

Public Advertising of California Qualification by Permit Offerings

Although it takes more time and effort than other types of offerings, a California qualification by permit (25113) offering has major advantages in terms of allowing public advertising and having low investor requirements.

The offering can only have California investors, but of course California is a populous state. The offering also must not trigger federal law.

To be exempt from federal regulation under the intrastate “safe harbor”, the offering company must be a California entity with its principal place of business in California, and 80%+ of its assets, revenues and expenditures in/from California. The other alternative, which is in a grayer area, is that the offering company must be a California entity with its principal place of business in California and a “predominant” amount of its “income-producing operations” within California.

Unlike with other offerings, California must approve the 25113 offering and issue a permit for it before the offering can begin. Both a substantial application and a private placement memorandum must be submitted to the State for review.

Once the application is submitted, it usually takes the State approximately eight weeks to approve the application and issue the permit, although the State can ask for changes and that can take additional time.

Generally the State requires that the money from investors be placed in a bank impound account and not released until the minimum amount to carry out the project has been raised.

To receive a lighter review from the State than the usual “merit” or “fairness” review, the offering must be limited to no more than \$5 million and impose certain financial requirements on the investors. These restrictions are far less than for accredited investors, though. Basically, an investor must either:

- (1) have a minimum net worth of at least \$75,000 and minimum gross income of \$50,000 per year; or
- (2) have a minimum net worth of \$150,000.

In either case, the investment may not exceed 10 percent of the net worth of the investor, and net worth is determined exclusive of homes, home furnishings and automobiles.

Note that if the offeror will be operating in the real-estate field, qualification by permit cannot be used with an LLC (versus a corporation) unless certain real-estate requirements set out in the Code of California Regulations are met.

In any event, the purchasers must agree that they will hold the securities for a minimum

of nine months. Also, if equity (versus promissory notes) is being offered, there must be only one class of voting securities.

Other restrictions apply as well, but those are the major ones. Companies located in California may well want to use this type of offering even though publicly advertised Rule 506 offerings will be possible in a few months, as the latter will be limited to accredited investors only and will require verification of accredited investor status. Companies located outside California may want to consider forming a subsidiary or affiliate there.

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