

**RONALD REAGAN, GOVERNOR, STATE OF CALIFORNIA
ROBERT H. VOLK, COMMISSIONER OF CORPORATIONS**

Release No. 5-C

**GUIDELINES FOR DETERMINING WHEN SECURITIES
ARE BEING "OFFERED TO THE PUBLIC"**

Under the Corporate Securities Law of 1968, the question whether or not securities are being offered to the public, arises in various circumstances, including the following:

- 1. Under Section 25100(1), an exemption from the qualification requirements of the Law is provided for certain short-term commercial paper, but this exemption is not available for promissory notes offered to the public in amounts of less than \$5,000 in the aggregate to any one purchaser.**
- 2. Under Section 25102(a), an exemption from the qualification requirement for issuer transactions is provided, subject to certain conditions, for any offer (but not a sale) of securities not involving any public offering, and also for the execution and delivery of a sales agreement pursuant to such offer.**
- 3. Under Section 25102(e), (f), and (g), an exemption from the qualification requirement for issuer transactions is provided for any offer of sale of evidences of indebtedness, partnership or joint venture interests, and certain participating interests in railroad rolling stock or other equipment, if the transaction does not involve a public offering.**
- 4. Under Section 25104(a), an exemption from the qualification requirement for nonissuer transactions is provided for any offer or sale of a security by the bona fide owner thereof for his own account if the sale is not accompanied by the publication of any advertisement and is not effected by or through a broker-dealer in a public offering.**

This release is intended to set forth guidelines which may be of assistance in a determination of the question whether in the foregoing situations, or in other cases in which the question may arise, securities are being offered to the public. This question, it should be observed, must be considered individually in each case, based upon the special circumstances of that case. In this sense, the question is a mixed question of fact and law.

It must be recognized that the factors listed below as relevant to a determination of the question, are not to be regarded as exclusive, and that the weight to be given to each of the factors will vary from case to case. The final conclusion thus is determined not by an arithmetical procedure but by a value judgement. In some instances a single factor may be considered as dominant, whereas in others, many factors may be of essentially equal importance in arriving at a final conclusion.

The following factors, which are not discussed in their order of importance, are considered relevant in determining whether securities are being offered to the public:

(a) The number and character of offerees and investors. While it has been said that an offering to not more than a small, relatively insignificant number of persons would not be a "public offering," provided, of course, that the securities are not acquired with a view to their further distribution, the question cannot be determined exclusively by reference to the number of prospective offerees or investors. A promoter may recruit a few investors - or indeed a single investor - by an appeal to the general public through newspaper advertising or handbills, or through the employment of a securities broker who is engaged in service to the public at large. To the extent that numbers are significant, the number of offerees must be considered as well as the number of investors. Thus, the fact that the invitation is addressed indiscriminately to a large number of persons indicates a public offering, even if the offer is accepted by only a small and selective group.

It is important to consider not only the number of offerees and investors, but also the manner in which they

have been selected. If the offering is addressed indiscriminately to an heterogeneous group, it is more likely to be a public offering than if offerees are selected with emphasis on their business or financial experience or other characteristics rendering them suitable for the particular investment.

More specific guidelines are provided in the rules of the Commissioner for the situations set forth in paragraphs 2, 3, and 4 above.

With respect to the securities set forth in paragraph 2 above, Rule 260.102.1 provides that a public offering is not involved in an offer made to not more than 25 persons exclusive of offerees within the categories described in subdivision (1) of Section 25102 of the Code. A husband and wife (acting for themselves or for their minor children) are counted as one person for purposes of the Rule. No presumption is created by the Rule that an offering to more than 25 persons is a public offering.

With respect to the transactions set forth in paragraph 3 and 4, Rule 260.102.2 provides that an offer or sale does not involve a public offering if offers are not made to more than 25 persons and sales are not consummated to more than 10 of such persons, and if all of the offerees either have a pre-existing personal or business relationship with the offeror or its partners, officers, directors or controlling persons, or by reason of their business or financial experience could be reasonably assumed to have the capacity to protect their own interests in connection with the transaction. Offerees and investors within the categories described in subdivision (1) of Section 25102 of the Code are not counted, and a husband and wife (acting for themselves or for their minor children) are counted as one person for purposes of the Rule. No presumption is created by the Rule that an offering not conforming thereto is a public offering.

(b) The relationship of the offerees to each other. Pre-existing relationship among members of the group to which the offering is addressed, may be significant in determining the character of the offering, other things may be equal. Thus an offering to a relatively large number of persons may not be an offering to the public if a close relationship of blood, friendship or business association exists among all members of the group. However, just as an offering to a single individual may be considered a public offering by virtue of the public appeal made in attracting the individual, so an offering to a group of closely related persons may be public in character if the initial appeal to the group was of a public nature. Also, the group may be so large and the relationship among its members so impersonal as to characterize the group as merely a segment of the general public, and to make an appeal limited to the group a public offering notwithstanding the relationship existing among members of the group. Thus an offering to all of the employees of a large company, such as the Ralston Purina Company, has been held by the Courts to constitute a public offering, and a similar conclusion has been reached in connection with an offering to a large professional organization, such as the Los Angeles County Medical Association.

(c) The relationship between the issuer and the offerees. A close relationship between the offerees and the issuer which indicates that the former are purchasing the security in reliance upon their personal confidence in the issuer, is a factor tending to characterize the offering as essentially nonpublic in nature. But where such close relationship exists only with one or a few members of the investor group, the lack of a relationship to the other investors continues to be indicative of a public offering. In addition, the fact that the investors are relative strangers to the issuer suggests a public offering, even though they are recruited by persons having a close relationship with the issuer, and even though a relatively close relationship exists among all members of the offeree group. As stated above, in connection with the transactions set forth in paragraphs 3 and 4, the applicability of Rule 260.102.2 to an offering addressed to not more than 25 persons, followed by sales to not more than 10, is predicated upon a pre-existing personal or business relationship of all offerees with the offeror or its partners, officers, directors, or controlling persons, in the absence of business or financial experience on the part of the offerees as specified in the Rule.

(d) The size of the offering. The size of the offering may have a bearing upon the question whether securities are being offering to the public. Size, in this context, refers to both the dollar amount of the financing and

the number of units into which the issue is divided. An offering consisting of only a few units is less likely to be considered of a public character than one consisting of a large number of units, and, similarly, an offering which is relatively large in dollar volume, will tend to be characterized as public. If the size is such, either in terms of units or dollars, as to indicate a public offering, who do not purchase for resale, does not eliminate entirely the possibility of a public offering. Inasmuch as frequently the intent of the initial investors concerning permanent retention or subsequent transfer of the securities, is not fixed or ascertainable, the fact that the offering is large enough to permit of redistribution to the public is a significant factor, with others, indicative of a public offering.

Where the number of units offered is small, but these units are convertible or divisible into a large number of units, it is the number into which they are convertible or divisible which must be considered. Thus, where promissory notes are originally sold in large denominations, the fact that they are divisible into small denominations is a factor to be considered as tending to support the conclusion that a public offering is present.

The fact that identical securities are already being traded by the public on a national exchange or in the over-the-counter market, and that the new issue is likely to reach such market in the future, is of significance. Similarly, an offering which, viewed alone, might not be considered as a public offering may be integrated into a public offering in such a way as to make it public. Thus an interstate offering of promissory notes or partnership interests may be subjected to the California qualification requirement, although limited offering to be made in California, if considered independently, might be characterized as private in nature. However, under Section 25608, the filing fee payable in this case is computed upon the value only of the securities sought to be sold in California.

(e) The manner of the offering. Perhaps the most significant single factor which can be cited, is the manner in which investors are to be sought. Although not conclusive, the fact that the investment initiative proceeds from the purchaser of the securities tends to indicate a private offering. On the other hand, the fact that the issuer or its representative is the moving force in producing the sale, or that it creates and maintains an organized effort intended to expedite the distribution of the security, indicates a public offering. Moreover, it is significant to consider whether the offering appeal is to be made by a means or media designed or likely to bring the security to the attention of a large and indiscriminately constituted group, such as by use of the public press, trade publications, radio or television, mass mail-advertising and the offering of commissions for referrals or sales, tend to indicate a public offering, as does the employment of professional solicitors, advertising firms, or public relations experts.

(f) The character of the security offered. Since some types of securities are more familiar or attractive to the investing public than others, the character of the security has a bearing upon the question whether the offering is to the public. Shares of stock and evidences of indebtedness, with their usual rights and preferences, and subject to the incidents normally provided in corporate articles and bylaws, are more likely to be viewed as the subject of a public offering than securities containing unusual or uncommercial arrangements which make them desirable and appropriate only for a relatively limited group of selected investors, and unsuitable and unattractive to others and to the general public.

Likewise, the character of the business which is being financed is significant in the determination whether the financing is public in character. Industry and certain real estate developments, increases the possibility of, are inducement for, the public investment.

The six factors which have been discussed are only the principal elements entering into the definition of a "public offering." They have been mentioned because they are most frequently determinative of the character of the issue; but in the consideration of this sophisticated and mixed question of fact and law, other factors also may be relevant in a particular case and may attain primary significance in the determination.

It may be said generally that the question whether an offering is public or not in situations not covered by the Rules of the Commissioner above referred to, must be resolved by the issuer or seller in consultation with legal counsel. The Department will attempt to render assistance in the analysis of factual situations and in the understanding of the legal principles applicable thereto.

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**By order of
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