

CR 85-135

CERTIFICATE

STATE OF WISCONSIN                    )  
OFFICE OF THE                            )     ss.  
COMMISSIONER OF SECURITIES         )

TO ALL TO WHOM THESE PRESENTS SHALL COME, GREETINGS:

I, Ulice Payne, Jr., Commissioner of the State of Wisconsin Office of the Commissioner of Securities and custodian of the official records of said agency do hereby certify that the annexed rules promulgated under Chapter 551, Stats., relating to securities registration exemptions were duly approved and adopted by this agency on February 24, 1986.

I further certify that said copy has been compared by me with the original on file in this agency and that the same is a true copy thereof, and of the whole of such original.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the official seal of the Office of the Commissioner of Securities in the City of Madison, this 24<sup>th</sup> day of February, 1986.

(SEAL)

  
\_\_\_\_\_  
ULICE PAYNE, JR.  
Commissioner of Securities  
State of Wisconsin

RECEIVED

FEB 24 1986  
3:50 pm  
Revisor of Statutes  
Bureau

ORDER OF THE  
OFFICE OF THE COMMISSIONER OF SECURITIES  
STATE OF WISCONSIN  
ADOPTING, AMENDING AND REPEALING RULES

To repeal SEC 2.01(7); to renumber SEC 2.01(8) to (11); to amend SEC 7.02(1)(b); and to create SEC 2.02(10)(j), SEC 2.025 and SEC 2.027, relating to securities registration exemptions.

RECEIVED

FEB 24 1986

Revisor of Statutes  
Bureau

Pursuant to the authority vested in the Office of the Commissioner of Securities by secs. 551.63(1) and (2), 551.22(17), 551.23(18) and 551.53(1)(b), Wis. Stats., the Wisconsin Commissioner of Securities repeals, amends and adopts rules interpreting those sections as follows:

1 SECTION 1. SEC 2.01(7) is repealed.

ANALYSIS: This section repeals the so-called "blue chip" registration exemption because that exemption was replaced by a so-called "seasoned issuer" registration exemption of s. 551.235, Stats., enacted by statute in 1985 Senate Bill 38 (published November 1, 1985, effective January 1, 1986). That statutory registration exemption was based on a proposed rule exemption entitled Seasoned Issuer Exemption By Filing that was contained (as proposed SEC 2.023) in this Clearinghouse Rule 85-135 when it was originally distributed for public comment. The seasoned issuer exemption combines concepts from the "blue-chip" exemption and from the Registration by Filing procedure in Section 302 of the Revised Uniform Securities Act ("RUSAct"), recently adopted (in August, 1985) by the National Conference of Commissioners on Uniform State Laws. Because of the enactment of the statutory "seasoned issuer" exemption in s. 551.235, Stats., the "seasoned issuer" exemption rule proposal is deleted in this Clearinghouse Rule 85-135.

*CSP*  
*2/26/86*  
SECTION 2. SEC 2.01(<sup>8</sup>~~8~~) to (<sup>10</sup>~~11~~) are renumbered SEC 2.01(7) to (<sup>9</sup>~~10~~).

ANALYSIS: This SECTION renumbers the remaining subsections following the "blue chip" exemption in subsection SEC 2.01(7) that is repealed in SECTION 1.

1 SECTION 3. SEC 2.02(10)(j) is created to read:

2 SEC 2.02(10)(j). Any offer or sale of securities that  
3 qualifies for use of a transactional registration exemption  
4 under s. 2.025 or 2.027.

ANALYSIS: This SECTION is a rule-numbering convention used to facilitate the formatting and numbering of lengthy rules. The SECTION adds a new provision to the list of transactional registration exemptions already prescribed under SEC 2.02(10) utilizing the Commissioner's general discretionary authority under sec. 551.23(18), Wis. Stats., to exempt those transactions the Commissioner by rule finds that registration is not necessary or appropriate for the protection of investors. The new provision itself only contains cross-references to the two new rule provisions containing the text of the transactional exemptions.

The two registration exemption rules are based upon recommendations in a July 31, 1985 Report of the Wisconsin Commissioner of Securities Administrative Rule Advisory Committee ("ARAC"). That committee was appointed by the Commissioner in March, 1985 for the purpose of determining the feasibility of adopting administrative rules providing exemptions from merit review for certain equity securities offerings.

The two rules are proposed securities registration exemptions affecting the merit review process, and are structured to deal with two separate categories of issuers. The first rule is directed toward "non-seasoned" firms/firms in the promotional or developmental stage that are, in most instances, making their first public stock offering. The second rule is designed for use by corporations domiciled and principally operating in Wisconsin who will use at least 80% of the offering proceeds in their Wisconsin operations.

Each exemption is a transactional registration exemption requiring a filing of certain prescribed information with the Commissioner's Office for each

offering to be made in Wisconsin using such exemption.

There has been recent controversy with regard to making changes affecting the Wisconsin merit review process, including whether administrative rule changes, as contrasted with statutory changes, are the most appropriate mechanism to implement the changes. The ARAC Report had some strongly-held views in that regard, concluding on page 59 thereof that "because merit review standards are applied by rule, it would be an appropriate first step to relax those standards by administrative rules which would exempt a limited class of equity offerings from merit review."

The ARAC Report went on to state that: "Having considered the experience of the few states which attempted to modify the merit standards in recent years, ARAC is convinced an administrative rule is a more efficient approach to modifying merit review than a statutory amendment for the following reasons: (a) an administrative rule can be adopted more quickly than a proposed statutory change, (b) a rule can be changed far more quickly in the event clarification is necessary, and (c) the experience of other states indicates that attempts to modify the merit review standards by statute have either failed completely, obtained an entirely different result than that intended by its sponsors, or required several clarifying amendments resulting in delay and confusion."

The need for an evaluation period to study the effects of the administrative rule changes on the merit review process was also dealt with at length in the ARAC Report. On page 58, the Report stated that: "ARAC acknowledges that adoption of the proposed rules may constitute a substantial change in the manner in which the offer and sale of securities will be regulated in Wisconsin. Changes of such magnitude bring with them their own attendant measure of risk. The approach set forth in the [non-seasoned issuer rule] is based in part on the rules adopted in the few other states which have examined this issue. The changes in those other states have occurred so recently that it is not possible to form a judgment on their impact."

The proposed [Wisconsin issuer rule] is an attempt by ARAC to stimulate entrepreneurial activity by relaxing merit review standards. To ARAC's knowledge, this precise approach has not been attempted elsewhere. For these reasons, ARAC recommends that the proposed administrative rules be adopted by the Commissioner and subjected to a period of no less than two years evaluation in order to give the Commissioner sufficient time to take into consideration any concerns which investors, issuers, underwriters, securities counsel, legislators or the Commissioner might have in connection with the operation of the proposed rules."

It is the intent of the Commissioner's Office, following adoption of the finalized rules, to utilize its computerized data entry and retrieval capabilities to develop meaningful information regarding the utilization of the two registration exemptions and the types and characteristics of the issuers making use of them.

1 SECTION 4. SEC 2.025 is created to read:

2 SEC 2.025 NON-SEASONED ISSUER REGISTRATION EXEMPTION BY  
3 FILING. Except as provided in sub. (6) a transactional  
4 registration exemption is available under s. 551.23(18),  
5 Stats., for any offer or sale of common stock that meets the  
6 conditions set forth in subs. (1) to (5) of this section,  
7 unless a condition or conditions is waived by the  
8 commissioner upon a showing of good cause.

9 (1) FEDERAL REGISTRATION STATEMENT. A registration  
10 statement for the securities shall have been filed under the  
11 securities act of 1933 and, prior to any sale in this state,  
12 the registration statement shall have been declared effective

1 by the U.S. securities and exchange commission.

2 (2) UNDERWRITING. The offering shall be made pursuant  
3 to a firm commitment underwriting by one or more qualifying  
4 managing underwriters. As used in this subsection,  
5 "qualifying managing underwriter" means a managing or  
6 co-managing underwriter of the offering, not affiliated with  
7 the issuer, or the sponsor or controlling person of the  
8 issuer, by means of direct or indirect common control, who  
9 either meets each of the conditions in par. (a) 1 to 5 or  
10 receives a designation by letter from the commissioner under  
11 par. (b) of this subsection.

12 (a)1. The underwriter shall be a member in good  
13 standing of the National Association of Securities Dealers,  
14 Inc., and shall have been during the five-year period  
15 preceding the offering.

16 2. The underwriter shall have been engaged as a  
17 managing or co-managing underwriter in not less than 5 firmly  
18 underwritten public offerings pursuant to effective  
19 registration statements under the securities act of 1933  
20 during the five-year period preceding the offering.

21 3. The underwriter shall have had positive net income  
22 after taxes according to its financial statements in at least  
23 3 fiscal years during the five-fiscal-year period preceding  
24 the offering.

1           4. A majority of the principal officers of the  
2 underwriter shall have been engaged in the securities  
3 business for the five-year period preceding the offering; and

4           5. The underwriter shall be licensed as a  
5 broker-dealer in Wisconsin.

6           6. An underwriter shall be presumed qualified under  
7 subds. 1 to 5 upon the filing with the commissioner of a  
8 certification that the conditions in subds. 1 to 5 are  
9 satisfied. The certification shall be in letter form signed  
10 by an officer, partner or principal of the underwriter, or by  
11 counsel for the underwriter, and shall be filed with the  
12 commissioner at least 10 days prior to the proposed effective  
13 date of the registration statement filed with the U.S.  
14 securities and exchange commission.

15           (b) For an underwriter not qualified under par. (a),  
16 the underwriter may be designated a qualified managing  
17 underwriter for the offering by letter issued by the  
18 commissioner prior to any offer or sale of the securities in  
19 this state. The designation shall require an application by  
20 letter filed with the commissioner at least ten days prior to  
21 the proposed effective date of the registration statement  
22 filed with the U.S. securities and exchange commission. In  
23 making the designation, the commissioner shall consider,  
24 without limitation, and the applicant's letter shall address,

1 the following factors:

2 1. The number of underwriters involved in the  
3 offering;

4 2. The size and experience of the underwriter's staff;

5 3. The net capital of the underwriter;

6 4. The independence of the underwriter from the  
7 issuer;

8 5. The past operating history of the underwriter; and

9 6. The total size of the offering.

10 (3) SPECIFIC REQUIREMENTS FOR THE OFFERING.

11 (a) The common stock being offered shall have a public  
12 offering price of at least \$5.00 per share.

13 (b) The aggregate amount of the offering shall be \$1  
14 million or more.

15 (c) Neither the issuer, any qualified managing  
16 underwriter, nor any officer, director, controlling person or  
17 affiliate of the foregoing, is subject to disqualification  
18 under s. 551.23(19)(c), Stats.

19 (d) For an offering that is the initial public offering  
20 by an issuer under the securities act of 1933, the  
21 registration statement filed under sub. (1) receives full  
22 review by the U.S. securities and exchange commission.

23 (4) FAIRNESS TO INVESTOR STANDARDS.

1           (a) Promoters equity investment. If the offering is by  
2 a corporation in the promotional or developmental stage, the  
3 existing capital of the corporation shall be at least 10% of  
4 the aggregate offering price of the securities to be sold in  
5 the offering. As used in this subdivision, a "promotional or  
6 developmental stage" corporation means a corporation that has  
7 had no positive earnings from operations for any fiscal year  
8 during the 3 fiscal years immediately preceding the filing of  
9 the federal registration statement in sub. (1) or the shorter  
10 period of its existence. As used in this subdivision,  
11 "Existing capital" means the total of all amounts contributed  
12 to the corporation in cash and the reasonable value of all  
13 tangible assets contributed to the corporation as determined  
14 by independent appraisal, and as adjusted by the  
15 corporation's retained earnings.

16           (b) Promotional stock. The total amount of promotional  
17 stock held of record or beneficially by all promoters of the  
18 corporation shall not exceed 40% of the amount of the  
19 corporation's common stock to be outstanding upon completion  
20 of the offering. As used in this paragraph, "promotional  
21 stock" means all stock issued during the three years  
22 preceding the filing of the federal registration statement in  
23 sub. (1), other than those shares for which the promoters  
24 paid an amount per share equal to the public offering price

1 in cash or the reasonable value of tangible assets  
2 contributed to the corporation as determined by independent  
3 appraisal. As used in this paragraph, "promoter" means any  
4 officer or director of the corporation or any person owning  
5 of record or beneficially 5% or more of the outstanding  
6 voting securities of the issuer, or affiliates of any of the  
7 foregoing.

8 (c) Options and warrants. The corporation shall  
9 represent in writing to the commissioner that during the 12  
10 month period following the offering, options and warrants to  
11 purchase the common stock of the issuer held by its officers  
12 and directors will not exceed 10% of the outstanding common  
13 stock of the corporation. The exercise price of any options  
14 and warrants to purchase common stock of the corporation  
15 shall be at not less than 85% of the fair market value of the  
16 common stock on the date of grant.

17 (5) FILING REQUIREMENTS. (a) Materials to be filed.  
18 The issuer or applicant shall file with the commissioner:

19 1. A copy of the registration statement filed with the  
20 U.S. securities and exchange commission for the securities  
21 being offered;

22 2. A notarized original consent to service of process  
23 signed by a person authorized by the issuer;

24 3. A written statement specifying how the requirements

1 for use of the exemption in this section are met;

2 4. A fee of \$500; and

3 5. An undertaking signed by a person authorized by the  
4 issuer or applicant to file promptly all pre-effective  
5 amendments to the registration statement, to notify promptly  
6 the commissioner by telephone or wire of the date and time  
7 when the federal registration statement becomes effective,  
8 and to file promptly with the commissioner two copies of the  
9 final prospectus.

10 (b) Time for filing. The documents and fee prescribed  
11 in par. (a) shall be filed with the commissioner not later  
12 than the earlier of the date of the first use of the  
13 preliminary or final offering document in this state or the  
14 first sale in this state.

15 (6) NONAVAILABILITY FOR CERTAIN ISSUERS OF SECURITIES.  
16 The registration exemption under this section is not  
17 available for offers or sales of common stock by the  
18 following issuers of securities:

19 (a) A corporation that has had a class of its  
20 securities registered under section 12 of the securities  
21 exchange act of 1934 for each of its 5 fiscal years  
22 immediately preceding the filing of the federal registration  
23 statement in sub. (1).

24 (b) An open-end or closed-end management company, or a

1 face amount certificate company as defined in the investment  
2 company act of 1940.

ANALYSIS: This "non-seasoned issuer" registration exemption by filing created in this SECTION is the first of the two registration exemptions based upon recommendations in the July 31, 1985 Report of the Commissioner's Administrative Rule Advisory Committee ("ARAC"). The subject matter of this finalized rule addresses the issue raised by ARAC in its Report--charting an appropriate middle ground between the securities regulatory extremes of full "merit" review of public securities offerings and reliance on full disclosure standards alone. The ARAC rule proposal specifically intended to achieve a middle ground. ARAC stated in its Report that it did not propose complete abandonment of merit review in Wisconsin for several reasons that it set forth. A major reason is that if reliance is placed on full disclosure standards alone, investors victimized by securities fraud would have as their only recourse, pursuing statutory remedies of rescission through court action. Those statutory remedies would not accord investors sufficient redress since in most cases, the offering would have already been completed and the offering proceeds long since dissipated.

As a result, the ARAC recommendation combined four major elements. First, the offering must be made pursuant to a firm commitment underwriting by one or more "qualified managing underwriters" (as defined) who may not be affiliated with the issuer. Second, full disclosure of the issuer and the terms and conditions of the offering must be provided. (This disclosure is presumed if the offering is made pursuant to a federal registration statement). Third, the offering must meet prescribed minimum fairness-to-investor standards relating to limitations on options and warrants and required minimum levels of promoters investment. Fourth, a filing with, and disclosure review by, the Commissioner's office is required. Other substantive requirements, while not major elements under the ARAC recommendation, included: (i) that the offering price of the securities be at least \$5

per share in order to prevent use of the exemption by "penny stock" offerings; and (ii) a disqualification-from-use provision if the issuer or underwriter has been the subject of injunctive, criminal or certain administrative enforcement actions, whether or not securities related.

In determining the category of issuer to be the focus of the exemption, ARAC made several observations and conclusions: (i) "Much of the criticism of merit review in public offerings has been made in the context of a registration by coordination where the issuer is attempting to sell its securities nationally." (ARAC Report, page 12); (ii) "The empirical data reviewed by ARAC indicates that the claims that merit review impedes economic development are anecdotal. Established firms usually have access to needed capital from a variety of sources." (ARAC Report, page 38); (iii) ". . . with respect to established firms, the relative costs of merit review over and above compliance with the full and fair disclosure requirements at the federal level, are small in comparison to the other expenses of a public offering . . . ." "Thus ARAC does not agree that merit review materially impedes economic development in Wisconsin insofar as established firms are concerned. These firms appear to have the resources and experience to comply with merit requirements." (ARAC Report, page 59); and (iv) ARAC noted that "the merit review standards have the most impact on promotional or developmental stage companies" because of the lack of an "established track record" of operations and earnings and an "established market for their securities." (ARAC Report, page 40). Flowing from those observations, the ARAC recommendation focused on non-established firms/firms in the promotional or developmental stage that are offering their equity securities in Wisconsin in the context of a public offering, often an initial public offering.

The ARAC Report stated that adoption of its recommended rule which would exempt certain equity offerings from the full merit review registration process "would improve the perception by industry and investors of Wisconsin as being a 'pro-business' state."

With that advance billing, the Commissioner of Securities Office creates in this SECTION a transactional registration exemption in SEC 2.025 combining all four of the major elements of the ARAC recommendation, together with the additional two substantive items in that recommendation. Additionally, a specific subsection is included to provide that the exemption's use will be by the appropriate type/category of issuer identified in the ARAC Report--namely, "non-established" corporations (or "non-seasoned" as designated in the title of this exemption) or corporations in the promotional or developmental stage. A discussion of the particulars of the various provisions of SEC 2.025 is contained in the following paragraphs.

The introductory paragraph limits the exemption to common stock offerings and contains the mechanism by which its use will be directed toward the appropriate type of issuer. The mechanism consists of a cross-reference to sub. (6) of the rule which excludes the following issuers from use of the exemption: (i) investment companies (mutual funds and unit investment trusts) which were not intended beneficiaries of the exemption (see par. (6)(b)); and (ii) corporations that have been "publicly held" (through having a class of their equity securities registered under section 12 of the Securities Exchange Act of 1934) for each of the five fiscal years preceding the offering (see par. (6)(a)).

As a result of comment letters received and hearing testimony given, and for the purpose of providing greater ability for use of this exemption by issuers, the exclusion from use of the exemption in SEC 2.025(6)(a) is revised from its form in the August 30, 1985 comment draft by extending from a three year level to a five year level the Section-12-registered-company criteria. A three year/section 12 public reporting company criteria is one of the requirements which must be met in order for an issuer to be designated a "seasoned" issuer under the statutory exemption created in s. 551.235, Stats., by 1985 Wisconsin Act 38. However, while the 3 year public reporting company level used in s. 551.235, Stats., may be

appropriate in establishing minimum criteria for being a "seasoned" or "established" issuer, the same 3 year level is not necessarily an appropriate criteria for setting a maximum duration beyond which an issuer can no longer be considered "non-seasoned" (and thus unable to use the exemption in this SECTION). Three years as a "publicly held" (Section 12 reporting company) may or may not result in an issuer becoming "seasoned" or "established" with regard to product development or financial condition. The 5-year time period represents a more appropriate presumption of the outside timing parameters beyond which an issuer should no longer be considered in the category of a non-established/ non-seasoned issuer. Consequently, under the language of the exclusion as revised, an issuer is not disqualified from use of the "non-seasoned" issuer exemption until after five years as a section 12 public reporting company. Thus, an issuer can continue to utilize the SEC 2.025 "non-seasoned" registration exemption for its common stock offerings until that time.

Also as a result of comment letters received and hearing testimony given, the introductory paragraph of SEC 2.025 is amended from its comment draft form by adding a clause granting the Commissioner of Securities the authority to waive any of the prescribed conditions for use of the exemption upon a showing of good cause by an issuer. The waiver authority will accord flexibility to the exemption to enable it to be utilized in appropriate instances where justification is shown as to why in a particular offering, compliance with one or more of the conditions for use of the exemption is not necessary for the protection of investors. Similar waiver authority is accorded to the Commissioner in the introductory paragraph of the "seasoned issuer" statutory exemption of s. 551.235 in 1985 Wisconsin Act 38.

Subsection (1) of the rule provides the full-disclosure element contained in the ARAC recommendation by requiring the offering to be made pursuant to a federal registration statement.

A revision to sub. (1) as a result of comment letters received and hearing testimony relates to

the requirement in the comment draft form of the rule that the federal registration statement must receive a "full review" by the U.S. Securities and Exchange Commission ("SEC"). The SEC's current practice under a registration statement review policy announced by the SEC in October, 1980, is not to give a full review to all registration filings by securities issuers. Rather, although under that policy the initial public offering by an issuer will receive full review by the SEC, subsequent registrations by the same issuer generally will receive either some form of limited review or will receive no review, depending upon the facts and circumstances of a particular offering and the SEC's assessment of the degree of review warranted. Retaining in the rule a "full review" requirement that would be applicable to all offerings by an issuer thus would restrict an issuer's ability to use this exemption for subsequent offerings beyond the initial public offering. This result would occur because the non-seasoned issuer exemption in this SECTION is available for use by an issuer throughout a period until after the expiration of 5 years as a publicly-held (Section 12 reporting) company. During that period, an issuer may effectuate one or more SEC-registered securities offerings, such that retaining a "full SEC review" requirement in this exemption would substantially restrict its use because subsequent offerings by the issuer beyond its initial public offering may not ever receive full review by the SEC. Consequently, to achieve the dual results of not restricting use of the exemption for subsequent offerings by an issuer while assuring that a full review for adequacy of registration statement disclosures occurs at least for an issuer's initial public offering, the "full review" requirement is deleted from sub. (1) and a new par. (d) is added under sub. (3) SPECIFIC REQUIREMENTS FOR THE OFFERING. Under the new sub. (3), if an offering seeking to utilize the registration exemption under SEC. 2.025 is the initial public offering for an issuer, the registration statement filed with the SEC must receive a "full review" for disclosure adequacy. With regard to this issue, it is to be noted both that the staff of this Office will have an opportunity to review for disclosure adequacy the

disclosure materials utilized in each filing claiming use of the exemption in Wisconsin, and that the Commissioner has authority under s. 551.24, Stats., to revoke an exemption for any offering where it is necessary to do so in the public interest or for the protection of investors.

Subsection (2) of the rule contains the ARAC Report element requiring the offering to be made pursuant to a firm commitment underwriting by one or more "qualified managing underwriters" (as defined) who may not be affiliated with the issuer. That requirement provides several/the important investor protection benefits discussed in the ARAC Report. In the Report it was pointed out that: (i) the statutory liabilities imposed under federal and state securities laws on underwriters regarding offering document disclosures result in their conducting a due diligence investigation regarding the accuracy of those disclosures; (ii) in a "firm commitment" offering (as contrasted with a "best efforts" offering), the underwriter is committing its capital and is "at risk" in the resale of the securities, and thus will price the stock being offered at a price not inconsistent with the stock prices of comparable issuers in the trading market; and (iii) the underwriter under the exemption must be totally independent from the issuer (or the issuer's controlling person(s)) and thus not subject to conflicts of interest in performing its due diligence investigation and in committing its capital pursuant to the firm underwriting. Section 302(a)(7) of the RUSAct contains similar requirements to the effect that participating underwriters must be NASD members and purchase in a principal capacity the securities to be offered to the public.

The objective standards for being a "qualifying managing underwriter" in subds. (2)(a)1. to 4. of the rule are nearly identical with those in the ARAC recommendation. Such standards relate to an underwriter's: (i) business longevity (requiring that the underwriter be a member in good standing of the self-regulatory organization for broker-dealers, the National Association of Securities Dealers ("NASD"), for the five year period preceding the offering); (ii) experience in

underwriting (requiring that the underwriter shall have acted as a managing or co-managing underwriter for at least five firmly underwritten public offerings during the five year period preceding the offering); and (iii) financial condition/profitability (requiring the underwriter to have positive net income after taxes for at least 3 fiscal years during the 5-fiscal-year period preceding the offering). Subdivision (2)(a)5. of the rule contains an additional requirement that the broker-dealer must be licensed under the Wisconsin Uniform Securities Law. That requirement enables the Commissioner's Office to have direct licensing jurisdiction over the qualified managing underwriter. Such jurisdiction includes the ability of the Commissioner's Office to institute appropriate license-related sanctions against the underwriter for violations of the Wisconsin Uniform Securities Law. Those sanctions could not be instituted if the underwriter were not a licensee. Subdivision (2)(a)6. contains the same presumption-of-qualification language as that set forth in the ARAC recommendation by establishing a requirement that a certification be filed with the Commissioner that the qualification criteria are met. The filing is required to be made at least ten days prior to the effective date of the federal registration statement. Also, par. (2)(b) sets forth the same procedure as that contained in the ARAC recommendation for an underwriter to apply to the Commissioner for a designation as a qualified managing underwriter.

Subsection (3) of the exemption contains the same three substantive requirements that are in the ARAC recommendation relating to: (i) a public offering price of at least \$5 per share to prevent use of the exemption for offerings of "penny stock"; (ii) minimum aggregate offering price of \$1 million of the securities in the offering; and (iii) a disqualification-from-use provision if the issuer or underwriter has been the subject of injunctive, criminal or certain administrative enforcement actions.

Subsection (4) of the exemption rule contains both: (i) the two minimum fairness-to-investor standards contained in the ARAC recommendation

relating to limitations on options/warrants and required levels of promoters investment; and (ii) a third fairness-to-investor standard regarding a maximum permitted level of promotional stock. The inclusion of certain minimum fairness-to-investor standards in the ARAC recommendation was consistent with the middle ground ARAC was establishing between the regulatory extremes of full merit review of public securities offerings and reliance on full disclosure standards alone. ARAC, in discussing its rationale for including certain fairness-to-investor standards in its recommendation, states on page 69 of its Report: "ARAC acknowledges that the interests of underwriters and those of the investing public may not always be congruent. Some issuers and underwriters favor the liberalization and/or even-handed application of certain regulations rather than the complete elimination of merit review." "ARAC's conversations with underwriters who might be affected by the rule indicate that many underwriters favor the retention of certain minimum fairness standards as a protection for investors and as additional leverage over issuers to require them to restructure their operations and the offering so as to be fair to the underwriter's investment clientele."

The specific benefits to investors intended to be derived by including the two fairness standards in the ARAC recommendation are, as the ARAC Report notes: (1) the options and warrants provision "limits the potential for significant dilution of the public investor's ownership interest in the issuer within 12 months of the offering"; and (2) "the promoter's investment limitation is an attempt to ensure that insiders have some minimum stake in the continued success of the enterprise and that public investors are not being asked to shoulder the entire risk of the enterprise in the public offering."

Paragraphs (4)(a) and (4)(c) of SEC 2.025 contain the two minimum fairness-to-investor standards from the ARAC recommendation. The 10% promoters equity provision in par. (4)(a) parallels the 10% requirement in the ARAC recommendation. The provision also uses the language (including

definitions) from the promoters investment registration rule in SEC 3.05 which was applied (until 1984 when the language was changed to incorporate by reference the NASAA 10% promoters investment standard) by the staff in the review of securities registration applications.

Paragraph (4)(c) of the rule in this SECTION deals with options and warrants in a manner paralleling that used in the ARAC recommendation--namely, requiring a written representation to be filed by the issuer that during the twelve-month period following the offering, options and warrants to officers and directors will not exceed the limit prescribed in the rule. The option/warrant limitation in the proposed rule is set at a 10% level, not the 15% level in the ARAC recommendation. The reason for the difference is that the 10% level (which is the current standard under the registration rule of SEC 3.04(4)(a) applicable to non-Wisconsin issuers) is seldom the sole barrier to registration of a common stock offering in Wisconsin by corporate issuers, whether the issuers are "seasoned" or "non-seasoned." Additionally, the 10% limitation in (4)(c) extends only to options/warrants held by officers and directors. It would not limit the use of options/warrants as employment inducement to key employees of the corporation who were not officers or directors. Also, the limitation does not apply to options/warrants issued to underwriters.

Paragraph (4)(b) of the rule makes a substantive modification from the ARAC recommendation by including a promotional stock limitation as a fairness-to-investor standard. The rationale for including a promotional stock limitation is reflected in comments made by ARAC on page 17 of its Report regarding the role of the Commissioner of Securities in applying registration standards under the securities law. ARAC noted that the Commissioner's role involves an evaluation "whether there is a fair and reasonable sharing of the risks "[and to that there should be added, in this Office's opinion, the potential for reward]" of an enterprise between promoters, insiders and the investing public." In an examination by this Office during consideration of this rule of the

various fairness-to-investor standards applicable to securities registration filings, the standard that has by far the most significant impact on the allocation of risk and reward between promoters and investors is the promotional stock rule. Inability to meet the promotional stock registration standard is a major reason registration applications filed by non-established/promotional or developmental corporations for offerings of their common stock do not achieve registration in Wisconsin.

The operation of the promotional stock standard can be shown in an example using a securities registration application filing in which the public investors would be putting up 90% of the risk capital to be used by the corporation, but would be receiving only 20% of the stock of the corporation (representing the potential for reward). In such a situation, registration of the offering could be denied on the basis of excessive promotional stock to insiders unless the risk/reward disparity were somehow justified or the excessive promotional shares were deposited under an escrow agreement which provides that the escrowed shares may not be released until certain earnings tests are achieved by the corporation.

However, for purposes of evaluating the promotional stock standard under this rule the ARAC Report on page 25 comments that the current Wisconsin [promotional stock] standards "appear to be too restrictive, particularly for small, promotional stage companies."

In seeking to address and resolve the promotional stock issue in light of that assessment by ARAC, the promotional stock provision in par. (4)(b) of this rule is set at a 40% level. The 40% level is substantially more liberal than this Office's application of the North American Securities Administrators Association, Inc. ("NASAA") promotional stock guidelines currently incorporated by reference in Wisconsin under rule SEC 3.04. Those guidelines enable an administrator to require escrow of shares in situations involving promotional stock at levels as low as 15%. The past practice of this Office has been to require escrow of promotional shares exceeding 25% for

promotional or developmental issuers. Additionally, this Office in dealing with more established issuers not in the promotional or developmental stage has required escrow at even lower levels of promotional stock. The NASAA promotional stock guidelines, and presumably their application, caused ARAC to deem those guidelines "too severe." Additionally, the NASAA guidelines use a complicated formula for determining the impermissible levels of promotional stock. The 40% level adopted in this proposed exemption is much easier to compute.

The 40% level of promotional shares permitted under sub. (4)(b) of the rule, when added to the 10% "fully-paid-for" shares promoters are entitled to receive when they meet their 10% promoters investment requirement in (4)(a), results in a 50% overall level of ownership of shares in the corporation by the promoter and would still permit utilization of the exemption-by-filing rule in this SECTION. The 50% promotional stock level resulting from combined application of subs. (4)(a) and (b) of the rule corresponds to the "money gets half" precept in the venture capital realm. Under that general standard, in situations where a promoter of a corporation approaches a venture capital firm seeking to obtain 90% or more of the risk capital needed by the corporation, the venture capital firm can expect that it will receive at least 50% of the potential for reward in exchange for contributing that 90% risk money. In practice, venture capital firms, as a result of their bargaining position (of having the money being sought by the corporation), and their business knowledge and negotiation skills, ensure that the opportunity for reward they receive (expressed in terms of ownership of the entity, either directly in common stock or through convertible securities) is commensurate with the risk position taken. At the least, such venture capital firms will otherwise protect their risk investment in a corporation through pledges of available collateral, preferred creditor positions or other devices.

There are additional reasons beyond the "money gets half" venture capital standard for utilizing the 40% promotional stock/50% overall level in the

rule. Based on an evaluation of the number and characteristics of the common stock filings received by this office seeking registration, establishing a promotional stock level under the rule at the 25% level currently applied under NASAA guidelines would not result in any appreciable net increase of total offerings filed with this office by that "universe" of "non-seasoned" issuers looking to market their common stock in Wisconsin.

It would merely result in those issuers who would normally file and become cleared on a registration basis (because their promotional stock levels were under 25%) using the SEC 2.025 exemption-by-filing because it is a "faster track" to clearance to sell in Wisconsin. A 40% promotional stock level would provide an inducement for an indeterminate, but substantial, number of non-seasoned issuers considering marketing their securities nationally, to file in Wisconsin. This is because until adoption of this proposed rule, such issuers would tend not to file in Wisconsin because of the "chilling effect" of Wisconsin's promotional stock standards that are perceived nationally as "too severe."

Consequently, it is the assessment of the Commissioner of Securities Office that where the intended purposes of making a rule proposal in this area are: (1) to send out a pro-business signal to industry and investors; and (2) to develop a registration exemption for use by corporate issuers who are not established or are in the promotional or developmental stage and whose primary problem in meeting registration standards relates to promotional stock levels; it appears appropriate to "widen the door" under the registration exemption rule in this SECTION in terms of promotional stock levels permissible.

Following adoption of the rule using a 40% promotional stock level, this Office can see what its experience is with regard to the number and type of issuers seeking to use the exemption-by-filing exemption rule in this SECTION. Such point again underscores the necessity of utilizing the administrative rule mechanism to create these two new registration exemptions. If the experience

of this Office under this rule, or any of the other rules, indicates that any of them are being misused, or result in unintended consequences that adversely affect investor protection, appropriate action can be taken by the Commissioner's Office. Such includes immediate action where necessary utilizing the Commissioner's authority to enact emergency rules.

Subsection (5) of the rule requires a notification to be filed with the Commissioner in order to utilize the exemption. The timing of the filing is required to be not later than the earlier of the first use of the offering document in Wisconsin or the first sale in Wisconsin. The timing provision parallels that in the filing requirements for the ULOE statutory exemption in s. 551.23(19), Wis. Stats. The requirement ensures that the Commissioner's Office will have full information regarding all securities offerings being made in Wisconsin using the exemption as soon as the offering "hits the street." This allows the Commissioner to respond to any inquiries or concerns raised by persons in Wisconsin being solicited to purchase in the offering. The notification is comprised of the prescribed information and documents--including a written statement specifying how the requirements for use of the exemption are met--thus giving the Commissioner's Office the opportunity both to review the offering materials for disclosure-related concerns, and to verify compliance with the conditions and requirements for use of the exemption.

1 SECTION 5. SEC 2.027, is created to read:

2 SEC 2,027 WISCONSIN ISSUER REGISTRATION EXEMPTION BY  
3 FILING. If all the following conditions are met other than  
4 any condition or conditions waived by the Commissioner upon a  
5 showing of good cause, a transactional registration exemption  
6 is available under s. 551.23(18), Stats., for any offer or

1 sale of common stock of an issuer having, both before and  
2 upon completion of the offering, its principal office and a  
3 majority of its full-time employees located in this state:

4 (1) The securities sold in this state in the offering  
5 are purchased by not more than 50 persons described in s.  
6 551.28(7), Stats. The following are excluded in counting the  
7 50 persons:

8 (a) Persons described in s. 551.23(8), Stats.;

9 (b) Accredited investors as defined in rule 501(a) of  
10 Regulation D under the securities act of 1933; and

11 (c) Members of the immediate family of any executive  
12 officer or director of the issuer who have the same permanent  
13 residence as the officer or director.

14 (2) No commission or other remuneration is paid or  
15 given, directly or indirectly, for soliciting or selling to  
16 any person in this state in reliance on the exemption in this  
17 section, except to broker-dealers and agents licensed in this  
18 state.

19 (3) Neither the issuer nor any broker-dealer offering  
20 or selling the securities is or would be disqualified under  
21 s. 551.23(19)(c), Stats.

22 (4) The securities being offered have an offering price  
23 of not less than \$5 per share.

24 (5) An offering document meeting the disclosure

1 requirements of rule 502(b)(2) of Regulation D under the  
2 securities act of 1933 is delivered to each purchaser or  
3 prospective purchaser prior to the sale of the securities.

4 (6) The offering document provides that at least 80% of  
5 the net proceeds from the offering shall be used in  
6 connection with the operations of the issuer in this state.

7 (7) The issuer or applicant files with the  
8 commissioner:

9 (a) The offering document to be used in connection with  
10 the offer and sale of the securities not later than the date  
11 of the first use of the document in this state, together with  
12 a fee of \$200; and

13 (b) A copy of any advertising, other than the offering  
14 document, to be used in connection with the offer and sale of  
15 the securities not later than the date of its first use in  
16 this state, and a copy of any material amendment to the  
17 offering document, not later than the date of first use of  
18 the material amendment in this state.

ANALYSIS: As noted in the ANALYSIS to previous sections, the Wisconsin issuer registration-exemption-by-filing in this SECTION is based on the second of the two recommendations by ARAC. The exemption is intended to facilitate the raising of capital by Wisconsin-based corporations through providing greater access to Wisconsin capital markets and investors for those issuers with a substantial Wisconsin presence. The adoption of this Wisconsin issuer registration exemption-by-filing continues the policy of the Office of the

Commissioner of Securities of promulgating, by administrative rule, registration exemptions to assist small Wisconsin issuers in raising capital. Notably, effective September 1983, the agency adopted SEC 2.025 that provided a Wisconsin registration exemption to coordinate with Regulation D under the federal Securities Act of 1933. Section SEC 2.025, Wisconsin's first Uniform Limited Offering Exemption (ULOE), permitted sales of securities in a non-public offering to be made to up to 35 non-accredited investors, as well as sales to an unlimited number of "accredited investors" (as defined in Regulation D), within certain limitations. The ULOE under SEC 2.025 was subsequently repealed incident to adoption by the Wisconsin legislature of the statutory ULOE under sec. 551.23(19), Wis. Stats., effective in November of 1983.

A small Wisconsin issuer of securities currently has several statutory registration exemptions available for its non-public offerings of securities. In addition to the ULOE under secs. 551.23(19), Stats., sec. 551.23(10), Wis. Stats., provides an exemption for an issuer with its principal office in Wisconsin that has no more than fifteen security holders after the sales made pursuant to the exemption and certain requirements are met regarding sales commissions and limitations on media-type public advertising. Also available is sec. 551.23(11), Wis. Stats., that provides an exemption for transactions pursuant to offers made by any offeror to not more than 10 persons in a 12-month period.

The ARAC report notes that, in spite of the assortment of registration exemptions currently available to the small Wisconsin issuer, a category of offering remains which is subject to the registration requirement with no available exemption. That category is an offering made by an issuer without the assistance of an underwriter that is not sufficiently limited to qualify for use of any of the exemptions discussed earlier in this ANALYSIS. For example, an issuer might have capital needs which cannot be satisfied by an offering limited to a total of 15 investors, or might not have access to accredited investors, nor

enough other investors to satisfy its capital needs with a maximum of 35 purchasers. Such an issuer might nonetheless have difficulty attracting an underwriter. This is the sort of Wisconsin issuer which would derive special benefit from the Wisconsin issuer registration exemption by filing.

The ARAC Report also notes, "An important aspect of economic development involves fostering of entrepreneurial activity, creation of new jobs and encouraging new businesses to remain and grow in Wisconsin. If it is easier for a local business to raise capital in Wisconsin than in another state, the business has one more reason to stay here, rather than relocate, or to transfer or expand here if it is considering such a move. All businesses may be expected to need additional equity capital at some point in their existence."

"Raising additional capital has many attendant costs. As discussed earlier in this Report, companies in the promotional or developmental stage float offerings which are smaller than those of established firms. In smaller offerings the costs of compliance with securities regulation is higher as a percentage of total costs of the offering. These companies will find it more difficult to comply with merit review because the standards are biased against promotional or developmental stage companies. Further, existing exemptions from registration limit the issuers as to number and sophistication of purchasers and as to general advertising."

The finalized Wisconsin Issuer Registration Exemption by Filing rule addresses these concerns by providing an exemption from merit review for offerings of common stock equity securities by corporations with a substantial Wisconsin presence. Additionally, these offerings must meet certain other criteria designed to protect investors while allowing easier access to public markets. Marketing the offering is particularly facilitated under the proposed exemption in that media-type advertising (newspaper, etc.) is not precluded as is the case for issuers using the various private placement exemptions referred to earlier. The rule is designed to promote economic

development of the Wisconsin businesses and the local economy of which these form an integral part. The operation, requirements and effects of the rule, as well as its language which is largely identical to the ARAC recommendation, are discussed in the following paragraphs.

The introductory part of the rule limits its availability to an issuer of common stock that demonstrates a strong link with Wisconsin by requiring that the issuer have--both before the offering and upon its completion--its principal office in Wisconsin and have a majority of its full-time employees in Wisconsin. Following the receipt of comment letters and the public hearing procedure, the introductory paragraph of the rule in its comment draft form was revised by deleting the requirement that the issuer be incorporated under Wisconsin law. The requirement would unduly restrict Wisconsin-based businesses having the strong links with Wisconsin (in terms of a Wisconsin principal office and a majority of its employees in Wisconsin that are requirements under the exemption) from being able to use the exemption solely because the issuer was incorporated under another state's corporation law. Because it is not unusual for corporations with principal offices in one state to be incorporated under another state's corporation law (often Delaware's Corporation Law), deletion of the incorporated-under-Wisconsin-law requirement in the comment draft form of the rule is warranted. Additionally, sub. (6) of the rule requires that the lion's share of the capital proceeds raised from investors through use of the exemption be utilized in Wisconsin. This is accomplished by requiring the offering document to disclose that at least 80% of the net proceeds from the offering will be used in connection with the issuer's operations in Wisconsin. Failure to use the proceeds as represented by the issuer in its offering document would enable the Commissioner to institute appropriate enforcement action under the anti-fraud provisions of sec. 551.41, Wis. Stats. The 80% level in the rule corresponds with the same 80% use of proceeds requirement under federal Rule 147 for use of the federal "intra-state" registration exemption in sec. 3(a)(11) under the Securities Act of 1933.

As a result of comment letters received and hearing testimony given, the introductory paragraph of SEC 2.027 is amended from its comment draft form by adding a clause granting the Commissioner of Securities the authority to waive any of the prescribed conditions for use of the exemption upon a showing of good cause by an issuer. The waiver authority will accord flexibility to the exemption to enable it to be utilized in appropriate instances where justification is shown as to why in a particular offering, compliance with one or more of the conditions for use of the exemption is not necessary for the protection of investors. Similar waiver authority is added to the introductory paragraph of the "non-seasoned issuer" exemption in SECTION 4 of this proposed Rule-Making Order, and is present in the introductory paragraph of the "seasoned issuer" statutory exemption of s. 551.235, Stats., created in 1985 Wisconsin Act 38.

Investor protection is the intent and purpose of subsections (1) through (5) of the rule. Subsection (1) initially limits the total number of purchasers in Wisconsin to 50, each of whom must meet minimum investor suitability requirements relating to income and/or net worth that are prescribed in sec. 551.28(7), Wis. Stats. (That statute section is incorporated by reference in the rule). Additionally, Wisconsin investors beyond the 50 purchaser level are permitted where the investors either meet the high suitability standards of being so-called "institutional investors" as described in sec. 551.23(8), Stats., or are "accredited investors" as defined in Regulation D under the federal Securities Act of 1933. Also, members of the immediate family of any executive officer or director of the issuer who have the same permanent residence as the officer or director are excluded in counting toward the 50 purchaser level.

Subsection (2) provides that only persons licensed either as broker-dealers or as agents under the Wisconsin Uniform Securities Law may receive any commission or other remuneration for soliciting or selling securities to any person in Wisconsin in reliance on the exemption.

Subsection (3) makes the so-called "bad boy"/disqualification from use provision of section 551.23(19)(c), Stats., applicable to both the issuer any any broker-dealer offering or selling securities under the proposed exemption. Thus, as the ARAC report describes this provision, "if the issuer or broker-dealer has a history of improper activity, administrative sanctions or a criminal record for fraud, whether or not securities-related, the exemption is not permitted for use . . . ."

The \$5-per-share minimum price requirement in subsection (4) for stock sold under the exemption was established, according to ARAC, "to prevent Wisconsin from becoming a haven for (penny stock) issues . . . . The \$5 . . . price is an industry standard price for fairly high-quality offerings made on a firm underwriting basis."

Subsection (5) establishes a full disclosure/investor protection benefit by requiring an offering document to be provided to each purchaser or prospective purchaser prior to the sale of the securities. The offering document is required to meet the disclosure requirements of Rule 502(b)(2) of Regulation D under the Securities Act of 1933 (i.e., it should make the same kind of disclosures as are required on federal Form S-18). The ARAC report states that this requirement "is less burdensome than the current disclosure requirements for intrastate offerings."

Finally, in order that the Commissioner's Office have full information regarding all securities offerings being made in Wisconsin using the exemption as soon as the offering "hits the street," subsection (7) requires a notice to be filed with the Commissioner's Office not later than the date of the first use of the offering document in Wisconsin. The notice is comprised of the offering document required under subsection (5) and a fee of \$200. Also, the Commissioner's Office has the opportunity to review the materials submitted for any disclosure-related concerns. In addition, a copy of all advertising to be used in connection with the offer and sale of the securities must be

filed with the Commissioner not later than its first use in Wisconsin, as must a copy of any material amendment to the offering document.

The publication of advertising is permitted, including media-type advertising, under the exemption, subject only to the requirement in sub. (7) that a copy thereof be filed with the Commissioner not later than the date of the first use of the advertising.

1 SECTION 6. SEC 7.02(1)(b) is amended to read:

2 SEC 7.02(1)(b) Advertising published or circulated  
3 relating to a security exempted under s. 551.22, Stats.,  
4 except under s. SEC 2.01(3)(a); or relating to a transaction  
5 exempted under s. 551.23(4), (5), (6), (7) or (8), Stats.; or  
6 relating to a transaction exempted under s. 551.23(12), (13)  
7 or (14), Stats., if the issuer has any securities registered  
8 under section 12 of the securities exchange act of 1934 or  
9 exempted from registration by section 12(g)(2)(G) thereof or  
10 is an investment company registered under the investment  
11 company act of 1940; or relating to a transaction exempt from  
12 registration under s. SEC 2.027 where the advertising has  
13 been filed with the commissioner under s. SEC 2.027(7); or  
14 relating to a transaction subject to the filing requirements  
15 of section 14(d) of the securities exchange act of 1934;  
16 provided the transaction is not subject to the filing  
17 requirements of s. SEC 6.05(1).

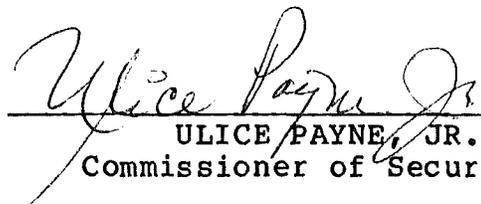
ANALYSIS: This SECTION provides an exclusion from the advertising filing requirement in sec. 551.53, Wis. Stats., and applies to advertising that has been filed in connection with use by a Wisconsin issuer of the exemption-by-filing provisions of s. SEC 2.207 created in SECTION 6. The advertising filing exclusion created in this SECTION is necessary to accomplish the intent of SEC 2.027 to allow issuers utilizing that transactional exemption to public advertising relating to the securities being offered, provided the advertising has separately been filed with the Commissioner under the exemption in SEC 2.027.

\* \* \* \*

The rules and amendments contained in this Order shall take effect as provided in sec. 227.026(1)(Intro.), Wis. Stats., on the first day of the month following publication in the Wisconsin Administrative Register.

Dated this 24<sup>th</sup> day of February, 1986.

(SEAL)

  
\_\_\_\_\_  
ULICE PAYNE, JR.  
Commissioner of Securities

# WISCONSIN LEGISLATIVE COUNCIL

LCRC  
FORM 2

## RULES CLEARINGHOUSE

RONALD SKLANSKY  
DIRECTOR  
(Phone 266-1946)



ROOM 147 NORTH, STATE CAPITOL  
MADISON, WI 53702  
PHONE 608-266-1304

RICHARD SWEET  
ASSISTANT DIRECTOR  
(Phone 266-2982)

BONNIE REESE  
EXECUTIVE SECRETARY

---

---

### CLEARINGHOUSE REPORT TO AGENCY

---

---

[THIS REPORT HAS BEEN PREPARED PURSUANT TO S. 227.029, STATS., AS CREATED BY CH. 34, LAWS OF 1979. THIS IS A REPORT ON A RULE AS ORIGINALLY PROPOSED BY THE AGENCY; THE REPORT MAY NOT REFLECT THE FINAL CONTENT OF THE RULE IN FINAL DRAFT FORM AS IT WILL BE SUBMITTED TO THE LEGISLATURE. THIS REPORT CONSTITUTES A REVIEW OF, BUT NOT APPROVAL OR DISAPPROVAL OF, THE SUBSTANTIVE CONTENT AND TECHNICAL ACCURACY OF THE RULE.]

#### CLEARINGHOUSE RULE 85-135

AN ORDER to repeal SEC 2.01 (7); to renumber SEC 2.01 (8) to (11); to amend SEC 7.02 (1) (b); and to create SEC 2.02 (10) (j), 2.023, 2.025 and 2.027, relating to securities registration exemptions.

Submitted by OFFICE OF THE COMMISSIONER OF SECURITIES.

9- 4-85. Received by Legislative Council.  
10- 2-85. Report sent to Agency.

RS:DLS:las;kjh

LEGISLATIVE COUNCIL RULES CLEARINGHOUSE REPORT

(Pursuant to s. 227.029, Stats.)

1. REVIEW OF STATUTORY AUTHORITY [s. 227.029 (2) (a)]
  - a. Rules appear to be within the agency's statutory authority
  - b. Rules appear to be unsupported by statutory authority, either in whole or in part
  - c. Comment attached  yes  no
  
2. REVIEW OF RULES FOR FORM, STYLE AND PLACEMENT IN ADMINISTRATIVE CODE [s. 227.029 (2) (c)]
  - a. Rules satisfactory
  - b. Rules unsatisfactory
  - c. Comment attached  yes  no
  
3. REVIEW OF RULES FOR CONFLICT WITH OR DUPLICATION OF EXISTING RULES [s. 227.029 (2) (d)]
  - a. Conflict or duplication not noted
  - b. Conflict or duplication noted
  - c. Comment attached  yes  no
  
4. REVIEW OF RULES FOR ADEQUACY OF REFERENCES TO RELATED STATUTES, RULES AND FORMS [s. 227.029 (2) (e)]
  - a. References appear to be adequate
  - b. References appear to be inadequate
  - c. Comment attached  yes  no
  
5. REVIEW OF LANGUAGE OF RULES FOR CLARITY, GRAMMAR, PUNCTUATION AND PLAINNESS [s. 227.029 (2) (f)]
  - a. Rules satisfactory
  - b. Rules unsatisfactory
  - c. Comment attached  yes  no
  
6. REVIEW OF RULES FOR POTENTIAL CONFLICTS WITH, AND COMPARABILITY TO, RELATED FEDERAL REGULATIONS [s. 227.029 (2) (g)]
  - a. No problems noted
  - b. Problems noted
  - c. Comment attached  yes  no
  
7. REVIEW OF RULES FOR PERMIT ACTION DEADLINE [s. 227.029 (2) (i)]
  - a. No problems noted
  - b. Problems noted
  - c. Comment attached  yes  no

# WISCONSIN LEGISLATIVE COUNCIL

## RULES CLEARINGHOUSE

RONALD SKLANSKY  
DIRECTOR  
(Phone 266-1946)

RICHARD SWEET  
ASSISTANT DIRECTOR  
(Phone 266-2982)



ROOM 147 NORTH, STATE CAPITOL  
MADISON, WI 53702  
PHONE 608-266-1304

BONNIE REESE  
EXECUTIVE SECRETARY

October 2, 1985

### CLEARINGHOUSE RULE 85-135

#### COMMENTS

[NOTE: All citations to "Manual" in the comments below are to the Administrative Rules Procedures Manual, prepared by the Revisor of Statutes Bureau and the Legislative Council, dated June 1984.]

#### 2. Form, Style and Placement in Administrative Code

a. Section SEC 2.023 would be clearer if it were reorganized as follows:

(1) DEFINITIONS. [NOTE: Include, in alphabetical order, the definition found in s. SEC 2.023 -- i.e., "material default," "finance company" and "liquid assets."]

(2) GENERAL REQUIREMENTS FOR EXEMPTION. A transactional registration exemption is available under...which meets the following requirements:

(a) The issuer is organized under the laws of...prospectus.

(b) A class of the issuer's securities is registered...and has been so registered for the three years...registration statement.

(c) The issuer has tangible net worth of not less than \$3,000,000 and has consolidated after tax net income from operation...last three fiscal years.

(d) In the fiscal year preceding the offering, neither the issuer nor any significant subsidiary has had a material

default...three years or more. It shall not be a material default...is cured within 90 days.

(e) A registration statement for the securities has been filed...commission.

(f) The offering is made pursuant to a firm commitment underwriting. Each of the underwriters participating in the offering of the securities...national association of securities dealers. None of the underwriters may be affiliated...common control.

(3) EQUITABLE OR CONVERTIBLE TO EQUITY OFFERING. If the offering is of common stock..., the following requirements shall be met in addition to the requirements under sub. (2):

(a) The issuer has a minimum of two independent outside directors.

(b) The issued and outstanding equity securities of the issuer:

1. On any date within...begins, are owned beneficially...and at least 500,000 shares are publicly held....

2. Have at least four market makers...1934.

(c) The securities being offered have:

1. Voting rights...with respect to:

a. The number of...; and

b. The right to vote...issuer; and

2. A public offering price...issuer.

(4) DEBT OR PREFERRED STOCK OFFERING.

(a) If the offering is of debt securities or preferred stock, whether or not convertible, the issuer, in addition to the requirements in sub. (2) must have consolidated...offering.

(b) If the issuer is a finance company...the net income requirement under par. (a) before deduction...expense.

(5) SUCCESSOR ISSUERS. An issuer meets the requirements in subs. (2) (b) and (c), (3) and (4) (a) if either the issuer...and if:

(a) The succession...; or

(b) All predecessors...succession.

(6) FILING REQUIREMENTS. The issuer or applicant shall file the following with the commissioner not later than the earlier of the date of the first use...in this state:

(a) A copy of the registration...

(b) A notarized....

b. On page 7, line 9, the word "shall" should replace the word "must."

c. On page 10, line 8, the phrase "this section" should replace the reference "s. SEC 2.023."

d. A similar type of reorganization should be used in s. SEC 2.025. For example:

(1) DEFINITIONS.

(2) REQUIREMENTS FOR EXEMPTION. Except as provided in sub. (2), a transactional registration exemption is available...that meets the following requirements:

Throughout the proposed rule, titles to subsections and paragraphs should be used in a consistent manner (e.g., if one paragraph in a section has a title, all the paragraphs in that section should have titles). Also, note that titles are not part of the text of the rule. There are several places in the proposed rule where the titles are used as introductory clauses (e.g., line 13, page 6). Also, note that titles to subsections are to be written in solid capital letters with no underscore and titles to paragraphs are to be written with an initial capital letter and underscored. The entire rule should be reviewed for its use of titles. [See s. 1.05, Manual.]

e. On page 21, line 17, the phrase "this section" should be replaced for the reference "s. SEC 2.025."

f. On page 31, in the first full paragraph, references should be to "sub. (3) (a), (b) and (c)." [See, also, page 15.]

## 5. Clarity, Grammar, Punctuation and Plainness

a. On page 3, the analysis of the rule appears to make the first mention of the "ARAC Report." A brief description of the report should be made at this point for the benefit of the reader.

b. On page 5, line 10, the word "present" appears to be unnecessary. [See s. 1.01 (9) (b), Manual.]

c. On page 8, lines 17 and 18, would the final clause of this sentence be clearer if it read "and shall take into account the proposed offering and the intended use of proceeds"?

d. In s. SEC 2.023 (2), second sentence, substitute "under the act" for "thereunder" and "the statement" for "that federal registration statement." In sub. (3) (c), page 6, line 7, substitute "if" for "provided that." In sub. (4) (e), the provision should be redrafted to avoid the use of parentheses. Also, on page 9, line 2, the reference should be to "par. (d)," not "par. (4) (d)."

e. In s. SEC 2.025 (2) (intro.), page 17, line 2, "section" should be "subsection" and in line 7, "subds. (a) 1. to 5." should be "par. (a) 1 to 5." In lines 18, 21 and 24, on page 17, substitute "five-year period preceding the offering" for "five preceding years." On page 18, lines 4 and 5, delete the periods in "1 to 5." On page 20, lines 12 and 19, "subdivision" should be "paragraph." On page 21, line 6, substitute "shall" for "will" and on line 17, substitute a semi-colon for the period.

f. On page 19, line 23, the word "any" is used. Is the word intended to mean that a promotional or developmental stage corporation is a corporation which has had no positive earnings from operations in one of the three preceding years or no positive earnings in each of the three preceding years? This should be clarified. [See also page 22, line 12.]

g. On page 21, line 24, could the word "promptly" be replaced with a specific time period?

h. In s. SEC 2.027 (intro.), insert: "If all the following conditions are met," at the beginning of the sentence and delete the last clause in lines 8 and 9, page 33. Also, substitute a colon for the comma on line 8 and "are" for "may be" on line 11, page 33. On page 34, substitute "is" for "may be" on line 8, delete "shall" on line 16, substitute "is" for "shall be" on line 20 and substitute "provides" for "shall provide" on line 22. On page 35, substitute "files" for "shall file" on line 1 and "of the document" for "thereof" on line 5. In line 11, does "its" refer to the "material amendment" or the "offering document." The word "its" should be replaced with more specific language.

i. In s. SEC 7.02 (1) (b), line 13, substitute "s. SEC 2.027 (7)" for "sub. (7) thereunder."

Report Prepared by the  
Office of the Commissioner of Securities  
Relating to Amendments to the  
Rules of the Commissioner of Securities

(a) Findings of Fact

(1) The Office of the Commissioner of Securities received and reviewed a Report dated July 31, 1985 from the Commissioner of Securities Administrative Rule Advisory Committee ("ARAC") containing recommendations for adoption of two administrative rules providing exemptions from merit review for certain equity securities offerings.

(2) The Wisconsin legislature in the 1985 biennial budget bill enacted as 1985 Wisconsin Act 29 directed the Office of the Wisconsin Commissioner of Securities to do the following in Section 3049(1)(g) thereof: (a) review the ARAC Report following its issuance; (b) inform the legislature of the Office's position with respect to the Report's recommendations; and (c) if the Commissioner's Office promulgated rules to carry out recommendations in the Report, to submit a report to the legislature six months after the rules take effect regarding the Office's observations on the experience resulting from the rules and any necessary proposed legislation.

(3) The Office of the Commissioner of Securities instituted the statutorily prescribed rule-making procedures under Chapter 227 of the Wisconsin Statutes for the purpose of adopting those two ARAC-recommended rules, together with an additional registration exemption rule developed by the Commissioner's office, plus related rules to implement the three registration exemption rule proposals.

(4) Copies of a Comment Draft of the proposed rules containing an explanatory ANALYSIS to each SECTION were distributed with the mailing of this agency's August, 1985 Wisconsin Securities Bulletin to all persons on the mailing list of the Bulletin. The Bulletin mailing list includes the general public, securities broker-dealer and investment adviser licensees, securities registrants, securities law practitioners, securities trade associates and regulatory bodies, and other interested persons. A cover letter from the Commissioner that accompanied the Comment Draft requested written comments on the proposed revisions or testimony at the public hearing held at the State Capitol in Madison, Wisconsin.

(5) During the public comment period and as a result of the public hearing, four letters were received setting forth specific comments on the rules as proposed.

(6) The public hearing on the rule revisions was held October 10, 1985 at 10:00 a.m. in Room 318 Southwest of the State Capitol.

(7) At the public hearing, testimony was presented by three persons (other than agency staff), two of whom also submitted comment letters referred to in para. (4).

(8) Following the comment period relating to the proposed rules, one of the 3 proposed registration exemptions -- namely, a "seasoned issuer" exemption rule proposed as SEC 2.023 -- was the basis for September 1985 Special Session Senate Bill 15 that was enacted as 1985 Wisconsin Act 38 (published November 1, 1985, effective January 1, 1986).

(9) Several of the comments made in the comment letters and in hearing testimony resulted in changes and modifications to the proposed rules as identified in part (c) of this Report.

(10) It is appropriate in the public interest and for the protection of Wisconsin investors for the Commissioner to seek to exercise his rule-making authority under sections 551.63(1) and (2), 551.22(17), 551.23(18), and 551.53(1)(b), Wis. Stats., to amend, adopt and repeal the attached rules to carry out the purposes of Chapter 551, Wis. Stats., the Wisconsin Uniform Securities Law.

(b) Statement Explaining Need for Rules

The statutorily prescribed rule-making procedures under Chapter 227 of the Wisconsin Statutes are being implemented for the following purposes:

(1) Promulgating two securities registration exemption rules affecting the merit review process. The exemptions are structured to deal with two separate categories of issuers. The first exemption is directed toward "non-seasoned" firms/firms in the promotional or developmental stage that are, in most instances, making their first public stock offering. The second exemption is designed for use by corporations organized and principally operating in Wisconsin who will use at least 80% of the offering proceeds in their Wisconsin operations; (2) Repealing the so-called "blue chip" registration exemption in SEC 2.01(7), Wis. Adm. Code, because that exemption was replaced by a so-called "seasoned issuer" registration exemption in s. 551.235, Wis. Stats., enacted by statute in 1985 Wisconsin Act 38 (published November 1, 1985, effective January 1, 1986). That exemption statute was based on a proposed rule exemption entitled Seasoned Issuer Exemption By Filing that was contained as proposed SEC 2.023 in this Clearinghouse Rule 85-135 when it was originally distributed for public comment. Because of the enactment of the statutory "seasoned issuer" exemption in s. 551.235, Wis. Stats., the "seasoned issuer" rule proposal was deleted from Clearinghouse Rule 85-135 in its attached proposed final form.

The two registration exemption rules contained in the attached Proposed Rule-Making Order are based on recommendations contained in a Report dated July 31, 1985 by the Commissioner's Administrative Rule Advisory Committee ("ARAC"). That Committee was appointed by the Commissioner in March, 1985 for the purpose of determining the feasibility of adopting administrative rules providing exemptions from merit review for certain equity securities offerings. The ANALYSES for the registration exemption rules contained in the attached Rule-Making Order include detailed discussions of the various requirements for use of the rules and the policy reasons behind them. The ANALYSES for the rules also discuss the necessity for implementing the exemptions via administrative rule, rather than by statute, as well as the need for a substantial evaluation period to study and assess both the effects of the changes and the types and the characteristics of the issuers making use of the exemptions.

(c) Explanation of Modifications Made as a Result of Public Comment Letters and Public Hearing Testimony

- As a result of the enactment of a "seasoned issuer" registration exemption by statute in s. 551.235, Wis. Stats., under 1985 Wisconsin Act 38 (published November 1, 1985, effective January 1, 1986), the "seasoned issuer" rule proposal in SEC 2.023 of the comment draft form of this Clearinghouse Rule 85-135 was deleted from its proposed final form as attached to this Report. Adoption of a "seasoned issuer" registration exemption by rule would be duplicative inasmuch as the "seasoned issuer" exemption statute is already in existence.
  
- As a result of comment letters received and hearing testimony given on the point, the introductory paragraph of SEC 2.025 is amended from its comment draft form by adding a clause granting the Commissioner of Securities the authority to waive any of the prescribed conditions for use of the exemption upon a showing of good cause by an issuer. The waiver authority will accord flexibility to the exemption to enable it to be utilized in appropriate instances where justification is shown as to why in a particular offering, compliance with one or more of the conditions for use of the exemption is not necessary for the protection of investors. Similar waiver authority was added to the introductory paragraph of the "Wisconsin issuer" registration exemption in SECTION 5 of the attached rules in their proposed final form, and waiver authority is present in the introductory paragraph of the "seasoned issuer" statutory exemption of s. 551.235, Wis. Stats., created in 1985 Wisconsin Act 38.
  
- As a result of comment letters received and hearing testimony given on the point, and for the purpose of providing greater ability for use of this exemption by issuers, the exclusion from use of the exemption in SEC 2.025(6)(a) is revised from its form in the August 30, 1985 comment draft by extending from a three year level to a five year level the Section-12-registered-company criteria. A three year/section 12 public reporting company criteria is one of the requirements which must be met in order for an issuer to be designated a "seasoned" issuer under the statutory exemption created in s. 551.235, Wis. Stats., by 1985 Wisconsin Act 38. However, while the 3 year public reporting company level used in s. 551.235, Wis. Stats., may be appropriate in establishing minimum criteria for being a "seasoned" or "established" issuer, the same 3 year level is not necessarily an appropriate criteria for setting a maximum duration beyond which an issuer can no longer be considered "non-seasoned" (and thus unable to use the exemption in this SECTION). Three years as a "publicly

held" (Section 12 reporting company) may or may not result in an issuer becoming "seasoned" or "established" with regard to product development or financial condition. The 5-year time period represents a more appropriate presumption of the outside timing parameters beyond which an issuer should no longer be considered in the category of a non-established/non-seasoned issuer. Consequently, under the language of the exclusion as revised, an issuer is not disqualified from use of the "non-seasoned" issuer exemption in this SECTION until after five years as a section 12 public reporting company. Thus, an issuer can continue to utilize the SEC 2.025 registration exemption for its common stock offerings until that time.

-- A revision to sub. (1) of SEC 2.025 as a result of comment letters received and hearing testimony relates to the requirement in the comment draft form of the rule that the federal registration statement must receive a "full review" by the U.S. Securities and Exchange Commission ("SEC"). The SEC's current practice under a registration statement review policy announced by the SEC in October, 1980, is not to give a full review to all registration filings by securities issuers. Rather, although under that policy the initial public offering by an issuer will receive full review by the SEC, subsequent registrations by the same issuer generally will receive either some form of limited review or will receive no review, depending upon the facts and circumstances of a particular offering and the SEC's assessment of the degree of review warranted. Retaining in the rule a "full review" requirement that would be applicable to all offerings by an issuer thus would restrict an issuer's ability to use this exemption for subsequent offerings beyond the initial public offering. This result would occur because the non-seasoned issuer exemption in this SECTION is available for use by an issuer throughout a period until after the expiration of 5 years as a publicly-held (Section 12 reporting) company. During that period, an issuer may effectuate one or more SEC-registered securities offerings, such that retaining a "full SEC review" requirement in this exemption would substantially restrict its use because subsequent offerings by the issuer beyond its initial public offering may not ever receive full review by the SEC. Consequently, to achieve the dual results of not restricting use of the exemption for subsequent offerings by an issuer while assuring that a full review for adequacy of registration statement disclosures occurs at least for an issuer's initial public offering, the "full review" requirement is deleted from sub. (1) and a new par. (d) is added under sub. (3) SPECIFIC REQUIREMENTS FOR THE OFFERING. Under the new sub. (3),

if an offering seeking to utilize the registration exemption under SEC 2.025 is the initial public offering for an issuer, the registration statement filed with the SEC must receive a "full review" for disclosure adequacy. With regard to this issue, it is to be noted both that the staff of this Office will have an opportunity to review for disclosure adequacy the disclosure materials utilized in each filing claiming use of the exemption in Wisconsin, and that the Commissioner has authority under s. 551.24, Wis. Stats., to revoke an exemption for any offering where it is necessary to do so in the public interest or for the protection of investors.

-- As a result of comment letters received and hearing testimony given on the point, the introductory paragraph of SEC 2.027 is amended from its comment draft form by adding a clause granting the Commissioner of Securities the authority to waive any of the prescribed conditions for use of the exemption upon a showing of good cause by an issuer. The waiver authority will accord flexibility to the exemption to enable it to be utilized in appropriate instances where justification is shown as to why in a particular offering, compliance with one or more of the conditions for use of the exemption is not necessary for the protection of investors. Similar waiver authority was added to the introductory paragraph of the "non-seasoned issuer" exemption in SECTION 4 of the attached rules in their proposed final form, and waiver authority is present in the introductory paragraph of the "seasoned issuer" statutory exemption of s. 551.235, Wis. Stats., created in 1985 Wisconsin Act 38.

-- Following the receipt of comment letters and the public hearing procedure, the introductory paragraph of SEC 2.027 was revised from its comment draft form by deleting the requirement that the issuer be incorporated under Wisconsin law. The requirement would unduly restrict Wisconsin-based businesses having the strong links with Wisconsin (in terms of a Wisconsin principal office and a majority of its employees in Wisconsin that are requirements under the exemption) from being able to use the exemption solely because the issuer was incorporated under another state's corporation law. Due to the fact that it is not unusual for corporations with principal offices in one state to be incorporated under another state's corporation law (often Delaware's Corporation Law), deletion of the incorporated-under-Wisconsin-law requirement in the comment draft form of the rule is warranted.

(d) List of Persons Appearing or Registering at the Public Hearing Conducted by Commissioner of Securities Ulice Payne, Jr. as Hearing Officer

- Randall E. Schumann, General Counsel of the Office of the Commissioner of Securities, made an appearance on behalf of the agency's staff to submit documents and information for the record.
- Randall E. Wade, Director, Bureau of Research Division of Policy Development, State of Wisconsin Department of Development. 123 West Washington Avenue, Madison, Wisconsin 53707
- Glen F. Hackman, Wisconsin Association of Securities Dealers, Inc. 777 East Wisconsin Avenue, Milwaukee, Wisconsin 53202
- Attorney Charles A. McKinney 780 North Water Street, Milwaukee, Wisconsin 53202

Comment Letters Received:

- Comment letter dated October 7, 1985, received October 9, 1985 from the State of Wisconsin Department of Development, 123 West Washington Avenue, Madison, Wisconsin, 53707.
- Comment letter dated October 8, 1985, received October 9, 1985, from the Wisconsin Association of Securities Dealers, 777 East Wisconsin Avenue, Milwaukee, Wisconsin, 53202.
- Comment letter dated October 8, 1985, received October 10, 1985, from Attorney Joseph Hildebrandt, 1 South Pinckney Street, Madison, Wisconsin, 53701.
- Comment letter dated October 9, 1985, received October 10, 1985, from the American Stock Exchange, 86 Trinity Place, New York, New York, 10006.

(e) Response to Legislative Council/Rules Clearinghouse Report Recommendations

(1) Acceptance of recommendations in whole:

Under 2. Form, Style and Placement in Administrative Code

- Consistent with the Rules Clearinghouse comment in para. e. regarding SECTION 4 concerning SEC 2.025(5)(a)3., the phrase "this section" was substituted for the reference "s. SEC 2.025".
- Consistent with the Rules Clearinghouse comment in para. f. regarding the ANALYSIS to SECTION 4 containing cross-references, the citations to the cross-references are changed to [as renumbered] "sub. (4)(a), (b) and (c)".

Under 5. Clarity, Grammar, Punctuation and Plainness

- Consistent with the Rules Clearinghouse comment in para. a. regarding SECTION 3 concerning SEC 2.02(10)(j), language is added to the ANALYSIS to explain the reference to the "ARAC Report".
- Consistent with the Rules Clearinghouse comment in para. e. relating to SEC 2.025 in its comment draft form, all of the recommended changes were made, consisting of: page 17, line 2, "section" changed to "subsection"; page 17, line 7, "subd. (a) 1. to 5." changed to "par. (a) 1 to 5"; page 17, lines 18, 21 and 24 "five year period preceding the offering" substituted for "five preceding years"; page 18, lines 4 and 5, deleting the periods in "1 to 5"; page 20, lines 12 and 19, "subdivision" changed to "paragraph"; page 21, line 6, "shall" substituted for "will"; page 21, line 17, a semi-colon is substituted for the period.
- Consistent with the Rules Clearinghouse comment in para. f. to clarify the use of the term "any" in SEC 2.025(4)(a) on page 19, line 23 of the comment draft form of the rule, the language "any fiscal year during" is substituted for "of its" to clarify the intent of the provision that the issuer cannot have had positive earnings in any fiscal year during the three fiscal year period preceding the offering. A similar clarification is made to SEC 2.025(6)(a) on page 22, line 12 of the comment draft of the rule by adding the language "each of" in the attached proposed final draft of the rule.
- Consistent with the Rules Clearinghouse comment in

para h. relating to SEC 2.027 in its Comment Draft form, all of the recommended changes were made, consisting of: on page 33, line 3, adding the language "If all the following conditions are met"; page 33, lines 8 and 9, deleting the "provided..." clause; page 33, line 9, substituting a colon for the comma; page 33, line 11, substituting "are" for "may be"; page 34, line 8, substituting "is" for "may be"; page 34, line 16, deleting "shall"; page 34, line 20, substituting "is" for "shall be"; page 34, line 22, substituting "provides" for "shall provide"; page 35, line 1, substituting "files" for "shall file"; page 35, line 5, substituting "of the document" for "thereof"; page 35, line 11, the word "its" was deleted and clarification was provided by adding the language "of the material amendment".

- Consistent with the Rules Clearinghouse comment in para. i. relating to SEC 7.02(1)(b), the language "s. SEC 2.027(7)" was substituted for "sub. (7) thereunder" on page 40, line 9 of the Comment Draft form of the rule.

(2) Acceptance of recommendations in part:

- In item para. d. of Form, Style and Placement in Administrative Code

The Rules Clearinghouse comment was that SEC 2.025 should be organized in the manner recommended for SEC 2.023. However, while the organization of part of SEC 2.023 was revised consistent with the manner recommended, the primary organization was made to be consistent with the organization given to the "seasoned issuer" statutory exemption in s. 551.235, Wis. Stats., in 1985 Wisconsin Act 38. Consistent with the Rules Clearinghouse comment to review and correct the use of titles throughout the rule-making order, revisions were made to the titles of several subsections and paragraphs of SEC 2.025.

(3) Rejection of recommendations:

- In items paras. a., b. and c. of Form, Style and Placement in Administrative Code, Rules Clearinghouse recommendations were made regarding SEC 2.023 concerning reorganizing the section and making two wording changes. The reasons for the rejection of those recommendations, as is set forth in item e.(4) below, is that SEC 2.023 was deleted from Clearinghouse Rule 85-135 in its proposed final form.

-- In items paras. b., c. and d. of Clarity, Grammar, Punctuation and Plainness, Rules Clearinghouse recommendations were made regarding SEC 2.023 concerning several language and wording changes. The reasons for the rejection of those recommendations, as is set forth in item e.(4) below, is that SEC 2.023 was deleted from Clearinghouse Rule 85-135 in its proposed final form.

-- In item para. g. of Clarity, Grammar, Punctuation and Plainness, the Rules Clearinghouse asked whether a specific time period could be used instead of the word "promptly" in SEC 2.025(5)(a)5. The reasons for not making the change are set forth in item e.(4) below.

(4) Reasons for not accepting recommendations:

-- The reason for not accepting the recommendations in items paras. a., b. and c. of Form, Style and Placement in Administrative Code, and in items paras. b., c. and d. of Clarity, Grammar, Punctuation and Plainness, all relating to SEC 2.023 of Clearinghouse Rule 35-135 in its comment draft form, is that SEC 2.023 was deleted from Clearinghouse Rule 85-135 in its proposed final form.

-- The reason for not accepting the recommendation in item para. g. of Clarity, Grammar, Punctuation and Plainness that asked whether a specific time period could be used instead of the word "promptly" in SEC 2.025(5)(a)5., is that prescribing a specific time period would not allow sufficient flexibility in the rule to account for uncontrollable variables affecting filing deadlines -- such as printing delays as well as mail delivery delays or items lost in the mails.

(f) Final Regulatory Flexibility Analysis

As was discussed in detail in the Initial Regulatory Flexibility Analysis for Clearinghouse Rule 85-135, the two rule provisions that would affect "small businesses" are those in SEC 2.025 and SEC 2.027 in the attached Proposed Rule-Making Order. The two rules are specifically designed for and intended for use by, corporate "small businesses" to make it easier for them to achieve authorization under the Wisconsin Uniform Securities Law to raise equity investment capital from Wisconsin investors through sale of their common stock. The first of the two exemptions is directed toward so-called "non-seasoned" corporations/corporations in the promotional or developmental stage that are, in most instances, making their first public stock offering. That exemption can be utilized by corporations not organized or located in Wisconsin as well as by Wisconsin corporations. The other rule is designed for use by corporations principally operating in Wisconsin who will use at least 80% of the offering proceeds in their Wisconsin operations.

Those two registration exemptions are based on the two recommendations contained in a Report dated July 31, 1985 from the Commissioner's Administrative Rule Advisory Committee ("ARAC"). That Committee (whose members included Mr. Randall Wade, Director of the Department of Development's Division of Policy Development), was appointed by the Commissioner in March, 1985 for the purpose of determining the feasibility of adopting administrative rules providing exemptions from merit review for certain equity securities offerings.

Capital raising in Wisconsin under the Wisconsin securities law is made easier for small business because the requirements, both substantive and procedural, for use of the two registration exemptions are reduced from the requirements currently applicable to those small businesses seeking to make public offerings of their securities in Wisconsin. The reduced requirements are summarized in part 2. of the Initial Regulatory Flexibility Analysis concerning reporting, bookkeeping and other procedures required for compliance with the rules. The requirements for use of the two registration exemptions of SEC 2.025 and SEC 2.027 are particularized in the explanatory ANALYSIS for each of the two exemptions.

As noted previously, not only are the substantive requirements for use of the registration exemptions less restrictive than the requirements currently applicable for public offerings of securities by small businesses, but also the procedural requirements for their use are eased. Specifically, under the current Wisconsin Uniform Securities Law requirements, a small business seeking to obtain authorization to make a public offering of its securities in Wisconsin must go through an extensive filing and review

securities registration procedure involving the Commissioner of Securities Office that usually takes a minimum of 2 to 3 weeks. During that period, the disclosure documents are reviewed for adequacy of disclosure, and the terms and conditions of the offering are reviewed for compliance with certain minimum fairness-to-investor standards. The process is called a "merit review" of the offering.

The rule exemption provisions of SEC 2.025 and SEC 2.027 provide exemptions from the merit review procedure and enable a securities offering to commence immediately upon the filing with the Commissioner's Office of the informational items listed in the respective rules.

With regard to the proposed revisions to the Rules of the Commissioner of Securities in Clearinghouse Rule 85-135 and the spirit and intent of 1983 Wisconsin Act 90 to allow small business affected by state agency rule-making to receive notice and opportunity for comment, the agency believes that those purposes were achieved by this agency's sending the Comment Draft of the proposed rules to all persons on the agency's Wisconsin Securities Bulletin mailing list. That mailing list included broker-dealer licensees as well as law firms and accounting firms, each of which group has contact (usually incident to client contact) with small businesses and their controlling persons so as to inform and notify such small businesses of the expanded capital raising ability accorded under these new registration exemption rules.

Consequently, because the two rules SEC 2.023 and SEC 2.025 affecting "small businesses" in Wisconsin were created and structured for the benefit of small businesses to facilitate the capital-raising process by such businesses, no modifications or revisions were made to "reduce" their impact on small businesses (because no such revisions were necessary).

During the public comment letter and public hearing procedure incident to consideration of the proposed rules, no comment letters or testimony was received suggesting changes to the rules with regard to their use by small businesses. Rather, one of the comment letters received relating to the rules was from James T. Flynn, Lieutenant Governor and Secretary of the Department of Development, whose letter urged promulgation in final form of both of the ARAC-recommended rules of SEC 2.025 and SEC 2.027 because they will make it much easier for small businesses to raise capital.

In summary, no changes to rules SEC 2.025 and SEC 2.027 were or are necessary for purposes of s. 227.016, Wis. Stats., under 1983 Wisconsin Act 90.