

SCOR OFFERINGS: RAISING SMALL MONEY

By Marilyn J. Holt, CMC

Money is the lifeblood of any company, but early-stage companies are too immature to generate their own, so they need infusions of capital from outside sources to survive. The ability to secure this quickly is vital.

You *know* that if people had invested in your company instead of one of Wall Street's big flops, they would be money ahead and singing your praises, not writing off the whole investment. You have a good idea, a great product, and a world-beating way to deliver it. However, your company does not fit the mold for venture capital:

- your company do not need very much money;
- your product is still early-stage high-tech;
- your company is really Main Street;
- your company most likely will not attract later-stage venture capital.

You still need money. Since there is little magic afoot for early-stage companies, you have to take positive steps.

If your best bet is OPM (other people's money), and you truly believe that you can provide your shareholders with real value, then there are some avenues beyond friends and family investors available to you. Can you say "yes" to these two statements?

- If we had \$500,000, this company would be a success.
- We could not justify investments of over \$2,000,000 within the next two years.

If "yes" is the answer to both, then you probably should be considering using the small business, or small company offering.

All offerings are called "investment vehicles," so let's think of these in terms of cars. Initial Public Offerings are like Ferraris (and cost much more). Venture Capital is like a Mercedes limousine. The small business offerings are economical. The Reg. D 506 offering is like a comfortable family sedan. The SCOR is like a sub-compact hybrid.

STATE REGULATED OFFERINGS

While we usually think of state securities divisions as the regulators ready to jump on us if we step out of line (and they will), they have another "core mission", and that

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“is to promote small business capital formation.” Yes, the states have programs to help you raise money. Since one of their other core missions is to protect unaccredited investors, the forms are cumbersome (they have gotten better over the years), and you have to prove that you are legitimate, which is why the forms are unwieldy. **The Small Company Offering Registration** (“SCOR”) provides small business a way to raise non-accredited investor money legally. Sometimes these offerings are called “direct public offerings” (DPOs) or “self-underwritten” offerings, because the company itself, and occasional a consultant, “sell” the stock.

There are several types of SCOR offerings. In some states there is an ULOR (Uniform Limited Offering Registration) offering, that is usually paired with the SCOR offering information. The ULOR offering is used for offerings up to \$5 million by a corporation that is not a development stage company, an investment company, or a 1934 Act reporting company. ULOR offerings have fallen out of favor because they tend to be more difficult than SCOR offerings, which are the simplest.

THE SCOR OFFERING

The Small Company Offering Registration (“SCOR”) allows corporations and limited liability companies (LLCs) to raise up to \$1 million during a period of up to 12 months through the sales of securities to the public. It is formed under the 504 Reg D (Rule 504 Regulation D) requirements.

Requirements vary among STATES; however Washington State has become a leader IN BOTH PROGRAMS OFFERED AND HELPING companies with this process.

Some of the requirements are less rigorous than for the 506 Reg D. Advertising, or mass solicitation may be used, including public meetings, advertisements, and the Internet. You can use commissioned sales people or finders. Perhaps most important, any type of investor may be included, both accredited and unaccredited, and they can receive any amount of the company from their investment.

However, since unaccredited investors can participate, the reporting is more rigorous. The financials must be prepared to GAAP (generally accepted accounting practice) standards, and the type of information allowed with-in the offering document, which is in the form of a preset group of questions, is quite narrow.

Companies that have used the SCOR offering, complain that the vision for the company cannot be explained well because of the limitations of the form. The other complaint is one that is beyond state control, and that is the lack of qualified accountants to produce GAAP standard financials in a timely and cost-efficient manner. Unfortunately, most accountants and bookkeepers are not able to do this. Also, few attorneys have focused their practice on this area, which means that it is difficult to find good legal advice concerning the SCOR offerings.

THE COORDINATED REVIEW

If you have reason to believe that you can raise a substantial portion of your equity investment in other western states, the Coordinated Review SCOR-West (CR-SCOR-West) should be considered. You would register in each state in which you want to make the offering, and one lead state coordinates the comments from all participating states regarding the offering. (There are other regional review programs.)

The participating western states are Alaska, Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming. California does not participate. The coordination has the general affect of making your company conform to the most restrictive of the state regulations.

For companies that may have already raised money, and are planning to be publicly traded on the OTCBB, NASDAQ Small Cap, Pink Sheets, or other exchange, the 40-state Coordinated Review-Equity (CR-Equity) may be most effective. While it coordinates the money raising blue-sky registration process in participating the states, the net affect has been to make the rules governing the offering conform to the most restrictive among the states. in which the issuer seeks to sell. The CR-Equity offering is designed to raise money in the range from \$5 million to \$20 million dollars.

The SCOR process is intended to be "low-cost", however *low-cost* is a relative term. The largest single cost most likely will be your GAAP conforming financials. These

have to be prepared basically back to day-one, although there are legal ways to reset day-one. Because Washington is a merit review state, legal review by your attorney may not be required, but it may be advised since mistakes you make on the disclosure forms will have to be corrected and reviewed by the state. The state will report its review of your documents in a comment letter. The process is designed to take no less than 30 days, so you should be prepared for three or four times as long, because there probably will be corrections and clarifications required. You will also have to maintain your financials, because as the process goes on so does your business, and the requirements for timely financial reporting move forward, too.

IS A SCOR OFFERING BEST FOR YOU?

The best place to start considering the SCOR process is by visiting your state's securities division web site. You need to closely study the forms and requirements before you make a decision. Before you commit to raising money, do your strategic planning, and determine how much money your company is going to burn through to get it to the corporate goals, or at least breakeven, which should be self-supporting. Think about the industry that you are in, the investors who will be attracted to your company, and how much time you need. You may find that a SCOR offering is right for you.

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SECURITIES CONTACTS FOR THE CR-SCOR-WEST PARTICIPANTS

- Alaska Department Of Community & Economic Development, Division of Banking, Securities & Corporation; URL: <http://www.dced.state.ak.us/bsc/secur.ht>. Regulations and forms are on-line.
- Arizona Corporation Commission Securities Division, at http://www.azcc.gov/divisions/securities/licensing_and_registration/reg-ulor.as Regulations and forms are on-line, including a link to Washington State Review.
- Colorado, State of Colorado, Division of Securities <http://www.dora.state.co.us/securities/u7off.ht>: Regulations and forms are on-line.
- Idaho, Idaho Department Of Finance Securities Bureau, <http://finance.state.id.us/SecuritiesBureau.aspx> Regulations and forms are on-line.
- Montana Office of the State Auditor, Securities Department, <http://sao.mt.gov/securities/capitalformationsba.as>
- Nevada Office of the Secretary Of State Securities Division, <http://sos.state.nv.us/securities>
- New Mexico Regulation & Licensing Dept., Securities Division, <http://www.rld.state.nm.us/Securities/index.htm> Regulations and forms are on-line.
- Oregon Department Of Consumer & Business Services, Division of Finance

& Corporate Securities; the URL for SCOR is

<http://www.cbs.state.or.us/external/dfcs> Regulations and forms are on-line.

- Utah Department Of Commerce, Division of Securities, the corporate finance URL is <http://www.securities.state.ut.u/>. Regulations and forms are on-line.
- Washington Department Of Financial Institution Securities Division: <http://www.dfi.wa.gov/sd/scor.htm> Regulations and forms are on-line. You can also call (360) 753-7115 (ask for the Small Business Section, or send an e-mail from the web site for answers to your questions or, better yet, to arrange a meeting. Washington leads in state support of these programs by providing knowledgeable help.
- Wyoming Secretary Of State, Securities Division; the corporate finance URL is <https://wyobiz.wy.gov/>
- To find the securities divisions of the other states, go to SEC LAW.com Guide to State Securities Administrators, the URL is <http://www.seclaw.com/stcomm.htm>.

AFTERWORD

It remains difficult to sell these stock shares on the secondary market, so SCOR stock is as illiquid as any other privately held stock. Washington State remains a leader in this offering type, and is a relatively easy place to incorporate and do business.

The URLs listed in this article may have changed.

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