A PRIMER ON "GOING PUBLIC"

How Companies Too Small for the National Stock Exchanges can Access Public Capital

by Michael Sauvante

edited by Vari MacNeil

The Commonwealth Group | 650 641 1246 | www.commonwealthgroup.net

TABLE OF CONTENTS

GOING PUBLIC — A SUMMARY

Current Situation

- Market favors large companies
- Minimum recommended market cap is $500,000,000
- In the U.S., companies with less than $300 million market cap are negatively incentivized to remain private
- Conventional process can cost a company more than $1 million

Benefits of Going Public

- Lower cost of capital
- Liquidity for investors, can sell shares at any time

Current Drawbacks to Going Public

- Costly ongoing reporting requirements
- Pressure from investors for short-term profits
- Lack of reward for sustainability behavior

Laws Surrounding Issuance of Stock

- Require that investors receive significant ("material") information concerning the securities being offered for sale by the company.
- Prohibit deceit, misrepresentations and other fraud in the sale of securities.
- Unless falling under various exemptions:
  - Company required to file documents in every state where it wishes to sell shares.
  - Company must provide periodic reports to the SEC and the states
  - All offerings must be registered

Exemptions

- Private offerings (no filings)
- Intrastate offerings (single state filing)
- Regulation A offerings (state and SEC filings)
- Regulation D offerings (three variations, some state and SEC filings)
- Accredited investor offerings (no filings)

Ways to Become a Public Company

- Conventional: Full SEC registration – includes IPO, converts existing restricted shares to unrestricted. Company can list on a stock exchange. EDGAR reporting

Other Options

- Rule 144 – converts restricted stock into unrestricted after legal determination that shareholders have held their stock for a sufficiently long time to warrant removal of resale restrictions
- Intrastate offerings – buyers must be resident in state where the company is domiciled. Resale restricted to in-state buyers for 9 months.
- SCOR Regulation D, Rule 504 – maximum $1 million offering in a 12-month period. Requires SEC filing with simpler financial statement and offering circular than full filing, no EDGAR reporting
- Regulation A – limited to $5 million offering in a 12-month period. Shareholders may resell up to $1.5 million alongside new offering, which reduces the $5 million by a corresponding amount. Requires SEC filing with simpler financial statement and offering circular than full filing, no EDGAR reporting

Shortcomings

- Only full registration facilitates exchange listing (to bring buyers and sellers together)
- Pink Sheets facilitates secondary trades only, no IPOs, considered high-risk investment due to loose "listing" requirements. Vulnerable to stock price manipulation
- OTC Bulletin Board requires SEC reporting on EDGAR, secondary trades only, no IPOs
- Automated Trading Systems are not considered full exchanges and are regulated by the SEC.

The Cooperative Alternative

- Provides a way for smaller companies to access public capital
- Creates a marketplace for smaller companies to attract investors interested in owning their stock.
- Can emphasize priorities other than profit maximization for listing companies and investors
  - Can prioritize sustainability, long-term focus
  - Can influence shareholder behavior to limit stock price manipulation.

GOING PUBLIC IN THE U.S.

"Going public" or being a "public company" are terms often used but rarely correctly understood. In the United States, companies are not "officially" designated as public or private, in fact, officially there is no such thing as a public company.

Rather those loose designations result from whether or not a company has issued[1] any securities (usually stocks and bonds)[2] that may be freely bought and sold. That is, whether or not any shareholder who owns shares of stock in a company is free to sell all or a portion of those shares to anyone at anytime. That in a nutshell is what characterizes a public company versus a private company.

However, the devil is in the details. There are multiple pathways by which even a single share of stock can be designated as "freely tradeable" by its owner, and understanding the laws surrounding this topic are crucial to successfully navigating this complex area.

Most people think of a public company as a large enterprise listed on a stock exchange. Yet a company need not be large or list on an exchange to be a public company, However, few people, including the CEOs and investors in small companies, are aware that their companies can be public. We explore how in this document.

SYSTEM FAVORS LARGE FIRMS

There are compelling reasons why companies might or might not consider becoming public, reasons that may be similar to all sizes of companies. But the realities of going public in the U.S. vary considerably based on size, with huge differences between large and small companies.

The current system is skewed in favor of large companies. For example, it is recommended that a company have a market capitalization[3] ("market cap") of at least a half a billion dollars if they wish to list on NASDAQ, which puts it in what the U.S. market calls a "small-cap" company size ($300 million – $1 billion). Even the name conveys the image that they view such companies as small. Clearly that is not what most people would think of as a small or medium-sized company, yet the U.S. market considers it tiny.

Going public on such an exchange can easily cost a company more than a $1 million, a price that often proves prohibitive for a small company. And it can also take a year or longer to go through the regulatory requirements and filings with the federal government and agencies in the 50 states.[4]

In the U.S. public markets, what most people would call "small companies" are viewed as nearly non-existent. The market defines the next level down from small-cap as the "micro-cap" ($50 million-$300 million) range. Yet even there we find few companies that most of us would define as small or medium size. Those would fall under what the market defines as "nano-cap" companies, which is the description for companies with market caps below $50 million!

For such real world "small" companies, the costs of going public in the U.S. are so high and the initial and ongoing regulatory compliance so demanding that most companies fitting those micro-cap and nano-cap ranges cannot afford to be public in the traditional manner.

Nonetheless, many such small companies would like to realize the benefits that being public brings and would be willing to explore alternative pathways for them to become public. This document focuses on alternative ways for small companies to go public at the stage in a company's life when it might contemplate:

- Expanding the scale and scope of ownership
- Raising additional funds from the public
- Providing existing shareholders with ways in which they can sell their holdings.

BENEFITS OF GOING PUBLIC

There are two key benefits from going public.

Cost of Capital

On the average it is much lower for public com-

1 Defined as the total number of a company's shares that have been sold and are held by shareholders. Issued stock can be held by insiders and by the general public.
2 A security is a fungible, negotiable instrument representing financial value. They include shares of corporate stock or bonds issued by corporations. Securities are broadly categorized into debt securities (such as banknotes, bonds and debentures) and equity securities, e.g., common stocks; and derivative contracts, such as forwards, futures, options and swaps. The company or other entity issuing the security is called the issuer.
3 http://en.wikipedia.org/wiki/Market_capitalization.

4 In contrast, Germany makes a distinction between small and large companies and provides radically different pathways for them to go public. On the Frankfurt Stock Exchange (the third largest exchange in the world behind the New York Stock Exchange and NASDAQ), smaller companies need not apply to the government and need only satisfy the requirements of the exchange itself. And the time required is a matter of weeks, with a cost easily under $100,000. Ongoing compliance thereafter is also much easier and less expensive.

panies, in particular with respect to equity versus debt. Cost of capital is defined as "... the cost of a company's funds (both debt and equity), or, from an investor's point of view ...the expected return on a portfolio of all the company's existing securities."

Investors are usually willing to buy a much smaller piece of a public company, for a given amount of money, than if the company were private.

Said another way, if an investor is willing to purchase X percentage of a company for Y amount of money, than that same investor would be willing to purchase only 1/3rd to 1/5th X percentage of that same company for that Y amount of money if the company is public. Thus the public company has to sell off smaller pieces of itself, translating to a lower cost of equity capital.

In contrast, a private company not only has to give up a larger piece of itself to get the capital it needs, it may not be able to get any money, let alone expensive money. As any entrepreneur can attest, it is very difficult to successfully raise money in private companies. In contrast, raising money in a public company is far easier. This topic is explored more fully here[5].

Liquidity for Investors

The easier it is to sell a stock, the more liquid the investment. Stocks in public companies are far more liquid than in private companies for both legal and practical reasons.

Those reasons are interconnected. Investors are willing to pay a lot more for a piece of a company when they have the ability to get out of that investment by freely selling their shares. Thus the liquid characteristic of public company's stock motivates buyers to pay more for that stock than they would if the company were private.

This makes it easier for a public company to raise money and the money costs the company less. Investors like it because they can more freely buy and sell their ownership interests, including the ability to take gains out of the company.

Other reasons to consider going public include prestige, ability to use the company's stock as currency in mergers and acquisitions, ability to attract employees with stock options and stock grants (because they can sell the shares they might buy with their stock) and more. However, there are several major downsides to being public, for companies large and small.

DOWNSIDE OF GOING PUBLIC

Besides the very substantial cost, by far the biggest reason for electing not to go public in the traditional manner is the huge burden represented by government regulations that place disproportionately high compliance costs (in time and money) on small companies. Large companies can easily bear such cost and inconvenience, but smaller companies can be buried by that burden. And to date, little has been done to sufficiently reduce those burdens at either the federal or state level. Barring a viable alternative, most are condemned to remain private and small whether they like it or not.

For companies falling below the $300-$500 million market cap threshold, going public usually means listing on the Pink Sheets,[6] which is not a fully fledged, regulated stock market. Companies listed on the Pink Sheets are disproportionately subject to external forces, in contrast to larger firms listed on the national exchanges. In particular by virtue of their small size and limited trading volume, companies on the Pink Sheets become highly vulnerable to stock price manipulation that can create wild swings in value and can in extreme cases even destroy it.

In addition, once a company elects to go public, management will come under enormous pressure to behave in ways that can also ultimately prove fatal to the company.

The investment community will relentlessly drive companies to focus on short-term profits. Companies that ignore that mandate are punished in the marketplace often by precipitous drops in their share price. Those who toe the line are rewarded by increasing share prices.

Such a mandate skews management decision making, often resulting in steps that may look good in the short run, but which can decimate the health of a company over the long haul. Those mandates have often caused companies to effect massive layoffs (thereby losing critical institutional knowledge), move factories offshore, take shortcuts with safety and environmental issues and other short-sighted actions that often boomerang not only on the companies but on society and the planet.

It is nearly impossible for a company to ignore those mandates and to behave in a more balanced and long-term sustainable fashion. Yet a substantial and growing number of managers and investors would like an environment that doesn't compel

5 *www.ceedprogram.com/conventionalfunding.html*

6 *www.pinksheets.com*

such behavior, especially for small and medium-sized companies. We address how to achieve such an environment at the end of this document.

THE BASICS

In order to better understand the world of public companies large and small, and what might be crafted to help smaller companies become public (avoiding many of the problems they might otherwise face), let us look at some fundamentals of corporations and securities law.

A corporation is an institution that is granted a charter by a governmental body, recognizing it as a separate legal entity having its own privileges and liabilities distinct from its owners. Ownership in a corporation is represented by shares of stock ("securities") in the corporation (defined further below) and the process of legally establishing a corporation is called "incorporation."

Usually the body that grants that charter is an entity established by a country's government. However, the U.S. is different in that although the federal government can create corporations, it nearly universally creates only government corporations and usually leaves the right to create for-profit and other corporations (including non-profits, LLCs, professional corporations, etc.) to the states, which have established their own laws governing the creation and administration of corporations.

A corporation is referred to as "domiciled" in the jurisdiction where it is formed. That jurisdiction's laws provide the legal structure under which that separate legal entity called a corporation is formed and thereafter operated.

Not all jurisdictions have the same laws, and some are considered more lenient or favorable to certain corporate participants or objectives than others. The majority of U.S. public corporations listed on the main stock exchanges are domiciled in Delaware because that state is considered to have the most favorable legal environment for large public corporations. Small public companies, on the other hand, are finding that the laws of Nevada are more friendly to their needs and objectives.

Ownership is fairly standard across the board. Corporations issue legal instruments (print or digital documents) that represent ownership interests, generally described as stock or shares.

Stock is generally issued as common stock or preferred stock and can be issued in different classes and/or series representing different levels of ownership accompanied by varying rights and privileges. The parties that form the corporation (not the government that granted the corporate charter) decide what types of stock they will issue and the rights and privileges that go along with them.

Corporations also issue other legal instruments such as bonds and other forms of debt that, along with stock and other instruments, represent a category of legal structures called "securities." The federal government formed the U.S. Securities and Exchange Commission (SEC) to oversee the nation's securities laws and systems. In turn, each state has its own version of the SEC. Any person or company involved in securities in the U.S. comes under the jurisdiction of the SEC and one or more of the state agencies.

In most cases, investors/owners make a cash investment in the company and receive stock in exchange. Sometimes they get stock in exchange for other forms of assets or even contributions of services to the corporation. Regardless of the kind of capital contributed, the owner receives these shares of stock in return.

Thereafter that stock represents a fractional ownership interest in that corporation and is considered the personal property of the owners, thereafter referred to as shareholders, stockholders or investors. Owners can be real persons or any other legal entity such as corporations, LLCs, partnerships, trusts or other collective enterprises. It is the original acquisition and subsequent disposal of ownership interests that concern the world of securities and the nature of being a public versus private company.

NEW COMPANY FORMATION

Not all businesses need to be corporations. In fact, the majority of the businesses in the United States are not. The choice in forming a corporation often rests on the amount of money needed to launch and run the business. Nearly every newly formed business needs some amount of money (capital) to commence operations and to grow the company. Yet the amount needed and where it comes from varies greatly based on the size of the company.

The vast majority of companies in this country are "mom-and-pop" businesses. The bulk of small, local businesses fall into this category. Most are established by owner self financing through savings, credit cards, loans against homes, etc.

However, when the capital requirements of the business go beyond the personal resources of the

founders, other financial sources have to be brought in. The most common way for that to occur is by having the company sell stock to investors. That opens up a Pandora's Box of federal and state securities laws and regulations, with the federal government (via the SEC) being the big gorilla in the mix.

LAWS SURROUNDING THE ISSUANCE OF STOCK

The legal minefield around raising corporate capital in the U.S. can trace its roots to the stock market crash of 1929. Before the crash, there were almost no meaningful laws concerning the issuance of stock by corporations, resulting in what was largely a free for all.

As a consequence of the crash, many thousands of investors (big and small) lost their investments in public companies. The government determined that it needed to establish rules and legal structures that would protect the public from the many abuses that had contributed to the severity of the crash.

What resulted were two bills that still dominate the world of U.S. corporations and the selling and distribution of financial interests in them: the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act").

The 1933 Act established the bulk of the rules pertaining to the first-time issuance of securities (stocks, bonds, options and other instruments) in corporations and other entities (in what is known as the primary market). After securities have been issued by the corporation to first-time buyers, the 1934 Act regulates the subsequent secondary trading (reselling) of those securities between persons often unrelated to the issuer, frequently through brokers or dealers.

The 1933 Act had two basic objectives:

- To require that investors receive significant (or "material") information concerning securities being offered for sale by the company (i.e., "issuer".)
- To prohibit deceit, misrepresentations and other fraud in the sale of securities.

Underlying the 1933 Act is the idea that a company offering securities should provide potential investors with sufficient information, about both the issuer and the securities, to make an informed investment decision. Disclosure of material information is accomplished through the registration (called a Registration Statement)[7] of securities with the Securities and Exchange Commission (the "SEC" or the "Commission"), the federal agency tasked with overseeing all investment activities. The SEC was created by the 1934 Act.

The issuing company is also required to file documents in every state where it wishes to publicly sell shares. Most companies going through this process want to sell their shares in every state and thus need to file with all 50 states and the territories. To facilitate that effort, the states have formed groups of states, allowing the company to file with a group to get approval from all the states in the group.

Once a company registers its securities with the SEC and the 50 states, it thereafter has to provide periodic reports to the SEC and the public and is called a "reporting company" (see below).

By default all offerings of stock and other securities by any corporation in the United States must be registered with the SEC (and in most cases with state regulatory agencies), unless the offering falls under one or more exemptions[8] from registration.

The registration process can be very complicated, expensive and time consuming. Thus most companies normally avoid it by utilizing an exemption.

Registration Exemptions

As most startup businesses are nowhere near ready to become a public company through the registration process, most turn to the exemption options for seeking initial funding.

The SEC provides for an array of exemption options to facilitate this. The most common include:

- Private offerings: require no government filings, no SEC-defined dollar limit.
- Intrastate offerings: require only a single state filing, no SEC-defined dollar limit, varies by state.
- Regulation A ("Reg A")[9] offerings: require both state and SEC filings, max $5 million.

7 Document required by the SEC for public offerings of securities. The registration statement, required by the Securities Act of 1933, discloses information on the management and financial condition of the issuer, and describes how the proceeds of the offering will be used.
8 Not all offerings of securities must be registered with the SEC. The most common exemptions from the registration requirements include: a) Private offerings to a limited number of persons or institutions; b) Offerings of limited size; c) Intrastate offerings; and d) Securities of municipal, state, and federal governments.
9 http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=20c66c74f60c4bb8392bcf9ad6fccea3;rgn=div5;view=text;node=17%3A2.0.1.1.12;idno=17;cc=ecfr#17:2.0.1.1.12.0.33

- Regulation D ("Reg D")[10] offerings: three variations. Under Rule 504[11] (max $1 million), Rule 505[12] (max $5 million) and Rule 506[13] (>$5 million) offerings (which require some state and SEC filings).

- Accredited Investor offerings: require no government filings, no SEC-defined dollar limit.

Those options are described at www.smallbusinessnotes.com/financing/secexemptions.html. There are other more exotic exemptions (for example Rule 144A[14] and Regulation S[15]), but the preceding list contains the ones most companies and their investors need be concerned with.

The most commonly utilized exemption is the "Private Offering Exemption," which the SEC defines in Section 4(2) of the Securities Act as exempt from registration "transactions by an issuer not involving any public offering" – simple sounding, but complex in its meaning. To qualify for this exemption, the purchasers of the securities must:

- Have enough knowledge and experience in finance and business matters to evaluate the risks and merits of the investment (the "sophisticated investor"), be able to bear the investment's economic risk, or have an established relationship with the issuer (founders et al.), such as family members or business colleagues.

- Have access to the type of information normally provided in a prospectus (a document required by the full SEC registration process).

- Agree not to resell or distribute the securities to the public.

In addition, the corporation may not use any form of public solicitation or general advertising in connection with the offering.

Resale Restrictions

We now come to the heart of the matter with respect to the rights of shareholders to sell their ownership interests (stock). Some shareholders are restricted in their ability to freely sell their stock, and others may do so without restriction. As noted, the ability to freely resell such stock is what loosely defines a company as a public company.

Public Companies.

One of the key benefits of going through the full SEC registration process is that the shares of stock so registered and subsequently purchased by shareholders can usually be freely bought and sold. Such companies and their shares of stock can usually be found listed on official stock exchanges.[16]

Stock exchanges are organizations that are set up to facilitate the trading of corporate securities and other instruments, and are designed to attract buyers and sellers to a common, convenient market to exchange their goods (securities). Such exchanges come under the jurisdiction of the SEC as a result of the 1934 Act. Companies found on such exchanges are commonly referred to as "public companies".

However, public companies (companies with issued securities that can be freely traded) need not list on an exchange. In fact, there is a whole category of public companies that trade "Over the Counter"[17] or OTC. Such trades were historically facilitated by stock brokerage firms in their own offices before the advent of the Internet.

Nowadays such trades may take place on certain exchanges as well as exchange-like systems such as the Pink Sheets,[18] an electronic quotation and trading system, based solely online, and the OTCBB[19] (OTC Bulletin Board), a similar system.

Many OTC companies become public companies through other means than doing a full registration with the SEC (explored below). As a consequence, they may or may not be a "reporting company." A reporting company files quarterly (10-Q) and annual reports (10-K) with the SEC on the Electronic Data-Gathering, Analysis, and Retrieval system (EDGAR)[20].

All companies that go through the full registration process with the SEC must be reporting companies (with certain rare exceptions). Companies that become public by other means need not report on EDGAR, unless they grow to have more than 500 shareholders *and* over $10 million in assets (not market

10 www.sec.gov/answers/regd.htm
11 www.sec.gov/answers/rule504.htm
12 www.sec.gov/answers/rule505.htm
13 www.sec.gov/answers/rule506.htm
14 Provides a safe harbor from the registration requirements of the 1933 Act for certain private resales of minimum $500,000 units of restricted securities to QIBs (qualified institutional buyers), generally large institutional investors with at least $100 million in investable assets.
15 Regulation S is a safe harbor that defines when an offering of securities will be deemed to come to rest abroad and therefore not be subject to the registration obligations imposed under Section 5 of the 1933 Act.

16 http://en.wikipedia.org/wiki/Stock_exchange
17 http://en.wikipedia.org/wiki/Over-the-counter_%28finance%29
18 http://en.wikipedia.org/wiki/Pink_Sheets
19 http://en.wikipedia.org/wiki/OTC_Bulletin_Board
20 http://en.wikipedia.org/wiki/EDGAR

cap),[21] at which point they are legally supposed to become a reporting company.[22]

EDGAR is designed to provide the investor community with updated financial and other information on the company so that they may remain fully informed about its condition and its activities. It entails data that provides updates to the same kind of information that was required of a company when it did its initial SEC registration.

One of the most recent federal laws related to such reporting is known as the Sarbanes-Oxley Act.[23] That bill was enacted as a reaction to a number of major corporate and accounting scandals including those affecting Enron, Tyco International, Adelphia, Peregrine Systems and WorldCom.

Compliance with Sarbanes-Oxley can be time consuming, complex and costly, thereby adding substantial burdens onto reporting companies.

Such burdens are especially hard felt by small and medium-sized companies. Many critics of Sarbanes-Oxley claim it is too restrictive and costly, especially for smaller companies, and many small companies do not go public as a result. In fact, it is the most often quoted reason that a small company elects not to go public.

Private Companies

As with public companies, the definition of a private company is related to the resale-ability of its stock and not by any kind of official designation. When all the shares of a company's stock are "restricted"[24] by the government (as opposed to restricted by the company itself) with respect to their sale and transference to other parties, then that company is considered to be private.

When shares are sold to an investor under one or more of the above exemptions, the stock is usually considered restricted stock. Such restrictions are usually explained by the company when it provides prospective investors information about the company, its management, the investment opportunity and the terms of the investment.

The investor is supposed to agree in writing that they understand and accept that their purchase of the stock comes with resale and transfer limitations. Those restrictions are also normally spelled out on the back of any stock certificates that the company may issue to the investor to substantiate ownership. Generally described as the "Restriction Legend," they closely resemble the following example:

"THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, PLEDGED OR HYPOTHECATED UNLESS THERE IS AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT COVERING SUCH SECURITIES, OR THE SALE IS MADE IN ACCORDANCE WITH RULE 144 UNDER SUCH ACT, OR THE COMPANY RECEIVES AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY STATING THAT SUCH OFFER, SALE, TRANSFER, ASSIGNMENT, PLEDGE OR HYPOTHECATION IS EXEMPT FROM THE REGISTRATION AND PROSPECTUS DELIVER REQUIREMENTS OF SUCH ACT.

"THE TRANSFER OF SECURITIES FOLLOWING THE COMPANY'S PUBLIC STOCK OFFERING IS SUBJECT TO A MARKET STANDOFF RESTRICTION FOR UP TO 180 DAYS."

This particular restriction legend example actually contains restrictions based on both SEC law and those imposed by the company itself. The first paragraph is designed to accommodate the SEC rules concerning restricted stock, whereas the second paragraph is imposed by the company.[25]

It is evident from the above that the stockholder is not allowed to sell their stock unless certain conditions are met. In the absence of those conditions, an individual stockholder may petition the company for permission to transfer ownership of those shares to another party, but such transfers are tightly controlled and not subject solely to the shareholder's wish. However, once those conditions are present, they can cause a company to evolve from being a private company to a public company.

BECOMING A PUBLIC COMPANY

In the U.S., there are five primary ways to directly become a public company. There are some other approaches, such as reverse mergers into a public

21 A company could have a market cap of $100M and less than $10M in assets and not be required to report.
22 SEC Disclosures Required for Public Companies www.smallbusinessnotes.com/financing/secdisc.html
23 http://en.wikipedia.org/wiki/Sarbanes-Oxley_Act
24 http://en.wikipedia.org/wiki/Restricted_stock

25 Market standoff means that even though the company may become a public company and listed on an exchange, the individual owners of stock may be restricted from selling their shares to prevent the current owners from rushing to sell off their shares too quickly and thereby hurting the company by driving down its stock price. Underwriters often demand such standoff agreements from companies that they take public. However, these are private decisions between the underwriter, the company and its shareholders and the government is not involved in this restriction.

shell company, but we will not address those here. Rather we will only deal with the ways a company can become public by its own actions.

The most well known is through the normal full SEC registration process, which can provide for both the selling of new shares in order to raise new funds and the unrestricted selling of existing shares.

The least well known (but easiest and least expensive) way is by satisfying the requirements spelled out in SEC Rule 144. This allows companies and their shareholders to convert from a private company to a public one simply by making a legal determination as to whether the shareholders have held their stock for a sufficiently long period to warrant removal of their resale restrictions. (There are nuances to this concept, but that is largely the requirement.)

Finally, the Intrastate Offering, the Regulation D – Rule 504 SCOR Offering (Small Corporate Offering Registration, a mini SEC registration) and the Regulation A Offering (another mini SEC registration) are more limited in scope than that realizable with the full registration process, but for smaller companies can provide a more than adequate means of going public.

All three provide for the ability to sell shares to the general public (thereby raising money for the company) and such shares may thereafter be sold to other parties (subject to certain conditions), by definition making them a public company.

Registration

With respect to a full-scale registration with the SEC, there are several categories of registration depending on the size of the company, and the size and scope of the desired registration (number of shares, their price, etc.).

The most common registration[26] (available to all companies) is through filing Form S-1 with the SEC. Forms SB-1 and SB-2 can be used by smaller companies, either because of the limited size of the offering or because the company is designated as a "small business issuer." Once a block of stock is properly registered with the SEC, its restrictions (including the restriction legend), can be removed and the shareholders are free to sell and transfer such shares.

Whether through an S-1, SB-1 or SB-2, the company may use the registration process to accomplish several objectives, primarily the first-time sale of a block of stock (IPO) and the ability to freely resell shares that have already been bought.

There is typically a third element, the listing of the company on a stock exchange, but that involves the company interfacing with the exchange and not the government. Interestingly, the public often sees all of these as one event, i.e., the company goes public on an exchange while issuing an IPO and secondary trading begins in its shares. But they are not. They are each discrete consequences of the registration process. We need to recognize that these three elements are separate and distinct, and each needs to be addressed separately.

So, with respect to a full SEC registration, the two primary objectives are:

- Register a block of shares that will be newly issued in a public offering (i.e., sale of new shares to the general public). If it is the first time the company is offering a block of shares to the public, it is usually called an Initial Public Offering or IPO for short. If the company has already done an IPO, the subsequent offerings are referred to as Secondary Offerings.
- Register a block of shares that have already been issued to existing shareholders. This process would convert those shares from restricted shares to unrestricted shares, which then may be freely sold to any willing buyer.

A company can do either of these types of registration (or several other nuances not covered here) and may further elect to list the company on a stock exchange in order to allow for the free trading of that company's securities and generally be recognized as a public company. They can also elect to not list, but still register their stock, so that they are a public company nonetheless, just one whose shares are bought and sold OTC.

There are more than enough sources of information available that spell out the SEC registration process so as not to justify its inclusion in this document. Suffice it to say it is an expensive, time consuming and difficult process.

Rule 144

At the opposite end of the spectrum from a full SEC registration we find Rule 144. SEC Rule 144 provides private companies with one of the easiest, least expensive and simplest options for becoming a public company. Yet is one of the least well known.

There is a general lack of knowledge about the main potential alternative to the SEC registration process – satisfying the conditions of SEC Rule 144 to convert restricted stock to unrestricted stock.

26 www.smallbusinessnotes.com/financing/secregis.html

Rule 144 comes into play once shares have been issued under one of the exemptions as covered primarily under the rules for Private Offerings, Regulation D offerings with the three variations under Rule 504 (non-SCOR), Rule 505 and Rule 506 offerings, or Accredited Investor Offerings, all referred to above under the section entitled Registration Exemptions..

When Congress created the 1933 Act, it and the SEC received a lot of feedback that shareholders needed to be able to sell their interests, even in private companies, and that the Act had to make provision for resale of such securities.

In considering such concerns, the SEC differentiated between investors who acquire stock for purposes of speculative gain and those who purchase the stock with long term, buy-and-hold objectives (a condition they call "coming to rest").

They determined that those who wanted to freely trade their shares would need to have those shares registered, whereas those held for long-term investment purposes could be exempted from registration.

Their original definitions for holding investments long term were considered to be too vague and over time the rules covering that contingency have evolved (including being influenced by various court decisions) into specifically quantified (and reasonably short) timeframes, with the most recent version having been put into effect by the SEC in 2008.[27]

In essence, Rule 144 provides for a straightforward way to convert restricted stock into unrestricted stock following a few simple rules, largely based on whether a particular shareholder has held onto the stock for a sufficiently long enough period that the SEC is satisfied the investment was not speculative, but long term in nature. If so, then the SEC's rules are designed to allow that shareholder to remove those restrictions and freely sell their shares.

Those rules vary depending on who owns the shares and under what conditions. The basic principles embedded in the current version of Rule 144 state that if a shareholder fits certain categories of investor, they may have their stock restriction lifted or modified so as to allow them to more freely sell and transfer their ownership interest, and thus for those private companies and their shareholders to convert into public companies. The categories are:

- Their relationship to the company, i.e., whether they are considered a "controlling" person or an "affiliate"[28] or "insider" of the company thereby having some influence over the company. Control parties are more limited in their ability to get out from under the full restrictions as compared to non-control parties, who can have them removed in their entirety.
- The fact that the company is either a reporting or non-reporting company.
- The length of time the shareholder has owned the stock (minimum six months for a reporting company and 1 year for a non-reporting company).
- The amount of shares the investor wishes to sell (potentially triggering the requirement to notify the SEC about the transaction by filing Form 144).

The most important point is that the shares have to be held for at least six months or a year (depending on the reporting status of the company). That is the prime condition for qualifying for removal of the restrictions. That's it.! How that gets qualified and what has to be done to legally remove the restrictions is simple and described below.

Note: The most recent SEC rules changes included provisions to allow shareholders to roll over their holding periods into new stock (called "tacking on") they receive in exchange for their original shares. This normally only applies when a security holder exchanges one type of security for another from the same company. For example, a lender may exchange a note issued by a corporation in a loan transaction for stock in that same corporation. In this case the lender's holding period for the newly acquired stock tacks back to the original date of the loan.

This concept may apply to other transactions such as mergers between two companies or when a company is brought in under an acquiring parent company (called a holding company) as a subsidiary. One ramification of the new rule, if approved by the SEC, is that a number of smaller companies might be able to band together to form a larger company that may become public almost immediately, allowing all of the shareholders to sell some shares.[29] This greatly increases the number of options available to

27 http://en.wikipedia.org/wiki/Form_144

28 An affiliate of an issuer is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer. The term "control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

29 See "Corporate Cooperatives" at www.commonwealthgroup.net/cc.html

private companies and their owners to convert into public companies without having to go through the full SEC registration process.

So what are the key steps needed for the removal of the restrictions previously associated with that stock? Removal of those restrictions is actually done strictly by the company (no government intervention), upon petition by one or more of its shareholders. Such action is normally authorized by the company if it obtains an "opinion" letter from an attorney attesting that their shareholder has satisfied the holding period and other terms of SEC Rule 144 and should be free to dispose of those shares as they see fit.

Thus all that needs to be done is for at least one shareholder to request the company to remove the restrictions, which in turn triggers a request for an attorney to review the details of the original issuing of the stock to that shareholder, and then for the attorney to put in writing that the shareholder has indeed satisfied the requirements of Rule 144 for removal of those restrictions.

However, what applies for one shareholder can also be done for a group of shareholders or even all the shareholders. In the latter case, in essence a private company has become a public company because all (or most) of the shareholders waited long enough and got an attorney to attest that they could now sell their shares publicly.

Let's look at just one shareholder pursing this process. A non-controlling/non-affiliate shareholder in a non-reporting company is required to hold their shares for a minimum of a year. Thereafter, subject to an attorney's opinion letter and the removal of restrictions by the company for all the shares in question, that shareholder would be free to sell some or all their shares to any willing buyer. There is only one other thing that shareholder may also have to do. If the total dollar value of the shares being sold is larger than certain thresholds, then the shareholder may be required to notify the SEC of the sale using Form 144, but it is in the way of a notification, not requesting permission. That's it!

Thus companies can evolve to the point where some or all of their shares may become freely tradeable, and they could be classified as a public company. This later point could have huge significance to many thousands of smaller companies whose owners/managers do not know that they have this Rule 144 option available to them for effectively converting their private company into a public company.

However, even if they were to take that step and proactively get an opinion letter and remove all or most of the restrictions on their shareholders' stock, that does not automatically help them and their shareholders to find buyers. To accomplish that, they would probably need to list with some form of common listing service, like the Pink Sheets or OTCBB, which helps to attract large numbers of potentially interested buyers to facilitate the movement of the stock, or the alternatives discussed at the end of this document. Just removing those restrictions also doesn't address the company's potential need for more capital. Let us pick up those topics later.

Intrastate Offerings

Intrastate offerings allow a company to raise money, and become a form of "local" public company in the process. Yet the intrastate offering is one of the least-used exemptions for fundraising. That is because there are limitations on who can purchase shares in such an offering, and even one minor violation of those limitations and rules can invalidate the entire offering. As a consequence, few companies have taken advantage of this type of funding, even though it avoid the pitfalls of full SEC registration.

However, the advent of the Internet and the use of computers greatly facilitates the tracking and control mechanisms that need to be in place to ensure that a company issuing securities under this exemption can remain in compliance. If they do, then this type of offering can be one of the most attractive, as it allows a company to raise a good deal of money from the general public and be in essence a local public company all in one shot. Buyers need only prove they are from that state, not whether they are wealthy (accredited investors), have sophisticated investment knowledge or know the owners of the business, conditions required of other kinds of offerings. And the costs and complexities of this approach can be substantially more reasonable than the SEC path.

Provided that issuers are careful to follow the rules, they will find that they can raise a nearly unlimited amount of money from almost anyone interested in investing in the company (i.e. a full public offering), provided that the buyers are residents of the state where the issuer is located and are willing to abide by certain restrictions (primarily resale ones). Depending on the state, the requirements for making such an offering can be some of the most attractive ones available to an issuing company.

Section 3(a)(11) of the Securities Act and Rule 147 promulgated thereunder, is generally known as the "intrastate offering exemption." This exemption facilitates the financing of local business operations. The preliminary notes to Rule 147 explain the purpose of the exemption as follows:

"Section 5 of the Act requires that all securities offered by the use of the mails or by any means or instruments of transportation or communication in interstate (i.e. – between states) commerce be registered with the Commission. Congress, however, provided certain exemptions in the Act from such registration provisions where there was no practical need for registration or where the benefits of registration were too remote.

Among those exemptions is that provided by Section 3(a)(11) of the '33 Act for transactions in "any security which is a part of an issue offered and sold only to persons resident within a single state or territory (i.e. intrastate), where the issuer of such security is a person resident and doing business within ... such state or territory."

That is, when it comes to various forms of commerce (including financial transactions) the federal government acknowledges that it has no interest in an activity that is solely restricted to a single state. They consider that activity a state's rights issue and leave it strictly up to the state to regulate and control, provided that no part of those activities impinge on the federal areas of jurisdiction.

The legislative history of that Section suggests that the exemption was intended to apply only to issues genuinely local in character, which in reality represent local financing by local industries, carried out through local investment.

To qualify for the intrastate offering exemption under SEC Rule 147:

- The issuer (company) must be incorporated in the state where the offering is made.
- At least 80% of the issuer's revenues must come from business within that state.
- At least 80% of the issuer's assets must be located in that state.
- At least 80% of the proceeds of the offering must be used in that state.
- Buyers of the offering must be state residents or an entity owned by state residents.

If the issuer complies with the above, and depending on particular state laws, there is usually no fixed limit on the size of the offering or the number of purchasers (not the case with all other exemptions). The company must determine and confirm the residence of each purchaser. If any of the securities are offered or sold to even one out-of-state person, the exemption may be lost, causing a violation of the registration requirements of the Securities Act.

This provision can also be problematic for companies conducting consecutive (i.e., back-to-back, in a short period of time) offerings or seeking investment capital through the use of more than one type of exempt financing. The SEC will often consider multiple rounds of financing as effectively one round (called "integrated"), if they are not separated clearly enough by time and/or conditions.

In such circumstances, the more restrictive rules may then apply to both offerings. Thus a company must be careful that a consecutive offering, or separate form of financing, is not integrated with the intrastate offering, thus destroying its exemption. Nonetheless, careful planning can avoid this problem and thus this form of offering can be very viable for the company and its owners.

Once those shares are properly sold under an intrastate offering, we find further that normal rules for other SEC exempt offerings also do not apply. In particular, the securities sold under an intrastate offering are not restricted under Rule 144 (the above defined federal rule affecting all other exempt offerings besides intrastate offerings).

Nonetheless the federal government still wants to guarantee that the intrastate offering was not used as a shortcut to reselling those securities to parties outside the state of the original offering. As a result, re-sales of securities sold in an intrastate offering may only be made to another person or entity resident in the same state – for a period up to nine months following the last sale of the securities under the offering (a shorter holding period than Rule 144's normal 1 year). Thereafter the securities may be sold without restriction to parties outside and inside that state, creating a multi-state public company.

Finally, many states allow some form of advertising or solicitation for intrastate offerings, which makes it easier to reach the intended investor community. Most other exempt offerings are quite restrictive on the amount of public advertising and promotion allowed (Reg D – Rule 504 and Reg A being the exceptions), thus again making the intrastate offering more attractive to local businesses wishing to take advantage of its benefits.

Regulation D – Rule 504

Rule 504, under SEC Regulation D, provides an exemption for the offer and sale of up to $1 million of securities in a 12-month period.

Rule 504 is dual in nature as one form allows for a public offering (i.e., general solicitation) under the Small Corporate Offering Registration (SCOR), while the other is a form of private offering that prohibits public solicitations.

In either case, a company may use this exemption so long as it is not a blank check[30] company and is not subject to Exchange Act reporting requirements. The other Regulation D exemptions (Rule 505 & 506), in general may not use public solicitation or advertising to market the securities and purchasers receive "restricted" securities, meaning that they may not sell the securities without registration or an applicable exemption.

However, when structured as a SCOR offering, companies can use this 504 exemption for a public offering of its securities and investors will receive freely tradable securities under the following circumstances:

- The company registers the offering exclusively in one or more states that require a publicly filed registration statement and delivery of a substantive disclosure document to investors.
- The company registers and sells in a state that requires registration and disclosure delivery and also sells in a state without those requirements, so long as it delivers to all purchasers the disclosure documents mandated by the state in which it registered.
- The company sells exclusively according to state law exemptions that permit general solicitation and advertising, so long as it sells only to "accredited investors."

Even if the company makes a private sale where there are no specific disclosure delivery requirements, it should take care to provide sufficient information to investors to avoid violating the anti-fraud provisions of the securities laws.

This means that any information it provides to investors must be free from false or misleading statements. Similarly, it should not omit information that would make the information it does provide investors, false or misleading.

30 www.sec.gov/answers/blankcheck.htm

Regulation A

Section 3(b) of the Securities Act authorizes the SEC to exempt from registration small securities offerings. By this authority it created Regulation A, an exemption for public offerings not exceeding $5 million in any 12-month period. If a company chooses to rely on this exemption, it must file (for review) with the SEC an offering statement, consisting of a notification, offering circular, and exhibits.

Reg A offerings share many characteristics with fully registered offerings. For example, companies must provide purchasers with an offering circular similar in content to a prospectus. Like registered offerings, the securities can be offered publicly and are not restricted, meaning they are freely tradeable in the secondary market. The principal advantages of Regulation A offerings over full registration, are:

- The financial statements are simpler and don't need to be audited.
- There are no Exchange Act reporting obligations (no EDGAR) after the offering unless the company has more than $10 million in total assets and more than 500 shareholders.
- Companies may choose among three formats to prepare the offering circular, one of which is a simplified question-and-answer document.
- You may "test the waters" to determine if there is adequate interest in your securities before going through the expense of filing with the SEC.

All types of companies which do not report under the Exchange Act may use Regulation A, except "blank check" companies, those with an unspecified business, and investment companies registered or required to be registered under the Investment Company Act of 1940.[31] In most cases, existing shareholders may also use Reg A to resell up to $1.5 million of securities, alongside the new shares being offered by the Reg A offering (which reduces the $5 million total by the amount of existing shares resold).

If it tests the waters, a company can use general solicitation and advertising prior to filing an offering statement with the SEC, giving it the advantage of determining market interest before incurring the full range of legal, accounting and other costs associated with filing an offering statement. It may not, however, solicit or accept money until the SEC

31 http://en.wikipedia.org/wiki/Investment_Company_Act_of_1940

staff completes its review of the filed offering statement and the company delivers prescribed offering materials to investors.

SHORTCOMINGS

All of these methods lead to a company becoming a public company by virtue of some or all of their shares becoming unrestricted and freely resellable. Four out of the five methods lead to raising money for the company (Rule 144 method being the exception). However, only one of these five usually translates into providing a company with all three of the objectives that cause companies to go public in the first place — the full registration process with the SEC resulting in a public offering and the listing on an exchange to facilitate secondary trades in the stock.

Just becoming a over-the-counter public company doesn't automatically resolve a company's financial objectives. In particular it does not facilitate secondary trading in its issued stock (only legally enables it, but does not facilitate bringing buyers and sellers together). It also does not raise funds unless the company issued an intrastate, Reg D – Rule 504 SCOR or Reg A offering.

Legally, a company could attempt to locate buyers and sellers on its own (for both public offerings and secondary trades). Although not all state rules are the same, companies can, on their own, raise public funds (intrastate, Reg D – Rule 504 SCOR and Reg A offerings)[32] or private funds (private, Reg D – Rule 504, 505, 506, and accredited investor offerings) under much more strict conditions and which later under Rule 144 can become publicly tradable stock. Some of those methods allow companies to publicly advertise (including via their own website) and others restrict what they may do with respect to offerings.

Resale of their shares is another matter. When the company's shares are no longer restricted, then the company may (depending on state law) facilitate the secondary trades in their own stock to the general public in just about any manner. That can include the use of their own website to carry out the mechanics of trading, including performing the transfer agency role (tracking the current owner of each share of stock) as well as the clearance function (arranging for the seller to be paid by the buyer).

However a single company may lack the critical mass to attract enough attention to adequately achieve these goals. Both of these objectives (public offerings and secondary trades) may be difficult to do without the benefit of some common meeting place that brings many buyers and sellers together for a number of companies, not just one. Most companies that try to go it alone, even though they legally can, have very limited success.

THE PINK SHEETS, OTCBB & ATS

As a consequence, in the U.S. the most common place that smaller companies turn to for attracting a larger number of buyers and sellers is the Pink Sheets or the OTCBB.

The Pink Sheets

The Pink Sheets is not a formal stock exchange, regulator or a broker-dealer. It describes itself as an "electronic quotation and trading system" for over-the-counter securities market and operates an "inter-dealer quotation service. It facilitates secondary trading only between broker-dealers and does not allow IPOs and secondary public offerings, so it is not a complete solution. It appears to more correctly fit under a new SEC-controlled category called an automated trading system (ATS). An ATS is a computer trading program that automatically submits trades to an exchange.

The Pink Sheets looks like, and behaves to a large extent like, a fully fledged stock exchange, listing thousands of companies. However, the requirements for "listing" on the Pink Sheets have historically been extremely loose and as a result, the system has garnered a reputation as a high-risk investment environment, both for the listing companies and their investors. Some of the listing companies are SEC reporting companies, but most are not.

To their credit and to counter that negative image, the owners of the Pink Sheets have established several new categories for their listing companies. Those require the listing companies to provide the service with greater financial and other detail, thereby more closely resembling their more formal exchange competitors.

Investors can have a higher degree of confidence in those alternatively listed companies, at least from the standpoint that the information posted about them is probably more reliable than other company information published on the Pink Sheets.

32 See Direct Public Offerings http://en.wikipedia.org/wiki/Direct_public_offering

But it is still not up to the level required on the formal exchanges and with the SEC's EDGAR system, even though the top end of those categories approaches the quality of information found on those exchanges, including audited financials.

Quality information aside, there is one other key weakness about the Pink Sheets that can be problematic for listing companies. They are more vulnerable to stock price manipulation by outsiders who can game the system.

Naked short selling[33] (though legally banned, is considered common) and ginned up news stories can create a high degree of volatility in the stock price of Pink Sheets- listed companies. Such volatility can actually bring down a company through no fault of its own.

So in addition to the "maximize profit" pressures, companies wishing to list on the Pink Sheets face these additional issues in their quest to obtain capital and facilitate secondary trades for their shareholders.

The OTC Bulletin Board

Like the Pink Sheets, the OTCBB is not a formal stock exchange and likewise describes itself as an "electronic quotation and trading system" for the over-the-counter securities market. The Pink Sheets is currently much larger than OTCBB and dwarfs it in terms of volume of companies and trades. However, most people consider the OTCBB to be a step above the Pink Sheets, in part because every listing company is required to be an SEC reporting company on EDGAR, and therefore the standards for listings are higher. Some companies list on both systems but probably not for long as it appears likely that OTCBB will be discontinued in 2011.

Companies currently quoted on the OTCBB must be fully reporting (i.e., current with all required SEC filings) but have no market capitalization, minimum share price, corporate governance or other requirements to be quoted. Companies which have been "de-listed" from stock exchanges for falling below minimum capitalization, minimum share price or other requirements often end up being quoted on the OTCBB.

Many people also incorrectly consider OTCBB to be either a part of or affiliated with NASDAQ. There is no formal relationship between the two.

And like the Pink Sheets, companies listed on OTCBB are subject to various stock manipulations. It also facilitates secondary trading only and does not allow IPOs and secondary public offerings, so like the Pink Sheets, is not a complete solution.

Automated Trading Systems

In the 1990s, in recognition of the changes caused by the Internet, the SEC created a new category of trading environment called an Automated Trading System (ATS).[34] ATSs are not considered full exchanges and are regulated by the SEC.

THE COOPERATIVE APPROACH

What can smaller companies do to overcome these problems?

We believe the solution lies in what a company is legally allowed to do on its own, including raising its own public and private funds, converting some or all of its restricted stock into freely tradable stock and establishing a means (primarily web-based) wherein it could reach out to a public audience and in the process, facilitate the secondary trades of its shareholders' stock.

Historically, the major problem encountered with this approach is a lack of a critical mass to attract enough buyers and sellers. If we could overcome this problem, we can build on this foundation to allow companies to more directly control their own financial destinies, without reliance on other environments that may not prioritize the best interests of the individual companies.

One way is to get a number of like-minded companies to join forces. It would not take a very large number of companies to start the process, and it could grow quickly. For example, when the London Stock Exchange in 1995 spun out a junior exchange for smaller companies called the Alternative In-

33 http://en.wikipedia.org/wiki/Naked_short_selling

34 SEC definition of ATS - Shall mean any organization, association, person, group of persons, or system: (1) that constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of Rule 3b-12 under the Exchange Act; and (2) that does not (A) set rules governing the conduct of subscribers other than the conduct of such subscribers' trading on such organization, association, person, group of persons, or system, or (B) discipline subscribers other than by exclusion from trading. See proposed rules at www.sec.gov/rules/proposed/34-39884.pdf, final rules at www.sec.gov/rules/final/34-40760.txt and the SEC regulations for ATSs at http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=4adea4fc04dfd83dc5da9c9d10c5182b&rgn=div5&view=text&node=17:3.0.1.1.3&idno=17#17:3.0.1.1.3.0.101

vestment Market (AIM)[35] it commenced operations with only 10 listing companies. Today, just 15 years later, there are over 1,300 companies listed.

One of the key benefits of coming together in this way is that members could establish a group identity attractive to a particular type of investor. That might be an industry such as renewable energy or organic farming, a particular geographic region, or a particular size of company such as small companies focused on serving local communities. Such a group would be considered an "affinity group."

Such affinity groups automatically aggregate an investor community interested in the nature of the businesses. Each company will bring its existing shareholders who would be joining a larger group of like-minded investors, which could help to draw additional investors. Once a group identity is established, it can become self-reinforcing, helping to create critical mass.

This environment could help participating companies list their stock for secondary trades, facilitate the movement of initial public and secondary offerings, and help ensure that the trading environment nurtures their long-term health and wellbeing, providing benefits to all stakeholders.

SEC: THE FLY IN THE OINTMENT

There are several problems with this approach.

- **SEC Restrictions**: This collaborative effort could possibly be viewed as an ATS by the SEC and therefore come under its supervision. And if the group establishes rules that go beyond those allowed for ATSs, there is even greater likelihood that the effort will be deemed a "stock exchange" and be subject to further SEC restrictions and oversight.

- **Large Company Bias**: SEC rules and regulations are well known to favor larger companies. The commission takes a heavy handed approach to regulation that, while designed to protect the investing public, more often imposes unreasonable demands and expenses on smaller companies, disproportionate to the scope of problems that the regulations are designed to protect against.

- **Rules Don't Fit Small Firms**: Decades of complaints to Congress and the SEC have yielded little in the way of accommodation to the needs of smaller businesses, and if anything, recent SEC activities (spurred by the various Wall Street scandals) have made things even more difficult for small and mid-size companies. Yet it is typically larger companies that represent the bulk of the corporate misbehavior with which the SEC is concerned

- **Foreign Listing Option**: The United States is considered to be one of the most unfriendly countries with respect to regulation of small companies going public. In contrast, stock exchanges like the AIM market in London, the Frankfurt Stock Exchange[36] in Germany and others are viewed as much more friendly to the needs and concerns of smaller companies. As a consequence, a number of smaller U.S. companies have elected to go public on these foreign stock exchanges.

- **Regulation of Foreign Listed Firms**: Even if a company goes public in another country, the long arm of the SEC reaches out and can cause serious difficulties for those companies if they stray from very strict guidelines on what they can do as a foreign exchange listed company. In addition, just listing on such an exchange does not relieve a company from the "profit maximization" mandate.

- **Profit-Only Mandate**: Being defined as a stock exchange may be counterproductive, as the bulk of SEC rules are based on an old public market model that does not reflect the needs of evolving companies, especially regarding goals other than profit maximization.

AN INNOVATIVE ALTERNATIVE

What can be done to step out from that restrictive environment and into one that is more friendly to the needs of smaller companies? The key lies in recognizing that the act of trading in stocks and other securities is itself the reason for regulatory oversight. That is, if the group establishes a common means to facilitate secondary trades in the stock of the listing companies, it will probably automatically invoke brokerage laws at a minimum and perhaps stock exchange laws as well.

Yet the primary benefit of such a gathering place is that it can attract a critical mass of candidate investors. Should the group establish a common website where the companies can be listed with full, investor-friendly disclosures but not include a means to actually effect the trades in the stock of those companies, then the site would be viewed as an information site only and not an exchange. Google Fi-

35 www.londonstockexchange.com/companies-and-advisors/aim/aim/aim.htm

36 http://deutsche-boerse.com/dbag/dispatch/en/kir/gdb_navigation/about_us/20_FWB_Frankfurt_Stock_Exchange

nance and Yahoo Finance are two examples in this category.

The SEC addresses that issue on its website, saying: "In addition, systems that merely provide information to subscribers about other subscribers' trading interest, without facilities for execution, do not fall within paragraph (a) of Rule 3b-16. One commenter asked the Commission to clarify that such systems would not be viewed as exchanges. While such vendors may allow buyers and sellers to find each other, they do not provide a facility or set rules under which those orders interact with each other. Accordingly, the Commission agrees with this commenter that such systems are not exchanges."

So how would prospective shareholders be able to buy and sell shares in the companies listed on that information site? In most states, each company is legally allowed to manage the secondary trades in its own shares, as it would if it were to issue a Direct Public Offering (DPO)[37] and manage the secondary trades thereafter. The company could engage a broker in the process, but it would not be viewed as an exchange if it does not provide an automated system for matching the trades and manually intervenes to aid the process.

From our information site we can link to the separate websites maintained by the individual companies listed on the common site. Prospective shareholders would be alerted that they are leaving the common website and going to the company's (or the company's broker's) website to effect their trade. This makes it clear that the information site is not involved in the transaction. But to the user, the process is seamless.

The result is that individual companies that could have "gone it alone" by doing a DPO and setting up a website to facilitate trades in their stock are able to join forces with similar companies, creating drawing power and making it easy for prospective investors to find them.

THE UNIEX SOLUTION

The Commonwealth Group is forming such a system wherein our affinity group is based on small and medium-sized companies (SMEs) and the broader concept of sustainability.

Each company wishing to join is encouraged to incorporate sustainable practices in their operations, regardless of the product or service they provide.

The organization, called UNIEX, is being established in the United States. UNIEX is structured as a membership association with several classes of membership, the two most important being the companies advertising on the UNIEX website and their shareholders.

1. Member companies agree to promote their companies on a common website that will provide extensive information about each, including how they are implementing sustainable practices in addition to generic business information, including financials.

Parties interested in buying or selling shares in any company can follow a link to another website maintained by that particular company which facilitates the secondary trades in their shares and ensures that they are compliant with all relevant securities laws and other laws pertaining to being public companies. Users clicking those links are alerted to the fact that they are leaving the UNIEX website and going to the company's site.

2. Shareholders agree to purchase and sell their stock in the company via the terms defined by the UNIEX website and the listing company's website where they agree to abide by all its transaction rules, and to abide by all the other rules set forth by UNIEX as a condition of membership. ■

CONTACT US

Contact us at info@commonwealthgroup.net or 650 641 1246.

This article can also be found at www.commonwealthgroup.net/public. Other articles by Michael Sauvante can be found at www.commonwealthgroup.net/sauvante.html.

37 http://en.wikipedia.org/wiki/Direct_public_offering