised "manner of sale" conditions; and
- The seller may be required to file a Form 144 reporting the sale (or proposed sale), subject to the new reporting threshold.

"Manner of sale" requirement were eliminated and the volume limitations were eased for resales of debt securities by affiliates.

The provisions of Rule 144 are not available for the resale of securities initially issued by a *shell company* unless one year has elapsed from the date Form 10 information has been filed with the Commission.

The chart below is reproduced from SEC Release No. 33-8869 and helps clarify the new rules.

	Affiliate or Person Selling on Behalf of an Affiliate	Non-Affiliate (And Has Not Been an Affiliate During the Prior Three Months)
Restricted Securities of Reporting Issuers	*During six-month holding period* - no resale under Rule 144 permitted. *After six-month holding period* - may resell in accordance with all Rule 144 requirements, including: Current public information, Volume limitations, Manner of sale requirements for equity securities, and Filing of Form 144.	*During six-month holding period* - no resale under Rule 144 permitted. *After six-month holding period but before one year* - unlimited public resale under Rule 144 except that the current public information requirement still applies. *After one-year holding period* - unlimited public resale under Rule 144; need not comply with any other Rule 144 requirements.
Restricted Securities of Non-Reporting Issuers	*During one-year holding period* - no resale under Rule 144 permitted. *After one-year holding period* - may resell in accordance with all Rule 144 requirements, including: • Current public information, • Volume limitations, • Manner of sale requirements for equity securities, and • Filing of Form 144.	*During one-year holding period* - no resale under Rule 144 permitted. *After one-year holding period* - unlimited public resale under Rule 144; need not comply with any other Rule 144 requirements.

VI. SARBANES OXLEY AND CORPORATE GOVERNANCE

The Sarbanes–Oxley Act, which became effective on July 30, 2002, established new or enhanced standards for all U.S. public company boards, management, and public accounting

firms. It does not apply to privately held companies, but the principles introduced by SOX are arguably creating new standards by which all companies are being judged.

Some of the major principles introduced by SOX include:

- It establishes the Public Company Accounting Oversight Board, to provide independent oversight of auditing firms.
- It establishes standards for external auditor independence, to limit conflicts of interest. It restricts auditing companies from providing non-audit services for the same clients.
- It requires that senior executives take individual responsibility for the accuracy and completeness of corporate financial reports - including the obligation of the CEO and the CFO to certify quarterly financial reports that are filed with the SEC. It also imposes reporting obligations on in-house counsel who witness wrong-doing.
- It describes enhanced reporting requirements for financial transactions. It requires internal controls for assuring the accuracy of financial reports and disclosures, and mandates both audits and reports on those controls. It also requires timely reporting of material changes in financial condition and specific enhanced reviews by the SEC or its agents of corporate reports.

Director Independence

Section 301 of the Sarbanes Oxley Act[14] requires generally that members of the audit committee be members of the board of directors of the issuer, and are otherwise independent. In order to be considered independent, a member of an audit committee may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee: (i) accept any consulting, advisory, or other compensatory fee from the issuer; or (ii) be an affiliated person of the issuer or any subsidiary thereof.

Each exchange also has requirements for independence, generally requiring that a majority of the members of the Board be independent. Exchanges also establish their own requirements for Independence. The NYSE, for example, provides that no director qualifies as "independent" unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). It requires that the company disclose those determinations. It further defines certain situations which are "off limits" to a board determination that directors are independent, i.e., certain factors will automatically disqualify a person from being determined to be independent by the board.

[14] Securities Exchange Act, §10A.

Rules of Professional Responsibility for Attorneys

Sarbanes Oxley, Section 307 has been codified in Part 205, Rule 3 of the SEC rules. Under that section, in-house counsel is required to report "up the ladder" any *evidence* of a *material violation* of

- securities law
- breach of fiduciary duty
- or similar violation by the company or any agent of the company

Evidence is reportable if it would be unreasonable for a prudent & competent attorney NOT to conclude, under the circumstances, that it is reasonably likely that a material violation has occurred, is ongoing or is about to occur.

The reporting obligation raises question relating to client confidences. SEC rules have addressed t his issue as follows:

> Any report under this section (or the contemporaneous record thereof) or any response thereto (or the contemporaneous record thereof) may be used by an attorney in connection with any investigation, proceeding, or litigation in which the attorney's compliance with this part is in issue.
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> An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary:
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> > To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
> >
> > To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, proscribed in 18 U.S.C. 1621; suborning perjury, proscribed in 18 U.S.C. 1622; or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission; or
> >
> > To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.

VII. INSIDER REPORTING ISSUES

Section 16 of the 1934 Act requires every person who becomes the beneficial owner of more than 10% of any class of equity security registered under Section 12 of the 1934 Act and each officer and director to file an initial report on Form 3 within 10 days. To keep this information current, Section 16(a) also requires reporting persons to report changes in this

ownership on Form 4 with 2 business days and to file an annual report on Form 5 within 45 days after the end of the issuer's fiscal year for any transactions not previously reported. Reportable transactions include, by way of example, the granting of options or restricted shares under an incentive compensation plan.[15]

Effective June 30, 2003, all of these reports must be filed electronically and posted on the issuers's websites[16]. Before a person can complete the electronic filing a Form ID must be filed with the SEC in order to obtain a personal CIK Code and EDGAR access number. The Form ID is filed electronically through the following website:
https://www.filermanagement.edgarfiling.sec.gov/

Any person who is directly or indirectly the beneficial owner of more than five percent of the shares of a reporting company, must file a statement containing the information required by Schedule 13D, within 10 days after the acquisition. Generally, if the shareholder has no control intent and holds less than 20% of the class of shares, a shorter Schedule 13G may be filed within the 10-day period. [17]

Changes in ownership must be reported annually within 45 days of the end of the issuer's fiscal year. If any material change occurs, an amendment reflecting the change must be filed promptly. An acquisition or disposition of beneficial ownership of securities in an amount equal to one percent or more of the class of securities is deemed "material" and lesser amounts may be material, depending upon the facts and circumstances.

VIII. BROKER/DEALER ISSUES

Generally an entity that offers its own securities for sale is not considered a broker or dealer. The issuer's exemption does not apply to the personnel of a company who routinely engage in the business of selling securities. As a general rule, an employee is not required to register as a broker dealer if the employee is not compensated in a manner that is related directly or indirectly to the securities sold.

IX. EXCHANGE HAPPENINGS

On October 1, 2008, NYSE Euronext ("NYX") completed its acquisition of the American Stock Exchange, becoming the third-largest U.S. options marketplace. According to the NYX press release on that date, the transaction is expected to produce annualized run-rate cost savings in excess of $100 million by the end of 2009 and be accretive to earnings.

Prior to becoming a listed company on any exchange, a company must meet certain minimum listing standards. The current standards for listing on the American Stock Exchange can be met by compliance with any one of the following alternatives:

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[15] Securities Exchange Act, §16; Rules 16a-1 through 16a-13.
[16] SEC Release 33-8230, June 30, 2008.
[17] Securities Exchange Act, Rules 13d-1 through 13f-1.

(a) INITIAL LISTING STANDARD 1

(1) Size—Stockholders' equity of at least $4,000,000.

(2) Income—Pre-tax income from continuing operations of at least $750,000 in its last fiscal year, or in two of its last three fiscal years.

(3) Distribution—500,000 public shares and 800 public shareholders OR 1,000,000 public shares and 400 public shareholders.

(4) Stock Price/Market Value of Shares Publicly Held—See Section 102(b).

(b) INITIAL LISTING STANDARD 2

(1) History of Operations—Two years of operations.

(2) Size—Stockholders' equity of at least $4,000,000.

(3) Distribution—500,000 public shares and 800 public shareholders OR 1,000,000 public shares and 400 public shareholders.

(4) Aggregate Market Value of Publicly Held Shares—$15,000,000.

(5) Stock Price/Market Value of Shares Publicly Held—See Section 102(b).

(c) INITIAL LISTING STANDARD 3

(1) Size—Stockholders' equity of at least $4,000,000.

(2) Total Value of Market Capitalization—$50,000,000.

(3) Aggregate Market Value of Publicly Held Shares—$15,000,000.

(4) Distribution—500,000 public shares and 800 public shareholders OR 1,000,000 public shares and 400 public shareholders.

(5) Stock Price/Market Value of Shares Publicly Held—See Section 102(b).

(d) INITIAL LISTING STANDARD 4

(1) Total Value of Market Capitalization—$75,000,000; or Total assets and total revenue of $75,000,000 each in its last fiscal year, or in two of its last three fiscal years.

(2) Aggregate Market Value of Publicly Held Shares—$20,000,000.

(3) Distribution—500,000 public shares and 800 public shareholders OR 1,000,000 public shares and 400 public shareholders.

(4) Stock Price/Market Value of Shares Publicly Held—See Section 102(b).[18]

The securities of certain issuers which do not satisfy any of the above standards may be eligible for initial listing pursuant to the appeal procedures.

Companies that do not qualify for listing on any exchange often turn to the OTC Bulletin Board. Only and authorized OTCBB market makers can apply to quote securities on the OTCBB. Only SEC reporting companies who are current in their SEC reporting qualify to have their shares traded on the OTCBB. Issuers that do not meet this reporting requirement may be traded on the pink sheets.

X. SOME OTHER RESENT SEC ACTIONS

On Aug. 19, 2008, the SEC announced a successor to the 1980s-era EDGAR database, which is expected to give investors faster and easier access to information about public companies.[19] The new system is being called IDEA, short for Interactive Data Electronic Applications and will eventually replace the EDGAR system. According to the SEC press release, investors and others who currently use EDGAR will be able to continue doing so for the indefinite future. During the transition to IDEA, the SEC indicates that investors will be able to take advantage of new interactive, IDEA-like features that will be grafted onto EDGAR in the short run.

The SEC has proposed rules requiring companies to upgrade the current EDGAR system. According to the Release, under the new system, "financial statement information could be downloaded directly into spreadsheets, analyzed in a variety of ways using commercial off-the-shelf software, and used within investment models in other software formats. The rules would apply to domestic and foreign public companies that prepare their financial statements in accordance with generally accepted accounting principles as used in the United States (U.S. GAAP), and foreign private issuers that prepare their financial statements using International Financial Reporting Standards (IFRS) as promulgated by the International Accounting Standards Board (IASB). Companies would provide their financial statements to the Commission and on their corporate Web sites in interactive data format using the eXtensible Business Reporting Language (XBRL). The interactive data would be provided as an exhibit to periodic reports and registration statements, as well as to transition reports for a change in fiscal year. The proposed rules are intended not only to make financial information easier for investors to analyze, but also to assist in automating regulatory filings and business information processing. Interactive data has the potential to increase the speed, accuracy, and usability of financial disclosure, and eventually reduce costs."[20]

On August 27, 2008 the SEC voted to publish for public comment a proposed Roadmap that could lead to the use of International Financial Reporting Standards (IFRS) by U.S. issuers

[18] NYSE Alternext US LLC Company Guide, PART 1. (§§101-146).

[19] http://www.sec.gov/spotlight/idea.shtml

[20] Release No. 33-8924, May 30, 2008.

beginning in 2014.[21] The Commission announced that it would make a decision in 2011 on whether adoption of IFRS is in the public interest and would benefit investors. The proposed multi-year plan sets out several milestones that, if achieved, could lead to the use of IFRS by U.S. issuers in their filings with the Commission.

The SEC has again extended the time for non-accelerated filers to include a Section 404(b) attestation in their annual reports for fiscal years ending on or after December 15, 2008. Under the amendments, a non-accelerated filer will be required to file the auditor's attestation report on internal control over financial reporting when it files an annual report for a fiscal year ending on or after December 15, 2009. [22]

[21] http://www.sec.gov/news/press/2008/2008-184.htm

[22] Release no. 33-8934, June 26, 2008

ATTORNEY BIO

BEVERLY EVANS

BORN
RUSHVILLE, NEBRASKA, 1949

EDUCATION
CREIGHTON UNIVERSITY (B.A., 1971); UNIVERSITY OF NEBRASKA AT LINCOLN COLLEGE OF LAW (J.D., 1979)

ADMITTED TO BAR
1979, NEBRASKA; 1996, IOWA

AREAS OF LAW
BANKING
BUSINESS ORGANIZATIONS AND TRANSACTIONS
SECURITIES

MEMBERSHIPS
LINCOLN INNE
NEBRASKA STATE BAR ASSOCIATION
IOWA STATE BAR ASSOCIATION
BUSINESS LAW SECTION

CONCENTRATION

Bev is a senior shareholder of the Davis Brown Law Firm in the Business Division. She has a general practice in but not limited to the areas of Business Organizations, Mergers, Acquisitions and Securities.

PROFESSIONAL RECOGNITION

• **AV rated by Martindale-Hubbell**. An AV® certification mark is a significant rating accomplishment - a testament to the fact that a lawyer's peers rank him or her at the highest level of professional excellence.

SUMMARY

Bev enjoys working with start-up enterprises as well as with publicly-held companies, in regional as well as international transactions. She works with the Iowa Capital Investment Corporation (ICIC), an entity authorized by the state for the purpose of forming, through the use of incentive tax credits, a fund of funds designed to encourage the development of venture capital in the state. She also works with Iowa Community Development, L.C., (ICD) an entity that has successfully applied for and deployed Federal New Market Tax Credits. Her work with ICIC, ICD and with start-up enterprises has fueled her enthusiasm for the economic development potential of Iowa.

MEMBERSHIPS

• Iowa State Bar Association Business Law Section

• Author and editor Iowa State Bar Association Business Law Practice Manual.

OF NOTE

Bev is active in Lex Mundi, an international association of independent law firms. She represents the Firm at meetings around the world and enjoys developing worldwide relationships that enhance the Firm's ability to provide exceptional service to businesses interested in international trade or in engaging in international transactions.

LEX MUNDI