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Raising Capital - What You Don’t Know Could Hurt You

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Nine Common Myths about Private Offerings

A cash infusion is all that’s needed to fund the final stage of development for the next killer product and be first to market. From there, competitors will scatter to the winds. Turning to private investors is the answer. But wait—could it be more complicated than that?

Bringing in new investors can be a great way to bring cash into your business, but the pitfalls can jeopardize success. These common misconceptions and the facts noted here can help companies trying to raise capital for the first time.

- **Myth #1:** Securities laws only apply to public companies. IPOs and other public offerings are regulated by, and must be registered with, the Securities and Exchange Commission (SEC). Right. But who knew these laws apply to all securities offerings, including private offers and sales? Exemptions from registration are available for properly structured private offerings, but even those come with their own set of rules.

- **Myth #2:** Partnership interests are not securities. Most people think of securities as stock in a publicly traded company. It may come as a surprise that the definition of “security” is extremely broad and can include interests in partnerships and limited liability companies, notes, and even condominiums and orange trees.
- **Myth #3:** I can advertise for investors on my website. To qualify for a private offering exemption, the offering must be private. No advertising or general solicitation concerning the offering is permitted, including statements made in interviews, press releases, articles, and other publications. This rule is being modified for certain offerings made solely to accredited investors, but a change has not yet been implemented.
- **Myth #4:** I can sell to anyone I choose. Common exemptions allow an unlimited number of “accredited investors” to purchase securities in an offering. Generally, accredited investors are those with a net worth in excess of $1 million or annual income exceeding $200,000 or $300,000 combined with a spouse. Under these exemptions, no more than 35 non-accredited investors may participate. In most cases, all investors must have sufficient financial knowledge and experience to be capable of evaluating the risks and merits of an investment in your company.
- **Myth #5:** I can offer securities as often as I like. Multiple offerings of securities made within a short period of time may be integrated with each other and treated as one big offering. If the big offering otherwise satisfies securities laws and qualifies for an exemption, then no problem. But if it does not, you may have just conducted an illegal offering of unregistered securities – not a good result. Offerings made at least six months apart will generally not be integrated into a single offering.
- **Myth #6:** Only the federal government regulates securities. All 50 states have their own “blue sky” laws regulating securities offerings. In many cases, if you qualify for a federal exemption, you will also qualify for a state exemption. But most states still require filing of notices and payment of fees in connection with private offerings.
- **Myth #7:** If I qualify for an exemption, I’m home free. An exemption gets you out of registering your securities with the SEC, but it does not give you immunity from liability. Antifraud laws still apply. You could face significant liability exposure if you mislead investors, or simply neglect to provide material information they need to make an informed evaluation of the company.
- **Myth #8:** I don’t have to give investors any information about my company. For accredited investors, this is generally true. You may be able to avoid preparing a comprehensive offering book, but you should provide investors with information about the merits and risks of investing in your company. In fact, when doing so, ask yourself if you are telling them enough. Material omissions, even if unintentional, are as fatal as intentional misrepresentations with respect to violations of securities laws.
- **Myth #9:** I should give my investors the same information I give my customers. Not a good idea. Customer-focused marketing materials tend to emphasize only the positive about your business. In a securities offering, an overly optimistic outlook and a lot of promises may be construed as misleading. You don’t warn customers about the risks that your company could fail or that you may not deliver products on time. Potential investors, however, should be warned about those and other risks facing your business.

Obtaining private funds can be a win-win endeavor for all involved. Being aware of securities laws and ensuring compliance can streamline the process and avoid negative consequences with any securities offering.

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