

QUEEN
HG
4027.7
.R55
1999

Equinox Management Consultants Limited

IC

**SCORs: A Review of Academic
and Professional Literature**

Final Research Report

Prepared for Industry Canada

by

**Dr. Allan Riding, Principal Investigator
Equinox Management Consultants Ltd. and Carleton University**

March 29, 1999

SCORs: A REVIEW OF ACADEMIC AND PROFESSIONAL LITERATURE

Industry Canada
Library - Queen

OCT 05 2007

Industrie Canada
Bibliothèque - Queen

EXECUTIVE SUMMARY

BACKGROUND

This report draws on published academic and professional literature to reviews three topics that relate to ways in which small- and medium-sized enterprises (SMEs) can access public capital markets. The work reviews

- 1) the evolution and effectiveness of Small Corporate Offering Registrations (SCORs). SCORs are a mechanism by SMEs in the US can solicit capital directly from the public. The evolution of, and regulatory issues associated with; SCORs are also reviewed.
- 2) The study describes the current regulatory setting in Canada as it pertains to SMEs' ability to seek capital from public sources.
- 3) The study summarizes previous research pertaining to the effectiveness of Junior Capital Pools (JCPs), a mechanism by which Canadian SMEs can solicit capital directly from the public.

The study is motivated by the crucial role played by equity financing in enabling the job-creating growth of small firms, particularly early-stage businesses and knowledge-based firms. Furthermore, discussions appear to be underway regarding the possible reorganization of the nation's stock exchanges. In particular, several regional stock exchanges (Winnipeg, Vancouver) appear to be actively developing programs that are similar to JCPs (Cattaneo, 1999). The possibility of a national exchange through which junior and start-up companies can raise capital has been acknowledged (Martin, as reported by Cattaneo, 1999). Accordingly, this may be an opportune time to identify the most effective mechanisms that would permits SMEs to gain more cost effective access to public capital markets.

SCORs

In the US, a SCOR form is a question-and-answer prospectus that may be used by US small businesses to register issues of common or preferred shares (and debt, under certain conditions). The form provides uniformity of disclosure across the various regulatory regimes in effect across the states. The form is a widely-accepted trade-off between ensuring full and fair disclosure of information to investors, minimizing the costs to small firms, yet complying with federal and state securities legislation.

SCOR is an acronym for the Small Corporate Offering Registration. In the US, SCORs resulted from the *Small Business Investment Act of 1980*. This legislation amended Section 19 of the federal Securities Act of 1933. These amendments allowed for small businesses to raise up to \$1,000,000 through an direct public offering (DPO) of securities without federal registration. Subsequently (1992), the North American Securities Administrators Association (NASAA) adopted the use of the Small Corporate Offering Registration form (that is, Form U-7, the so-called SCOR form) for use in initial public offerings by firms that qualified under rule 504 of Regulation D. The SEC also adopted the SCOR form in 1992. Most state securities regulators have now adopted Form U-7, as a standard.

To qualify for the SCOR process, an issuer firm must have at least 10% equity equal to the amount of capital being raised. Any stock issued must be priced at a minimum of \$5.00 per share for both investors and insiders. The company may not split its stock or declare stock dividends for two years following the effective date of the registration. Proceeds of the offering must be placed in an escrow account until the minimum (firm-specified) amount of capital necessary for the company to achieve its stated objectives is raised.

While the SCOR form provides uniformity of disclosure, aspects of the issuance process do vary by state; hence, costs of filing vary by jurisdiction. Regulators in "merit" states review the SCOR form and related material and must pass on the merit of the application. In non-merit states, regulators ensure that the issuer has complied with the requirements and that full and fair disclosure has been obtained. Typically, (all-inclusive) costs range between \$7,300 and \$39,000 assuming the management of the firm does most of the work.

Initial indications suggest that SCORs may not be as effective a means of raising capital as had been hoped. The only available published study of SCORs revealed that of a sample of 119 SCOR registrations in 1994, only 12 raised sufficient capital to break escrow, raising an average of \$550,000.

In principal, the Pacific Stock Exchange has offered a venue for secondary trading of SCOR issues; as yet, however, no SCOR issue has met the listing requirements. SCORs are listed and offered through at least one internet web site; however, the extent to which secondary trading actually occurs it is not clear.

THE CANADIAN SETTING

From recent research, it is concluded that a minority of Canadian business owners seek equity. Those that do attempt to raise funds through a public solicitation must comply with the various provincial securities acts. In general, these acts require preparation of a prospectus unless the issue meets the terms of specific exemptions. These regulations have been criticized as a barrier to equity formation with the result that an Ontario Securities Commission Task Force on Small Business Financing (the "McCallum Task Force") has proposed sweeping changes that would bring the Ontario Securities Act more into line with the nature of the US regulations described here. The task force recommendations include establishment of a question-and-answer Small Business Prospectus Form that may not be unlike the SCOR document.

Currently, SMEs in Canada can access the public markets for equity through the Alberta Stock Exchange Junior Capital Pools (JCP) mechanism. Two early studies of the efficacy of the JCPs have suggested that these may be an effective way for SMEs to raise equity financing. In addition, these studies suggest that the JCPs also benefit shareholders, the exchange, and intermediaries. However, there appears to be a need to update these studies.

ISSUES YET TO RESOLVE

This review of the literature has identified several gaps that need to be addressed.

- Early indications are that SCORs may not be as effective as might have been expected in terms of raising early-stage equity capital. Therefore, a more comprehensive and up-to-date investigation of the efficacy of SCORs is required. The work should also examine the impacts on effectiveness of: diversity in states' Blue Sky laws; the quantity of local venture capital; and other factors. This work would require a significant research effort because there is no central registry of SCOR issuers in the US.
- Identification of best practices would also be a useful contribution of such a study. This might be accomplished through a pilot study based on selected US states. The parameters of such a study are outlined.

Parallel information is required regarding the Canadian setting.

- An updated assessment of the JCP program seems warranted. This report suggests possible aspects of terms of references for this study. The 1988-1992 period witnessed very few new JCP issues. It seems useful to determine whether or not this pattern has continued and, if so, why so few issuers are using the JCP vehicle.
- Research should review recent usage of the program, the effectiveness of the JCP process, liquidity of JCP shares, and the depth of the markets for junior issues.
- Additional information is required regarding regulatory changes that would be required to implement either SCORs or a national JCP-type market in Canada. This would usefully include an assessment of the current status of the recommendations advanced by the McCallum (OSC Task Force on Small Business Financing).

Finally, it is necessary to evaluate steps necessary for harmonization of securities regulations. It seems unusual that while NASAA (which includes Canadian regulators) adopted Form U-7, its usage does not seem to be being promulgated in any Canadian setting. With financial markets becoming increasingly desegregated, national and international harmonization of securities laws seems advisable.

SCORS: A REVIEW OF ACADEMIC AND PROFESSIONAL LITERATURE

CONTENTS

<i>Background</i>	1
<i>SCORs</i>	1
<i>The Canadian Setting</i>	2
<i>Issues yet to Resolve</i>	3
<i>Background</i>	2
<i>Introduction</i>	2
<i>The US Setting for Early-Stage Equity Capital</i>	3
Form U-7, State Laws, and Costs of Issuance	6
Success Rates of SCORs	6
Secondary Markets for SCORs	7
<i>The Canadian Regulatory Setting</i>	8
The Demand for Equity among Canadian SMEs	8
Current Canadian Legal and Regulatory Issues	8
Private Placements	9
The OSC Task Force on Small Business Financing	10
<i>JCPs: Canada's Version of SCORs</i>	12
History	12
Impacts of Alberta's Junior Capital Pools: The 1992 ASE Study	13
Impacts of Alberta's Junior Capital Pools: The Robinson Study	16
<i>Summary and Possible Next Steps</i>	16
Topics for Further Research	17
1. The Status of Regulatory Reform in Canada	17
2. An Update on the Effectiveness of JCPs:	18
3. Effectiveness of SCORs: A Pilot Study	19
<i>References</i>	21
<i>Appendix A: Promoting a Registered SCOR Offering on the Internet</i>	23
<i>Appendix B: Form U-7</i>	25

SCORS: A REVIEW OF ACADEMIC AND PROFESSIONAL LITERATURE

ALLAN L. RIDING
CARLETON UNIVERSITY AND EQUINOX MANAGEMENT CONSULTANTS LTD.

BACKGROUND

This report reviews the Small Corporate Offering Registration (SCOR) concept with a view to determining the potential applicability of SCORs to the Canadian setting. A SCOR is a (mostly) do-it-yourself securities registration document that has been accepted by 47 US states as a reasonable compromise between investor protection and affordable formation of capital for SMEs. In the US, SCORs play a role in SMEs' attempts to raise equity capital through direct offerings of securities to the public. This report therefore examines the status of Canadian regulatory and market settings with the purpose of identifying regulatory issues related to potential implementation of SCOR-type mechanisms in Canada. The history and studies of the efficacy of Alberta's Junior Capital Pools (JCPs) are also reviewed here.

The study is motivated by the crucial role played by equity financing in enabling the job-creating growth of small firms, particularly early-stage businesses and knowledge-based firms. Furthermore, discussions appear to be underway regarding the possible reorganization of the nation's stock exchanges. In particular, several regional stock exchanges (Winnipeg, Vancouver) appear to be actively developing programs that are similar to JCPs (Cattaneo, 1999). The possibility of a national exchange through which junior and start-up companies can raise capital has been acknowledged (Martin, as reported by Cattaneo, 1999). Accordingly, this may be an opportune time to identify the most effective mechanisms that would permit SMEs to gain more cost effective access to public capital markets.

INTRODUCTION

Growth of SMEs is rare (Arend and colleagues, 1997). While the impact of SMEs on job creation does not seem to be as strong as that originally reported by Birch (1979), those SMEs that do grow substantively account for a disproportionate share of new job creation (Picot and Dupuy, 1995; Arend and colleagues, 1997; and others). New businesses and knowledge-based firms (KBIs) do not usually possess the tangible assets that might qualify them for debt financing. Thus, access to equity capital is essential for new and growing firms. This need has been espoused by virtually every study of small business financing conducted in recent years.¹

¹ See, among others, Parliamentary Standing Committee on Industry (1994); Task Force on Restructuring the Financial Services Sector (1998).

Raising equity capital, however, is not straightforward. In the US prior to 1980, SMEs had to satisfy both federal regulations through the Securities and Exchange Commission (SEC) as well as state-specific regulations (known as "Blue Sky" laws). In addition, few small businesses could afford the high costs and strict listing requirements of most stock exchanges.^{2,3} Therefore, SMEs had little opportunity to raise capital by selling shares to the public. Moreover, small companies often report difficulty attracting new investors because there is no market where their shares could be bought and sold. To promote growth of SMEs, the Reagan administration in the US initiated policies to ease access to equity capital for them. Their goal was to devise a filing process that was simple enough for an entrepreneur to complete (with help from an attorney and accountant), yet one that was sufficiently thorough for full disclosure.

The Small Corporate Offering Registration (SCOR) process is a direct result of these initiatives. The acronym, SCOR, actually refers to the registration form, Form U-7, which is employed in the direct public offering. Form U-7 is essentially a question and answer prospectus process (a copy is appended in Appendix B). It was designed to enable small business owners to raise equity capital by originating their own offering and selling their own stock with the help of their regular accountants and lawyers. The SCOR sought to eliminate the need for hiring costly professional securities practitioners and thereby reduce the cost of issuing a public offering.⁴

THE US SETTING FOR EARLY-STAGE EQUITY CAPITAL

Prior to 1980, Regulation D of the Securities and Exchange Act of 1933 required that security offerings in the US be registered federally unless the offering fell under one of three exemptive rules (504, 505, and 506). The *Small Business Investment Incentive Act* of 1980 amended the terms of Rule 504, delegating to the states regulation of issues for less than \$1,000,000. This exemption is a broad one that:

- permits companies to sell up to \$1 million of securities in a 12 month period;
- places no limit on the number of persons purchasing the securities;
- imposes no conditions on purchasers;

² Such costs arise from the need to hire accountants, auditors, and attorneys who specialize in public offerings, preparation of detailed disclosure documentation, fees and commissions to investment bankers, and the cost in time diverted to the issuance by top managers of the business (see, for example, Jog, 1997; Andrews, 1995).

³ For an initial public offering (IPO) in the US (as well as in Canada), underwriters often require a company be generating sales of \$10 to \$20 million annually with annual profits of at least \$1 million. Moreover, successful IPOs also require a proven top management team and high potential future growth. In the US, for example, a NASDAQ listing requires the firm to have a minimum of \$4 million in assets and \$2 million in net worth. The costs associated with an IPO are also substantial. In Canada, issuance costs typically involve \$400,000 to \$600,000 for preparation of a prospectus, 5 to 9 percent of the issue size for underwriter fees and commissions, allocation of material top executive time, and opportunity costs due to underpricing (Robinson, 1997; Jog, 1997; Andrews, 1996). Similar cost structures prevail in the US.

⁴ Whether the U-7 system has actually accomplished this is open for debate, and criticized by Smith. Brad Smith, "Free Enterprise Advocates Must Work to Make the SCOR Produce Equity for Small Business," in the Scor-Net Internet Document.

- permits general solicitation or general advertising;
- permits the resale of securities; and,
- requires the issuer to file a Form D notice with SEC headquarters within 15 days of the first sale of securities under the exemption.

The *Small Business Investment Incentive Act* (1980) sought to reduce the costs of filing and raising investment capital, particularly by small businesses. It amended federal securities laws contained in Section 19 of the Securities Act of 1933. Specifically, Regulation D and Rule 504 were developed to make it easier, under certain conditions, for a company to raise up to \$1,000,000 without federal registration for an initial public offering (although the SEC does need to be notified).⁵

This legislation eased federal registration requirements and devolved regulatory responsibility for such offerings to the states. Therefore, issuers must comply with the securities legislation of each state in which an offering is to be registered. However, state security laws ("Blue Sky" laws) differed across states. Blue Sky laws were designed to protect potential investors from risky investments by ensuring that information asymmetry is minimized. They seek to ensure that investors are well informed. Therefore, if the goal of easing access to capital was to be realized, the need to provide a cost-effective means of complying with state regulations in a relatively uniform way was also required.

The first step to this end was accomplished in 1992 when the North American Securities Administrators Association⁶ adopted the use of the Small Corporate Offering Registration form (that is, Form U-7) for an initial public offering by firms that qualified under rule 504 of

⁵ Under the revisions, firms may also be exempted from federal prospectus and registration requirements. Under Regulation A, Section 3(b), of the Securities Act the SEC exempts small securities offerings of \$5 million or less in any 12-month period from registration. Firms that rely on this exemption must still file an offering statement (consisting of a notification, offering circular, and exhibits) with the SEC for review.

Regulation A offerings resemble registered offerings in that purchasers must be provided with an offering circular that is similar in content to a prospectus. Like registered offerings, the securities can be offered publicly and are not "restricted," meaning they are freely tradable in the secondary market after the offering. The principal advantages of Regulation A offerings, as opposed to full registration, are that financial statements are simpler and don't need to be audited; there are no Exchange Act reporting obligations 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; and, firms may "test the waters" to determine if there is adequate interest in the securities before going through the expense of filing with the SEC. This is important for smaller to medium-sized businesses who want to offer securities publicly but do not know if there is enough interest in them to warrant the legal fees and accounting fees associated with offerings. Firms that "test the waters," can use general solicitation and advertising prior to filing an offering statement with the SEC. This process indicates whether there is enough market interest before incurring the full range of legal, accounting, and other costs associated with filing an offering statement. Firms may not, however, solicit or accept money until the SEC staff completes its review of the filed offering statement and the prescribed offering materials have been delivered to investors. All types of companies which do not report under the Exchange Act may use Regulation A, except blind pool companies, those with an unspecified business, and investment companies registered or required to be registered under the Investment Company Act of 1940. In most cases, shareholders may use Regulation A to resell up to \$1.5 million of securities.

⁶ The North American Securities Administrators Association (NASAA) comprises securities regulators from 65 jurisdictions that include the US, Puerto Rico, Canada, and Mexico.

Regulation D. In 1992, the SEC also adopted the SCOR. The intent of the Small Corporate Offering Registration process was to provide an affordable avenue through which small businesses could raise funds while satisfying the needs for full disclosure. Forty-seven states, all except Delaware, Hawaii, Florida, Nebraska, and Alabama (under consideration), have accepted SCORs as registration by qualification.⁷

Therefore, the SCOR program is not a nationally regulated program. In effect, the SEC shifted the responsibility for monitoring small issues of equity to the states. The registration process, therefore, is a two-step procedure. Firms must qualify for exemption from SEC requirements⁸ and then register the SCOR under state-specific legislation. Issuers must comply with the laws of each state in which the offering is registered and the U-7 form must be submitted to each state in which the business intends to sell its stock.⁹

Firms using SCORs must have at least 10% equity equal to the amount of capital being raised. It can offer for sale common stock, preferred stock, or debt (under certain conditions). Any stock issued must be priced at a minimum of \$5.00 per share for both investors and insiders and the company may not split its stock or declare stock dividends for two years following the effective date of the registration. The securities registered and sold are transferable and tradeable; however, the offering size and the minimum \$5.00 per share price likely limit the size of any public market in the stock. Proceeds of the offering must be placed in an escrow account with an independent financial institution until the minimum (specified) amount of funds necessary for the company to achieve its stated objectives is raised.¹⁰ These costs are determined from the business plan submitted by the issuer firm. Some states also require an escrow account to ensure that the issuer raises more than the cost of completing the SCOR process.

One of the potential advantages of the SCOR system is that it facilitates a direct relationship between the firm offering the SCOR and its investors. This direct relationship, termed a Direct Public Offering (DPO), does not use an underwriter. The advantage to this type of offering is that the firm offering the SCOR is able to capture most of the capital from the sale of its securities. However, lacking the services of an underwriter, the transactions costs of marketing the shares may be significant.

⁷ For state-specific information, see <http://www.scor-net.com/parstate/main.htm/>.

⁸ Under Rule 504, issuers that are not subject to the reporting obligations of the SEC (nonpublic companies) and that are not investment companies may sell up to \$ 1,000,000 worth of securities over a 12-month period to an unlimited number of investors. US corporations may use SCORs to register securities for sale to the public except such companies as petroleum exploration or production companies, firms engaged in mining or other extractive industries, or blind pools. Firms whose management or stockholders have had a history of regulatory problems may not use SCORs.

⁹ Note that although firms filing SCOR issues do not have to register with the SEC, they are expected to provide the SEC with some information (Form D). "Form D is a relatively short form that asks for certain general information about the issuer and the securities being issued, as well as some specific data about the expenses of the offering and the intended use of the proceeds (Timmons, 497.)"

¹⁰ In addition, most states place escrow requirements of three to eight years on pre-existing stock ("promoters stock" or "cheap stock"). These restrictions relate to stock splits and dividends as well as on resale.

FORM U-7, STATE LAWS, AND COSTS OF ISSUANCE

A copy of the SCOR form U-7 is appended to this report. It is a 50-question document that must be filed by the firm seeking to register a SCOR offering. A SCOR offered in a given state can only raise capital from residents of that state. Many states also require that a large portion of the business conducted by the firm raising capital be within the state. Most states also require submission of the issuer firm's financial reports and completed business plans. For offerings of more than \$500,000, audited financial statements are required. For offerings of less than \$500,000, "reviewed" financial statements may suffice although most states reserve the right to require audited statements.

Because of the differences in state regulations, costs of filing vary by jurisdiction. Costs include legal, accounting, consulting, filing fees, phone, travel, postage, printing, etc. The offering can be sold in as many states as the owners think that they can sell a reasonable amount of stock. Depending on the company's management, a DPO can be prepared and registered for a few thousand dollars if management can do most of the work itself. Costs are higher, of course, if management is unwilling or unable to create the offering documents. However, most states limit the funds that the firm may expend on preparation. Reported costs range between \$7,300 and \$39,000 including accountants, lawyers, printing, postage, phone calls, seminars and advertising. Some of those firms that use "packagers" (agents who help prepare the documents and register the offering and may help sell it) encounter costs of more than \$100,000.

As noted, states vary in how they treat SCORs. New York, for example, registers investors rather than the offering; California restricts eligibility to investors who meet specified qualities of wealth and income. Some states are "Merit" states; others are "non-merit states. In non-merit states the regulators merely check to make sure that there is full and fair disclosure and that the filer has complied with requirements.

In Merit states regulators review and must pass on the material before they approve the offering. Regulators may request any additional information they believe is necessary to ensure full and fair disclosure. This additional information could pertain to any area of the filing but most frequently references financial data. States may also restrict the initial public offering according to its merit. For example, they may restrict the number and type of securities that can be sold and require lock-in periods for officers of the firm who hold stock. A lock-in period restricts the period of time during which an officer of the corporation may sell stock.

When state securities regulators are satisfied with the initial public offering and approve the filing, the firm may then begin selling the securities as described in the offering. The company may sell the offer directly to investors (however, in some states the selling officer must be registered). Otherwise, a commissioned selling agent or broker/dealer may sell the offering. Mass solicitations and public meetings may be used for selling purposes; advertising is permitted but may need to be pre-approved by state regulators. The management team will often do a "road show" to present the company to brokers who may then sell the stock onwards to public investors. If the issue is subscribed, the firm obtains the sought-for capital. The company usually has up to 12 months to sell the offering. When the minimum level set for escrow is reached, the company can break escrow and receive the money from the initial public offering.

SUCCESS RATES OF SCORS

There are few published studies of the effectiveness of SCORs. Osteryoung, Brau, and Kerr (1995) examined a sample of SCORs registered during 1994. The 119 SCORs in

their sample sought to raise a total of \$77.9 million (an average of \$665,000). In the event, the 119 registrations raised \$9.2 million from public sources. Only 12 of the 119 issues were deemed a success in that they either raised all the capital they sought or the issuer broke escrow. These 12 companies had sought an average of \$579,000 and actually raised a total of \$6.6 million, for an average of \$550,000. The 107 other firms that did not break escrow raised an average of \$24,000 of the \$663,000 average registered amount.¹¹

Aside from this study, searches of ABI-Inform, Econlit, and Discover located no other references to the success or the efficacy of SCORs. At least one commercial business, "SCOR Report" (for example, <http://scor-report.com/>) purports to maintain data on SCOR activity and sells such information by subscription. This business provided Osteryoung and his associates with the data for their study.

SECONDARY MARKETS FOR SCORS

Since April of 1995, the Pacific Stock Exchange (PSE) has, in principal, offered a secondary market for trading SCOR stocks. To qualify for listing on the PSE, a company must have at least \$500,000 in net tangible assets and \$750,000 in net worth. Also, it must satisfy all state Blue-Sky laws, have a minimum of 150,000 shares and at least 250 stockholders Levine (1994). To date, however, no company that has been successful with a SCOR offering appears to have met the listing requirements for the PSE (according to <http://ibchannel.com/dpo/small.htm>).

Secondary markets may also be developing on the internet. Several venues (for example, <http://www.dsm.com/> and <http://www.SCOR-Board.com/>)¹² appear to list SCOR direct public offerings; however, it is not always clear which offerings are primary and which constitute secondary trading opportunities. An alternate secondary market is significant because any firm filing a SCOR may be able to list on internet markets. (that is, with no additional screening requirements as with the PSE). Hence, the internet may theoretically provide more companies with access to an established capital market.

These mechanisms for public trading also offer a new dimension to creating investment portfolios, but also pose new regulatory concerns.¹³ Because most SCOR offerings are from entrepreneurial firms, these secondary markets potentially provide an opportunity for investors to incorporate entrepreneurial ventures into their portfolios, while diversifying the risk associated with these ventures. It is important to note though, that not all SCOR issues must, or will, be listed on a secondary exchange. Firms offering SCORs will voluntarily provide the necessary information for trading to the various exchanges.

It is not clear to what extent secondary trading actually occurs. There do not appear to be any publicly available professional or academic studies of the depth of markets for SCORs in the US.

¹¹ As Osteryoung and his associates point out, these data likely understate the true success rate of firms using SCORs because some firms in the sample that were not classified as "successes" may have raised the needed capital privately and either withdrawn their SCOR offering or not pursued the marketing process. No data was available on these instances.

¹² The latter site lists approximately 400 issuers across 32 states (Some issuers are duplicated because they list in multiple states; nor is it clear whether the listings are primary or secondary offerings).

¹³ See Appendix A for a discussion of some of these issues.

THE CANADIAN REGULATORY SETTING

THE DEMAND FOR EQUITY AMONG CANADIAN SMES

In recent research, the CBA (1998) documented that many owners of Ontario small businesses were unaware of sources of external financing other than banks and institutional lenders. This confirms earlier findings by Petersen and Shulman (1988) that Canadian owners of SMEs rely on bank financing to a greater extent than owners of small firms in other developed countries. Moreover, the majority of the owners who were aware of equity as a source of capital perceive that equity constitutes a threat to their autonomy and a majority would rather forfeit growth than use equity if control were threatened. The CBA research, therefore, suggests that it is a minority of business owners who would seek out equity capital to finance growth. Those that do wish to raise equity capital must then comply with security regulations to gain access.

CURRENT CANADIAN LEGAL AND REGULATORY ISSUES

Regulation of equity securities is primarily under provincial jurisdiction in Canada. As a generalization, regulators in most provinces follow closely amendments to the Securities Act of Ontario and most jurisdictions tend to pattern their regulations on Ontario's lead. Most jurisdictions normally require a prospectus and registration for public distributions of securities. As noted, preparing a prospectus is costly and, for the most part, precludes SMEs from access to public equity markets. There are, however, several exemptions from the prospectus requirement.^{14,15} The three most frequently employed exemptions follow.

1. The "private placement exemption" exempts a firm from prospectus and registration requirements if a single purchaser invests a minimum level of capital. This minimum varies by province: \$150,000 for Ontario; \$25,000 in Alberta and other provinces, and \$97,000 in yet other jurisdictions. This exemption assumes that an investment of this scale motivates the investor to conduct a careful evaluation. It also presumes that exempt investors are sufficiently qualified to evaluate properly the prospective investment, or that such investors have adequate access to expert advice.
2. The "seed capital" provision exempts issuing firms if they solicit from fewer than 50 potential buyers and end up selling securities to no more than 25 investors. The Act requires that each prospective investor have access to the same information about the issuer that a prospectus would contain.
3. Under the "private company" exemption, issuers are exempt so long as the securities "are not offered for sale to the public". Here, law defines a private company as one for which the right to transfer common shares is restricted and the number of common shareholders is limited to less than 50.

Given the uncertainties in terms of the legal interpretation of some of these exemptions when applied to specific cases, most deals involve legal counsel. Therefore, an offering memorandum normally accompanies an investment agreement and essentially replaces a prospectus. The cost

¹⁴ Clause 72(1)(a) of the Securities Act. Also 35(1)3 identifies registration exemptions.

¹⁵ For a more detailed and comprehensive review of these issues, see MacIntosh (1994).

of preparation of an offering memorandum, however, is significant.¹⁶ Even so, according to MacIntosh (1994, p. 59), informal investors "will typically be unable to find an applicable prospectus exemption". He recommends that the exemptions need to be "redrafted to permit investments by informal venture capitalists" and that in doing so (p. 60) "financing for smaller companies would ... be greatly facilitated".

PRIVATE PLACEMENTS

Perhaps the most frequently employed exemption is the private placement exemption. In a private placement, firms raise capital by selling securities directly to one or more investors. Investments made by institutional venture capitalists are usually private placements, as are most instances of mezzanine financing and investments made by private investors (angels). For a private placement, the investor must have agreed to take up the entire offering of the issued securities as an investment (that is, not for immediate resale or redistribution). The issuer and purchaser can arrange the transaction directly between themselves; alternatively, an investment dealer or limited market dealer will act as the issuer's agent. Private placements can be either debt or equity.

In general, banks, loan or trust corporations, insurance companies, and certain other institutions may purchase securities on an exempt basis. For an individual to obtain an exemption, he or she must demonstrate both significant pools of investment capital (usually at least \$5 million) and investment expertise. In addition, exemptions are available based on a minimum acquisition cost (\$150,000 in Ontario) to the purchaser. Although the buyer may not require the protection of a prospectus, a costly offering memorandum is still frequently used. Again, such costs of compliance may limit the availability of the private placement market to larger SMEs.

In most provinces, investors are also subject to a minimum holding period requirement. Securities acts established the hold period to prevent so-called "back door underwriting."¹⁷ As a result, securities issued through private placements often lack liquidity. The private placement purchaser, aware of the hold period, may require a discount on the issue price (Srivastava, 1993), thereby increasing the cost of funds to the issuer.

Issuers can circumvent the hold period by raising capital on international markets. MacIntosh (1994, p. 60) notes that "A lively Euro-equity private placement market has now developed in which Canadian issuers can raise as little as \$1,000,000, while avoiding most of the regulatory burdens associated with domestic offerings." Recognizing the need to ease regulatory constraints on capital formation for SMEs, MacIntosh (1994) advanced three recommendations:

1. reducing the hold period from the current (Ontario) requirements of between six and 18 months to a maximum of 90 days;
2. eliminating the provision whereby the hold period remains in effect even after the issuer has assembled a prospectus; and,

¹⁶The significant compliance cost associated with preparation of an offering memorandum may be the reason that Canadian informal investors invest in fewer firms than US counterparts and invest larger amounts.

¹⁷A "back door underwriting" is a transaction whereby an exempt investor buys an issue of securities and then re-sells them to non-exempt investors without the issuer ever providing a prospectus.

3. allowing private companies to raise relatively small amounts of capital with no resale restrictions at all.

THE OSC TASK FORCE ON SMALL BUSINESS FINANCING

Also in recognition of the need to facilitate access to capital the Ontario Securities Commission (OSC) established the OSC Task Force on Small Business Financing. Chaired by Susan McCallum, then Policy Advisor to the OSC, the Task Force was independent of the OSC. As yet, its report does not seem to have been endorsed by either the Commission or by the legislature. The Task Force identified the following among constraints on raising SME equity capital:

- information asymmetry, whereby insiders of SMEs, particularly in the case of high tech enterprises, are better informed than outside investors about the quality and potential of the business;
- the relatively high cost of small scale public financing transactions [whereby] ... the costs of due diligence, prospectus preparation, meeting continuous disclosure requirements and other costs outweigh the potential benefits;
- the perception that SMEs may be unable to generate the high returns required by investors;
- some entrepreneurs' negative perception of venture capital and unwillingness to share ownership;
- lack of a developed distribution network in the Canadian market place for offerings of less than \$10 million.

On the basis of their deliberations, the Task Force advanced a variety of recommendations for changes to the Securities Act of Ontario that, if adopted, would mitigate some of the barriers to equity formation. Among the recommendations were several that related specifically to small public offerings. The gist of the recommendations is consistent with the earlier suggestions of MacIntosh (1994). Two areas of the Task Force's deliberations are relevant to this report.

First, the Task Force proposed two new prospectus exemptions to assist SMEs in raising capital in the private placement market.

- The proposed "closely held business issuer" exemption would allow issuers to raise up to \$3 million provided the issuer has 25 or fewer security holders (excluding employees). As proposed, this exemption would replace the "private company" exemption which prohibits an "offer to the public".
- The Task Force also proposed an "accredited investor" exemption. According to this proposal, issuer firms could raise any amount of capital from any person or company who qualifies as an accredited investor. The Task Force suggested that accredited investors would include: certain institutions and governments; individuals who, together with their spouse, have net worth of at least \$1 million; individuals who have net incomes of \$200,000, or net income of \$300,000 when combined with their

spouse; corporations with net assets of more than \$5 million; and (v) directors, officers and promoters of the issuer. This proposed exemption would replace the "private placement" exemption. It would significantly ease access to private investor financing.

Second, the Task Force advanced recommendations intended to facilitate public offerings by SMEs, including:

- a new optional "question and answer" prospectus form for SMEs (the 'Small Business Prospectus Form') that would be easier for issuers to prepare and for investors to understand. This form would simplify the issuance process for qualifying SMEs. In addition, disclosure requirements would be oriented to SME investors, would relax the requirements for audited statements, and would exempt SME issuers from the requirement to file quarterly financial statements.
- simplifying the escrow requirements on initial public offerings;
- reducing the requirements for future-oriented financial information (or FOFI); and,
- eliminating the requirement that an underwriter sign an SME prospectus.

It is not clear if or when these proposals will be implemented; neither the Commission nor the legislature has yet endorsed the report. The changes may be resisted because the proposals may be viewed by some as an abandonment of investor protection in favour of capital formation.

However, securities legislation – which continues to form a primary to small scale public equity financing – remains a matter of provincial jurisdiction. Nonetheless, the dichotomy of responsibility whereby federal laws largely govern debt capital formation and provincial laws govern formation of equity capital presents a significant barrier to harmonization of efforts to ensure an adequate supply of financing for SMEs. Harmonization appears to be an idea consistent with the goals of the Government of Ontario (Government of Ontario Budget Speech, May 7, 1996):

"To make it easier for companies to raise funds in Canadian equity markets, Ontario will pursue an agreement with the federal government and with other interested provinces to delegate responsibility for securities regulation to a Canadian Securities Commission."

Harmonization and redrafting of securities legislation could ease significantly the task of financing for SMEs.

JCPs: CANADA'S VERSION OF SCORS

HISTORY

The origins of the Junior Capital Pool program of the Alberta Stock Exchange can be traced to November, 1985. The Alberta Resource Capital Corporation (ARCC) had submitted a prospectus to raise funds for identifying and exploring oil and gas participations. The Director of the Securities Commission sought a hearing as to whether or not it was in the public interest to issue a receipt for the prospectus because public investors were being invited to invest strictly on an assessment of ARCC's management and its potential. The Director felt that the structure of this financing (that is, a blind pool) was not in the public interest. However, the Commission ruled that a receipt should be issued for the ARCC prospectus.

The ARCC prospectus raised capital for the purpose of becoming listed on the ASE and identifying and exploring oil and gas participations. The shares were offered to the public at the same 5 cents per share price paid by the promoters for seed capital. The management of ARCC and the public investors were on an equal cost basis. There was therefore no dilution and the Commission imposed no escrow requirement. From ARCC's perspective, this was a very inexpensive method of accessing the capital market.

The Director, however, remained concerned about the commitment of promoters of blind pools and about the lack of escrow requirements. Therefore, the Director subsequently (May, 1986) advanced this concern to the Commission. The Commission supported the Director's ruling that the shares of the three blind pool companies owned by promoters be escrowed.

Following this precedent and a series of public meetings, moratoriums, and discussions, a new policy was formulated in May, 1987. According to the new policy, blind pools were no longer permitted. The name of the Policy was changed from blind pool to Junior Capital Pool Offerings. This amendment stated that blind pool offerings in the form of the ARCC prospectus were no longer permitted. The new policy reflected the following significant changes:

- A JCP company was not permitted to acquire properties or businesses located outside of Canada. This change was to minimize the risk of off-shore schemes and to assist in any future enforcement actions.
- A restriction was placed on trading between the date of the receipt for the preliminary prospectus and the time that the shares were posted for trading on the ASE. This change ensured that all trading would occur on a regulated stock exchange and accordingly be subject to policing by a self regulatory organization.
- A registered dealer was required to sponsor each prospectus. Investors would have the benefit of the due diligence review by the dealers as well as the "know your client" rules that govern brokerage sales.
- Rules were established to govern the release of founders' shares from escrow. This step helps ensure that the promoter(s) remained committed to

the success and development of the company.

- A second phase of the Program was established by which an Information Circular was required with respect to any Major Transaction. The circular was to be reviewed by the ASE and a shareholder vote was required to approve that Major Transaction.

The Program can be broken down into two distinct phases. The first phase is the clearing of a prospectus with the Commission to raise a small amount of money (usually \$100,000) for the purposes of identifying and evaluating a "Major Transaction." The second phase consists of clearing an Information Circular with the ASE. This Information Circular provides information related to the Major Transaction. The ASE requires that the Major Transaction be completed within 18 months of the shares being listed on the ASE.

As a result of the requirement for an Information Circular, the ASE review process, and the shareholder vote, the costs associated with accessing the capital markets increased over those associated with a blind pool. However, the change in Policy to the junior capital pool concept better addressed the need for investor protection. These steps fostered full, true, and plain disclosure concerning the Major Transaction and gave the shareholders ultimate say in the acceptance of the Major Transaction.

In summary, under the current regulations, the founders of the firm must make a minimum cash investment of \$100,000 in the shares of the firm. The firm can then make a JCP IPO on the Alberta Stock Exchange by selling additional shares to the public. The JCP listing differs from a regular Alberta Stock Exchange listing in that it is transitory. The listing expires within 18 months unless the firm makes a "major transaction". A major transaction is usually the acquisition of a significant asset purchase. A further offering of shares through the JCP market finances the major transaction. Once a major transaction is completed, the firm's listing status changes from a JCP to a regular listing on the ASE. Firms that fail to complete a major transaction within the 18-month window may lose their listing.

The Alberta Stock Exchange, in enacting the JCP concept, has established a variety of regulations designed to protect public investors. These include escrow requirements that forbid the founders of the JCP firm to trade until the initial listing, and a provision whereby only one third of the escrowed shares may trade annually for the subsequent three-year period. In addition, the exchange places requirements on the firm for complete and timely disclosure.

IMPACTS OF ALBERTA'S JUNIOR CAPITAL POOLS: THE 1992 ASE STUDY

The explicit objective of Alberta's Junior Capital Pool program is to provide junior start-up companies with "an enhanced opportunity to become listed on the Alberta Stock Exchange".¹⁸ The first evaluation of the JCP program was conducted by the Alberta Stock Exchange (ASE, 1992). It concluded, "the ASE, the brokerage industry, the Professional Advisors, and the investors have all experienced positive results from the Program." The specific findings included the following.

¹⁸ Alberta Stock Exchange Circular No. 7, p. 7-1.

BENEFITS TO BUSINESSES.

By the end of 1990, 397 JCP prospectus had been filed (of which 13 did not proceed to an offering). Of the 384 offerings,

- 273 (71%) companies were active and listed when the study as at the end of 1990.
- 4 JCP companies had changed listing from the ASE to the Vancouver Stock Exchange, 13 were listed on the Toronto Stock Exchange and 2 were listed on the Montreal Stock Exchange.
- 1 JCP company was inter-listed on NASDAQ and another NASDAQ inter-listing was pending.

Sixty-four JCP companies (16%) had been de-listed and 46 (13%) companies were suspended at the time the research was conducted. The suspensions were temporary; when resolved they typically resulted in the company either being de-listed or re-activated for trading. JCP companies had been de-listed for the following reasons:

- Failure to maintain the ASE minimum listing requirements which govern number of shareholders and capital - 33 cases (51% of delistings).
- At the request of the company - 12 cases (19% of delistings).
- Failure to complete a Major Transaction within the ASE 18 month time limit - 7 cases (11% of delistings).
- 5% of JCP companies completed a Major Transaction within six months of listing,
 - 45% required up to 18 months, and
 - 50% required more than 18 months or had not completed a Major Transaction at the time the research was completed.
- The initial prospectus offerings under the first phase of the Program raised \$40 million from retail investors.

BENEFITS TO INVESTORS

The report concluded that while some investors suffered losses, most public investors who purchased shares at the time of listing had an opportunity to sell their shares at a profit. Perhaps what is surprising is that losses were not more frequent given the small initial investment and the well-known high-risk nature of JCP companies.

- 74% of JCP companies had traded at an average price in excess of the prospectus offering price;

- 26% JCP companies had traded at an average price below the prospectus offering price.

It is not clear, however, whether these price changes occurred due to underpricing immediately following issue of the securities or whether they reflected subsequent secondary trading. If the former, it is not necessarily true that investors would have had the opportunity to trade at a profit.

BENEFITS TO THE ALBERTA STOCK EXCHANGE

As of December 31, 1990 there were 742 listed companies as compared to 396 at December 31, 1985. This 87% increase is largely attributable to the JCP Program and involves significant fee income to the ASE. JCP companies accounted for 37% of the companies listed on the ASE

BENEFITS TO INTERMEDIARIES

- Brokers earned \$1.2 million in underwriting commissions on the initial prospectus offerings.
- Underwriters made additional earnings from the options granted to them by the JCP companies at the time of the initial prospectus offering and continue to make commissions as a result of the secondary trading of JCP shares on the ASE.
- Professional Advisors earned an estimated \$6 million from the initial prospectus offerings, representing 14% of the gross proceeds raised from those offerings. Professional Advisors have also earned significant fees from the Information Circulars filed with the ASE and from their ongoing relationship with the JCP companies.

IMPACT ON SECURITY COMMISSION

The Program increased the workload of the Commission as a result of preliminary prospectus filings, escrow applications, exemption applications and enforcement actions.

- Since the inception of the Program 16% of all preliminary prospectuses filed with the Commission have related to the Program.
- Since 1986, approximately 20% of all enforcement orders of the Act have related to JCP companies or their directors and officers. In 1989 and 1990 this rate was about 30%.
- The majority of the enforcement actions relating to the Program dealt with the failure by JCP companies to comply with the continuous disclosure requirements of the Act and the ASE minimum listing requirements. The quantity of these enforcement actions has been increasing since 1989. This trend suggests that there is an increasing number of JCP companies that are not sufficiently mature, well capitalized or well managed to cope with the burden of being public. In addition, the mechanisms by which these junior companies can access additional working capital are limited.

- The overall costs of regulating the Program by the Commission have exceeded filing fee revenues it generated.

IMPACTS OF ALBERTA'S JUNIOR CAPITAL POOLS: THE ROBINSON STUDY

These generally positive experiences with the JCP program were echoed by research subsequently conducted by Robinson (1997). He found that:

- more than \$77 million was raised in 405 JCP IPOs between 1986 and 1992;
- JCP firms have raised more than \$475 million by means of post-IPO issues between 1986 and 1992;
- almost 86 percent of firms that used the JCP to go public between 1986 and 1992 had completed a major transaction by the end of 1992.

Notwithstanding these results, use of JCPs appears to have decreased during the 1988-1992 period as compared with the 1986-87 period. . The 1992 report of the ASE noted that of the 394 JCPs registered from inception of the plan until December 1990 only 20 were registered during 1989 and 1990. From Robinson's work, it may be surmised that only 21 JCPs appear to have been registered during 1991 and 1992. In view of the studies that seem to document the success of the JCP program, a further examination of the use and effectiveness of the JCP mechanism seems to be in order. The work should update these early studies and identify why interest in the program appears to have waned during the 1989-1992 period and whether or not this decrease has continued after the economy had turned around.

Catteneo (1999) identifies several potential shortcomings of programs such as JCPs. These include "the high costs of launching and then maintaining a public listing, difficulty in raising further funds, lack of support from investment houses after the initial JCP offering, and lack of liquidity". These seem to be issues that need further investigation.

SUMMARY AND POSSIBLE NEXT STEPS

This report summarizes a review of the professional and academic research literature that pertains to the North American context for sales of equity to the public markets for SMEs. It reviewed the recent legislative and regulatory developments of securities laws in both Canada and the US as these laws pertain to SMEs. The work reported on research on the efficacy of SCOR issues in the US and JCP issues in Canada.

This review of the literature has identified several gaps that need to be addressed.

- Early indications are that SCORs may not be as effective as might have been expected in terms of raising early-stage equity capital. A more comprehensive and up-to-date investigation of the efficacy of SCORs is required. The work should also examine the impacts on efficacy of: diversity in states' Blue Sky laws; the quantity of local venture capital; and other

factors. Identification of best practices would also be a useful contribution of such a study. This work may be impeded because, aside from the brief Form D's submitted to the SEC, there is no central registry of SCOR issuers in the US.

- Additional information is required regarding the details of regulatory changes that would be required to implement a SCOR process in the Canadian setting.

Parallel information is required regarding the Canadian setting.

- An updated assessment of the JCP program seems warranted. The 1988-1992 period witnessed very few new JCP issues. It seems useful to determine whether or not this pattern has continued and, if so, why so few issuers are using the JCP vehicle. Thus, research should review recent usage of the program, the effectiveness of the JCP process, liquidity of JCP shares, and the depth of the markets for junior issues.
- Additional information is required regarding regulatory changes that would be required to implement a wider JCP-type market in Canada. This would usefully include an assessment of the current status of the recommendations advanced by the McCallum (OSC Task Force) recommendations?

Finally, it is necessary to evaluate steps necessary for harmonization of securities regulations. It seems unusual that while NASAA (which includes Canadian regulators) adopted Form U-7, its usage does not seem to be being promulgated in any Canadian setting. With financial markets becoming increasingly desegregated, national and international harmonization of securities laws seems advisable.

A variety of review bodies have emphasized the need to facilitate access for equity capital for growing SMEs. This report has identified two vehicles (SCORs and JCPs) that are potential means of addressing this need. To address these issues more fully, three further research studies seem well-advised.

TOPICS FOR FURTHER RESEARCH

1. THE STATUS OF REGULATORY REFORM IN CANADA

Implementation of either SCOR-type processes or extension of JCPs beyond the Alberta setting must involve regulatory reform. It seems essential that such reform be harmonized across provincial jurisdictions (and perhaps with US laws) and that an appropriate balance of full disclosure and cost-effectiveness be obtained. Rousseau, working with MacIntosh, (1999) has reviewed these issues in depth as they relate to the Ontario context. Three research questions are implied for this study:

1. What legislative and regulatory changes would be required to implement SCORs or JCPs in each of the Canadian jurisdictions?
2. What mechanisms might be employed to harmonize such changes?

3. What is the status of the McCallum report? (This aspect may best be investigated through high level, perhaps ministerial, involvement.)

Virtually all of the Ontario groundwork for such work has been established in the various works of MacIntosh (1994, 1994a) and the OSC Task Force on Small Business Financing (1996). To the extent that the Securities Acts of other provinces are based on the Ontario Securities Act, this would not appear to be an extensive study and could be completed in a short time. The issues are straightforward and, to some extent, have been investigated. In view of the potential reorganization of securities markets in Canada and the recognized need to facilitate SMEs' access to public sources of capital, this work would seem to be timely and valuable.

2. AN UPDATE ON THE EFFECTIVENESS OF JCPS:

The most recent study of JCPs located by this work reviewed listings as at the end of 1992. Further work seems justified to:

1. Update the findings of the ASE (1992) and Robinson (1997) to determine if JCPs continue to be as effective as these studies suggest.
2. Extend the previous studies to assess specific questions related to the depth of the secondary markets for JCPs. In particular, such work would investigate trading frequencies and trading patterns of JCP listings, underpricing, secondary trading, and effectiveness. Such work might usefully be extended to any issues similar in spirit to JCPs on either the Vancouver or Winnipeg exchanges.
3. Examine the degree of regulatory oversight, investigation, and enforcement related to JCPs and the extent of fraudulent activity, if any.
4. Review the (so far) differing parameters of Alberta's JCPs, Vancouver's fledgling venture capital pool program, and Winnipeg's "Keystone Companies" initiative. A priori assessments of the rationale behind differences in the design of these programs and how such differences might relate to effectiveness should also be undertaken.
5. Assess the costs of establishing and maintaining a public listing, the ability of JCP firms to raise further funds, the degree of support from investment bankers, and the role of sector and region in the success of JCPs.

This work would be an empirical study involving significant data gathering and analysis. Data gathering would require several weeks of research assistance and analysis. Costs associated with purchase of data may also be involved. Time requirements would, of course, depend on the degree to which the JCP program has been used in recent years. Preliminary estimates would suggest a maximum of 40 person-days of research assistance and approximately 15 days of primary investigator time, over an elapsed time of approximately 90 days.

3. EFFECTIVENESS OF SCORS: A PILOT STUDY

The findings Osteryoung and his colleagues (1995) strongly suggest the need to review the effectiveness of SCORs as a means of raising capital. The difficulty of undertaking such work is underscored by the following extract from e-mail correspondence from John Blease, a Ph. D. student at the University of Oregon who has been studying SCORs. According to Blease:

This topic may not be the most prudent choice for a dissertation topic due data problems. However (my supervisor and I) both agree that the topic warrants future research and as such I am continuing my work in the area as time permits. There are three primary sources of data that are of interest to me and that I believe will speak to your research as well: the filing document (U-7), the amount ultimately raised, and the applicable Blue Sky laws. To date I have had limited success in obtaining U-7s. Each state acts as its own clearinghouse for these documents and the accompanying financials. I have contacted all 47 states that accept the SCOR documents as well as Puerto Rico and DC, and have received some information from 20 in response. Of those that have responded, some (Oregon, Kentucky, Conn., and Maine) have been very forthcoming with how to obtain copies of the documents (Kentucky provided them gratis). The others tend to acknowledge that they do handle the documents, but through either prohibitive copy costs (Nebraska charges \$2.50/page) or through overt statements such as "it is not feasible to make copies of all of these documents" their unwillingness has been clearly signaled. In and of itself, I do not necessarily consider this an insurmountable barrier, but it is a concern. In addition, only Washington appears to keep a fairly detailed history of each offer.

This experience suggests both the need to study further the impact and usefulness of SCORs and the problems inherent in undertaking a comprehensive review. Accordingly, it seems reasonable to proceed through a pilot project that focuses on the SCOR-related experiences in selected states. Blease's comments provide initial indications of states that might usefully be contacted.

The study could usefully address the following issues, among others:

1. Analysis of the overall effectiveness of SCORs as a vehicle for SME financing.
2. The extent of SCOR usage across selected states with reference to the nature of the regulatory settings of each state. For example, the work might examine whether or not SCORs are used more frequently and are they more or less effectively in Merit states than in Non-Merit states?
3. Identification of best practices with respect to SCOR usage.
4. The experiences of state regulators with respect to SCORs and the need for investigation, oversight, and review.

This study would seem to be of at least as much importance to policy makers in the US as to Canadian counterparts. The work involved would be primarily data gathering and analysis and the extent of such work would clearly depend on the number of states selected and which states would be involved. Such a study could, of course, be facilitated through involvement of US counterparts both at the operational level (e.g., Blease) and at the policy level (e.g., SBA, NFIB, etc.). Preliminary estimates would suggest a maximum of 60 person-days of research assistance

and approximately 15 days of primary investigator time, over an elapsed time of approximately 120 days.

REFERENCES

Amit, R., MacCrimmon, K. and Oesch, J. (1996) The decision to start a new venture: values, beliefs and alternatives. Presentation to the Babson-Kauffman Foundation Conference, Seattle, Washington.

ASE, (1992). Assessment of the JCP Program. Alberta Stock Exchange.

Arend, R., R. Amit, J. Brander, K. Hendricks, T. Ross, D. Whistler (1997). "The Market for Entrepreneurship: Theory and Empirical Evidence, Entrepreneurship, Proceedings of the Administrative Sciences Association of Canada, Vol 18, No. 21, St. John's, NFLD: 12-20.

Andrews, M., (1995). Initial Public Offerings: The Experience of Eight Canadian Growth Companies, The Conference Board of Canada, Ottawa.

Birch, D. (1979). The Job Generation Process, MIT Program on Neighborhood and Regional Change, Cambridge, Mass.

Blease, John. (1999) Correspondence.

Brill, Jack and Hal. (1995). "Along the Way to Going Public," Business, January/February.

Catteneo, C., National Post, January 7, 1999.

CBA [Canadian Bankers Association], (1996, 1997, 1998a), Small and Medium Sized Businesses in Canada: Their Perspective of Financial Institutions and Access to Financing, Canadian Bankers Association, Toronto, ON.

CBA (1998). Small Businesses in Ontario: An Assessment of Access to Capital, Canadian Bankers Association, Toronto, ON.

Cohen, Mark. (1995). "Small Firms Given Chance to See Shares Get Traded," Contra Costa Times Business, April 25.

Jog, Vijay (1997). "The Climate for Canadian Initial Public Offerings", in Capital Market Issues, P. Halpern, ed., Ottawa: Industry Canada.

Levine, Daniel S. (1994) "Small-Company Stocks Could SCOR Big at PSE," San Francisco Business Times, Week of October 28 - November 3.

MacIntosh, J. (1994). Legal and Institutional Barriers to Financing Innovative Enterprises in Canada, Government and Competitiveness School of Policy Studies, Queens University, Kingston, Ontario.

MacIntosh, J. (1994a). "Regulatory Barriers to Raising Capital for Small Firms", Canadian Financial Services Alert, Vol. 6 (8): 57-64.

National Venture Capital Association, 1994 Annual Review. Prepared by. Venture Economics

Investor Services.

Ontario Securities Commission (1996). Task Force on Small Business Financing, Final Report, Toronto.

Osteryoung, J., J. Brau, J. Kerr (1995). "An Empirical Investigation of SCORs (Small Corporate Offering Registrations): Do Geographical Region and Amount Offered Affect the Success of Offerings?" presented to the Babson Entrepreneurship Research Conference, Seattle.

Parliamentary Standing Committee on Industry, Taking Care of Small Business, Second Report, Government of Canada, Ottawa, 1994.

Petersen, R. and Shulman, J. (1987). "Capital Structure of Growing Small Firms: A 12-Country Study on Becoming Bankable", National Centre for Management Research and Development, Working Paper Series #87-06. School of Business Administration, the University of Western Ontario, London, Ontario.

Picot, G., Baldwin, J. and P. Dupuy (1996). "Job Creation by Company Size Class: Concentration and Persistence of Job Gains and Losses in Canadian Companies", Business and Labour Market Analysis Group, Statistics Canada, Ottawa, ON.

PSE (1995). "Pacific Stock Exchange Receives SEC Approval to Trade Small Business Securities: California State Officials Praise PSE's SCOR Marketplace," PSE News Release, April 20.

Perkins, John (1998). "Promoting a Registered SCOR Offering on the Internet", <http://ibchannel.com/dpo/scormain.htm>.

PSE (1995). "SCOR Marketplace for the trading of Small Corporate Offering Registration and Regulation A Securities", Pacific Stock Exchange, September.

Robinson M., (1997). "Raising Equity Capital for Small and Medium Sized Enterprises Using Canada's Public Equity Markets", in Capital Market Issues, P. Halpern, ed., Industry Canada.

Sargent, M. (1990). "Blue Sky Law: The SCOR Solution", Securities Regulation Law Journal, Vol. 18 (1): 93-102.

Scor-Net Internet Document, <http://www.scor-net.com>.

Smith, Brad. "Free Enterprise Advocates Must Work to Make the SCOR Produce Equity for Small Business," in the Scor-Net Internet Document, <http://www.scor-net.com/homepage/pubpol.htm>.

Srivastava, A. (1993), "Price Discounts on Equity Private Placements", Carleton University Working Paper 93-11.

Timmons, Jeffry A. (1994) New Venture Creation: Entrepreneurship for the 21st Century. Boston: Irwin.

APPENDIX A

The following is extracted verbatim from <http://ibchannel.com/dpo/scormain.htm>.

PROMOTING A REGISTERED SCOR OFFERING ON THE INTERNET

by
John Perkins, Esq.

The increasing number of users of the Internet has led several individuals and companies to consider using the Internet to promote their securities offerings. Such use has raised questions regarding the application of state securities laws to offers made on the Internet. In order to address these questions, the North American Securities Administrators Association (NASAA) created a committee to address these issues. That committee recommended a resolution to the NASAA membership, which was adopted at its recent Winter Meeting in Hilton Head, South Carolina.

The resolution is based upon a position taken by the state of Pennsylvania last year. It encourages states to exempt the offer of a security on the Internet when two conditions are met. One, the offer on the Internet indicates, directly or indirectly, that the securities are not being offered to residents of a specified state or states. Two, an offer is not otherwise directed to any person in a state by, or on the behalf of an issuer of securities.

In simple language, if the offering on the Internet indicates which states the offer is valid in, or the states in which the offer is not made, the offering will be exempt as long as no other material or information regarding the offering is sent into the state. If a person in a state where the offering is not registered requests information about the offering, the issuer or their representative must respond that the security is not registered in that state, and no information may be sent by E-mail, mailed by regular mail, or responded to with a telephone call providing information about the offering.

However, there is nothing to prevent the company from maintaining a list of persons responding, and making a decision about whether to file for registration in a particular state on the basis of responses to the Internet offer.

The most important fact to remember is that information about the security can be placed on the Internet only after the security is registered in some state. The mere filing of the security offering does not allow the posting of information to the Internet. You must have a registration from a state. When a posting is made to the Internet, it must set forth the states in which the offering is registered or that the offer is not being made in certain particular states.

In addition, the resolution encourages states to allow sales pursuant to offers on the Internet, when either the sales occur after the offering is registered and the final prospectus or U-7 has been delivered to the investor or when the sale is exempt from registration under the state's law.

As with all actions of NASAA it is important to remember that this resolution is not binding upon a particular state; however, it suggests that this is the position that will be taken by all NASAA's jurisdictions. If a person is planning on making an offer of a SCOR filing on the Internet, it would

be wise to check with the states in which registration is sought to see if they will follow the NASAA resolution.

APPENDIX B

SCOR Instructions (general) and Form U-7

SMALL CORPORATE OFFERING REGISTRATION FORM

Form U-7as adopted by NASAA on April 29, 1989

Instructions For Use of Form U-7

(Not Part of Disclosure Document)

I. Introduction

Form U-7 has been developed pursuant to the Small Business Investment Incentive Act of 1980 (now contained in Section 19 of the Securities Act of 1933) which prescribes State and Federal cooperation in furtherance of the policies expressed in that Act of a substantial reduction in costs and paperwork to diminish the burden of raising investment capital, particularly by small business, and a minimum interference with the business of capital formation.

Form U-7 is the general registration form for corporations registering under state securities laws securities that are exempt from registration with the Securities and Exchange Commission (the "SEC") under Rule 504 of Regulation D. It is designed to be used by Companies, the attorneys and accountants for which are not necessarily specialists in securities regulation.

Historically, state legislatures have generally followed two approaches to the regulation of public offerings of securities such as those made under Form U-7. Some states deal solely with the disclosure made to investors. In addition to disclosure, other states also apply substantive fairness standards to public offerings in order to assure that the terms and structure of the offering are fair to investors. In particular, those standards are designed to require the promoters of the enterprise to share its potential risks and rewards fairly with the public investors. Those standards vary from state to state and as a general rule must be complied with by a Company in order to register its securities in those states.

You may anticipate receiving comments from examiners in many of the states in which Form U-7 registration is sought. Depending upon the regulatory approach taken by the state, those comments may be limited to requests for disclosure of additional information or may also require that certain terms of the offering be modified to comply with the state's substantive fairness criteria. Failure to resolve outstanding comments can lead to denial of an application for registration.

A Company, prior to using Form U-7, may wish to contact the staff of the securities administrator of each state in which the offering is to be filed to review applicable substantive fairness standards. It may be possible to arrange a prefiling conference with the administrator's staff. The states that apply such standards may identify those standards in an appendix to these instructions or may use other means to make them available.

II. Qualification for Use of Form

To be eligible to use Form U-7, a Company must comply with each of the following requirements.

A. The Company must be a corporation organized under the laws of one of the states or possessions of the United States which engages in or proposes to engage in a business other than

petroleum exploration or production or mining or other extractive industries. "Blind pool" offerings and other offerings for which the specific business or properties cannot now be described are ineligible to use Form U-7.

B. The securities may be offered and sold only on behalf of the Company, and Form U-7 may not be used by any selling security-holder (including purchasing underwriters in a firm commitment underwriting) to register his securities for resale.

C. The offering price for common stock (and the exercise price, if the securities are options, warrants or rights for, and the conversion price if the securities are convertible into, common stock) must be equal to or greater than \$5.00 per share. By execution of the application and filing of the U-7 in any state, the Company thereby agrees with the Administrator that the Company will not split its common stock, or declare a stock dividend, for two years after effectiveness of the registration; provided, however, that in connection with a subsequent registered public offering, the Company may upon application and consent of the administrator take such action.

D. The Company may engage selling agents to sell the securities. Commissions, fees, or other remuneration for soliciting any prospective purchaser in this state in connection with this offering may only be paid to persons who, if required to be registered, the Company believes, and has reason to believe, are appropriately registered in this state.

E. This form shall not be available for the securities of any Company if the Company or any of its Officers, Directors, 10% stockholders, promoters or any selling agents of the securities to be offered, or any officer, director or partner of such selling agent: (i) has filed a registration statement which is the subject of a currently effective registration stop order entered pursuant to any state's securities law within five years prior to the filing of the application for registration hereunder; (ii) has been convicted within five years prior to the filing of the application for registration hereunder of any felony or misdemeanor in connection with the offer, purchase or sale of any security or any felony involving fraud or deceit, including, but not limited to, forgery, embezzlement, obtaining money under false pretenses, larceny, or conspiracy to defraud; (iii) is currently subject to any state administrative enforcement order or judgment entered by that state's securities administrator within five years prior to the filing of the application for registration hereunder or is subject to any state's administrative enforcement order or judgment in which fraud or deceit, including but not limited to making untrue statements of material facts and omitting to state material facts, was found and the order or judgment was entered within five years prior to the filing of the application for registration hereunder; (iv) is subject to any state's administrative enforcement order or judgment which prohibits, denies, or revokes the use of any exemption from registration in connection with this offer, purchase, or sale of securities; (v) is currently subject to any order, judgment, or decree of any court of competent jurisdiction temporarily or preliminarily restricting or enjoining, or is subject to any order, judgment or decree of any court of competent jurisdiction, permanently restraining or enjoining, such party from engaging in or continuing any conduct of practice in connection with the purchase or sale of any security or involving the making of any false filing with the state entered within five years prior to the filing of the application for registration hereunder; (vi) the prohibitions of paragraphs (i) - (iii) and (v) above shall not apply if the person subject to the disqualification is duly licensed or registered to conduct securities related business in the state in which the administrative order or judgment was entered against such person or if the broker-dealer employing such party is licensed or registered in this state and the Form B-D filed with this state discloses the order, conviction, judgment, or decree relating to such person. No person disqualified under this subsection may act in a capacity other than that for which the person is licensed or registered; and (vii) any disqualification caused by this section is automatically waived if the state securities administrator or agency of the state which created the basis for disqualification

determines upon a showing of good cause that it is not necessary under the circumstances that registration be denied.

If any of the circumstances in clauses (ii), (iii) or (v) of the preceding paragraph has occurred more than five years from the date of the application for registration hereunder, these circumstances should be described in response to Question 45 as a Miscellaneous Factor.

F. Use of the Form is available to any offering of securities by a Company, the aggregate offering price of which within or outside this state shall not exceed \$1,000,000, less the aggregate offering price for all securities sold within the twelve months before the start of, and during the offering of, the securities under SEC Rule 504 in reliance on any exemption under section 3(b) of the Securities Act of 1933 or in violation of section 5(a) of that act. The Form is not available to a Company that is an investment company (including mutual funds) or is subject to the reporting requirements of 13 or 15(d) of the Securities Exchange Act of 1934.

G. The Company shall file with the SEC a Form D of Regulation D under the Securities Act of 1933 claiming exemption of the offering from registration under such act pursuant to Rule 504. A copy of the Form D with appropriate state signature pages shall be filed with the administrator at the same time as filed with the SEC.

III. General Requirements For Use of Form

A. The Form U-7 when properly filled in, signed and submitted, together with the exhibits scheduled below and a Form U-1 Uniform Application to Register Securities, constitutes an application for registration for the states listed at the bottom of the cover page of the Form. There should be filed with each state there listed a signed original of the Form, together with an executed Form U-1 and a signed original of the consent to service of process constituting Exhibit 7. Any references in the Form U-1 to SEC registration and effectiveness should be disregarded and Questions 6 and 8(a) of the Form U-1 are inapplicable. The Form U-1 should set forth the amount of securities being registered in that state and the method of calculating the filing fee, and there should be enclosed a check for the amount of the filing fee. Each state must separately declare the registration effective by an order to that effect unless that state has some other procedure applicable to registration on Form U-7. Once registration is effective as to a given state, the effective date should be noted at the bottom of the cover page of the Form. Any changed or revised Disclosure Document must also be signed.

B. Each question in each paragraph of the Form should be responded to. If the question or series of questions is inapplicable, so indicate. Each answer should be clearly and concisely stated and in the space provided; however, notwithstanding the specificity of the questions, responses should not involve nominal, immaterial or insignificant information.

C. If the provided space is insufficient, additional space should be created by cutting and pasting the Form to add more lines or by putting the Form on a word processor and adding more lines in this or a similar manner. Irrespective of which method is used, care should be taken to assure that the Form is accurately and completely reproduced. Smaller type size should not be used, and script or italic type styles should be avoided.

D. There must be submitted to the administrator an opinion of an attorney licensed to practice in a state or territory of the United States that the securities to be sold in the offering have been duly authorized and when issued upon payment of the offering price will be legally and validly issued, fully

paid and nonassessable and binding on the Company in accordance with their terms.

E. The Disclosure Document on Form U-7 constitutes the offering circular or prospectus and the Form once filled out, filed and declared effective may be reproduced by the Company by copy machine or otherwise for dissemination to potential investors. (The Company is cautioned to control the copying and distribution to preclude inaccurate or unreadable copies from being used and to prevent other unauthorized uses for which the Company may nevertheless be deemed responsible.) These Instructions are not part of the Disclosure Document and should not be included. Reproduced copies should be on white paper and should be stapled or secured in the left margin without a cover of any type.

F. The Company should expect that the office of the administrator may have comments and questions concerning the answers set forth on the Form and that changes may be required to be made to the answers before the registration is declared effective. Comments and questions may either be included in a letter or made by telephone communication initiated by the office of the administrator in response to the filing.

G. No offers or sales may be made in this state until the registration has been declared effective by the administrator. To make offers or sales before the registration is effective could lead to a stop order or other proceeding which would preclude use of the Form in this or any other state and could give rise to a right of rescission by investors enforceable against management, principal stockholders and the selling agents as well as the Company. When the registration has been declared effective in this state, offers and sales may be made in this state even though registration in other states has not been declared effective. This Disclosure Document must be delivered to each investor before the sale is made, e.g. (a) before any order is entered; (b) any subscription agreement is signed; or (c) any part of the purchase price is received. The registration statement will be effective only for the same time period specified in the order of the administrator, which may be different for different states; however, no registration statement shall remain effective in a particular state for a period greater than one year.

H. After the registration has been declared effective, and while the offering is still in progress, if any portion of the Form should need to be changed or revised because of a material event concerning the Company or the offering to make it accurate and complete, it shall be so changed, revised, or supplemented. If changed, revised or supplemented, (including an addition on the cover page of another state in which the offering has been registered) the Form as so changed, revised or supplemented, clearly marked to show changes from the previously filed version, should be filed and cleared with the administrator of this state before use. If any of the changes or revisions are of such significance that they are material to the making of an investment decision by an investor, and if the minimum proceeds have not been raised, after filing with and clearance by the administrator, the Disclosure Document on this Form as so changed, revised or supplemented should be recirculated to persons in this state that have previously subscribed, and they should be given the opportunity to rescind or reconfirm their investment.

I. Options, warrants and similar rights to purchase securities constitute a continuous offering of the underlying securities during the exercise period and require the securities to be registered and the Disclosure Document to be kept continuously current throughout the exercise period through the use of the above amendment procedure or by means of a supplement, as appropriate. Upon any change, revision or supplement to the Disclosure Document, a copy must be promptly furnished to the holders of options, warrants and similar rights.

J. Any and all supplemental selling literature or advertisements announcing the offering should be

filed by the Company and cleared with the securities administrator of each state prior to publication or circulation within that state. An announcement should not be a sales motivation device and should normally contain no more than the following: (1) the name of the Company, (2) characterization of the Company as indicated on the Cover Page of the Disclosure Document, (3) address and telephone number of the Company, (4) a brief indication in ten words or less of the Company's business or proposed business, (5) the number and type of securities offered and the offering price per security, (6) the name, address and telephone number of any selling agent authorized to sell the securities, (7) a statement that the announcement does not constitute an offer to sell or solicitation of an offer to purchase and that any such offer must be made by official Disclosure Document, (8) how a copy of the Disclosure Document may be obtained, and (9) the Company's corporate logo. Clip and return coupons requesting a copy of the Disclosure Document are permitted in printed announcements. (For example, an announcement in "tombstone" format with a black-lined border and using the following language would ordinarily be acceptable: "50,000 shares, common stock; \$5 per share; (Logo) XYZ Corporation, a development stage database computer software company now conducting operations; Midtown, Ohio; Selling agent: ABC Securities, 1234 Main Street, Midtown, Ohio, (321) 123-4567; This announcement does not constitute an offer to sell or the solicitation of an offer to buy the securities, which offer may be made only by means of an official Disclosure Document; A copy of the Disclosure Document may be obtained by contacting the selling agent at the above address and telephone number." Similarly, a classified advertisement using the following language would ordinarily be acceptable: "Common stock of XYZ Corporation, a development stage database computer software company now conducting operations, Midtown, Ohio. Price \$5 per share. Total offering 50,000 shares. This announcement does not constitute an offer to sell or the solicitation of an offer to buy the securities, which offer may be made only by means of an official Disclosure Document. A copy of the Disclosure Document may be obtained by contacting the Company, Industrial Park, Suite 12B, 456 Mill Road, Midtown, Ohio, (321) 321-4321.")

The issuance of any but routine press releases or the granting of interviews to news media during, or at about the same time of, an offering could constitute indirect advertising, which if not precleared with the securities administrator would be prohibited. Any unusual news article or news program featuring the Company during this period, particularly if present or future earnings, or the pending offering, are mentioned, could delay or cause suspension of the effectiveness of the registration and disrupt the offering. Consequently any such news article or news program, no matter by whom it may be initiated, should generally be discouraged during this period.

IV. Instructions as to Specific Captions and Questions

BE VERY CAREFUL AND PRECISE IN ANSWERING ALL QUESTIONS. GIVE FULL AND COMPLETE ANSWERS SO THAT THEY ARE NOT MISLEADING UNDER THE CIRCUMSTANCES INVOLVED. DO NOT DISCUSS ANY FUTURE PERFORMANCE OR OTHER ANTICIPATED EVENT UNLESS YOU HAVE A REASONABLE BASIS TO BELIEVE THAT IT WILL ACTUALLY OCCUR WITHIN THE FORSEEABLE FUTURE. IF ANY ANSWER REQUIRING SIGNIFICANT INFORMATION IS MATERIALLY INACCURATE, INCOMPLETE OR MISLEADING, THE COMPANY, ITS MANAGEMENT AND PRINCIPAL STOCKHOLDERS MAY HAVE LIABILITY TO INVESTORS. THE SELLING AGENTS SHOULD EXERCISE APPROPRIATE DILIGENCE TO DETERMINE THAT NO SUCH INACCURACY OR INCOMPLETENESS HAS OCCURRED, OR THEY ALSO MAY BE LIABLE.

A. Cover Page. The Cover Page of the Disclosure Document is a summary of certain essential information and should be kept on one page if at all possible. For purposes of characterizing the

Company on the cover page, the term "development stage" has the same meaning as that set forth in Statement of Financial Accounting Standards No. 7 (June 1, 1975).

B. Risk Factors. The Company should avoid generalized statements and include only those factors which are unique to the Company. No specific number of risk factors is required to be identified. If more than 16 significant risk factors exist, add additional lines and number as appropriate. Risk factors may be due to such matters as cash flow and liquidity problems, inexperience of management in managing a business in the particular industry, dependence of the Company on an unproven product, absence of an existing market for the product (even though management may believe a need exists), absence of an operating history of the Company, absence of profitable operations in recent periods, an erratic financial history, the financial position of the Company, the nature of the business in which the Company is engaged or proposes to engage, conflicts of interest with management, arbitrary establishment of offering price, reliance on the efforts of a single individual, or absence of a trading market if a trading market is not expected to develop. Cross references should be made to the Questions where details of the risks are described.

C. Business and Properties. The inquiries under Business and Properties elicit information concerning the nature of the business of the Company and its properties. Make clear what aspects of the business are presently in operation and what aspects are planned to be in operation in the future. The description of principal properties should provide information which will reasonably inform investors as to the suitability, adequacy, productive capacity and extent of utilization of the facilities used in the enterprise. Detailed descriptions of the physical characteristics of the individual properties or legal descriptions by metes and bounds are not required and should not be given.

As to Question 4, if more than five events or milestones exist, add additional lines as necessary. A "milestone" is a significant point in the Company's development or an obstacle which the company must overcome in order to become profitable.

D. Offering Price Factors. Financial information in response to Questions 5, 6 and 7 should be consistent with the Financial Statements. Earnings per share for purposes of Question 5 should be calculated by dividing earnings for the last fiscal year by the weighted average of outstanding shares during that year. No calculations should be shown for periods of less than one year or if earnings are negative or nominal. For purposes of Question 8, the "offering price" of any options, warrants or rights or convertible securities in the offering is the respective exercise or conversion price.

E. Use of Proceeds. Use of net proceeds should be stated with a high degree of specificity. Suggested (but not mandatory) categories are: leases, rent, utilities, payroll (by position or type), purchase or lease of specific items of equipment or inventory, payment of notes, accounts payable, etc., marketing or advertising costs, taxes, consulting fees, permits, professional fees, insurance and supplies. Categories will vary depending on the Company's plans. Use of footnotes or other explanation is recommended where appropriate. Footnotes should be used to indicate those items of offering expenses that are estimates. Set forth in separate categories all payments which will be made immediately to the Company's executive officers, directors and promoters, indicating by footnote that these payments will be so made to such persons. If a substantial amount is allocated to working capital, set forth separate sub-categories for use of the funds in the Company's business.

If any substantial portion of the proceeds has not been allocated for particular purposes, a statement to that effect as one of the Use of Net Proceeds categories should be included together with a statement of the amount of proceeds not so allocated and a footnote explaining how the Company expects to employ such funds not so allocated.

F. Plan of Distribution. In Question 26 if the proposed business of the Company requires a minimum amount of proceeds to commence, or to proceed with, the business in the manner proposed, there shall be established an escrow with a bank or savings and loan association or other similar depository institution acting as independent escrow agent with which shall be immediately deposited all proceeds received from investors until the minimum amount of proceeds has been raised. Any failure to deposit funds promptly into the escrow shall be grounds for enforcement proceedings against the persons involved. The date at which the funds will be returned by the escrow agent if the minimum proceeds are not raised shall not be later than one year from the date of effectiveness of the registration in this state.

G. Capitalization. Capitalization should be shown as of a date no earlier than that of the most recent Financial Statements provided pursuant to Question 46. If the Company has mandatory redeemable preferred stock, include the amount thereof in "long term debt" and so indicate by footnote to that category in the capitalization table.

H. Officers and Key Personnel of the Company. The term "Chief Executive Officer" means the officer of the Company who has been delegated final authority by the board of directors to direct all aspects of the Company's affairs. The term "Chief Operating Officer" means the officer in charge of the actual day-to-day operations of the Company's business. The term "Chief Financial Officer" means the officer having accounting skills who is primarily in charge of assuring that the Company's financial books and records are properly kept and maintained and financial statements prepared.

The term "key personnel" means persons such as vice presidents, production managers, sales managers, or research scientists and similar persons, who are not included above, but who make or are expected to make significant contributions to the business of the Company, whether as employees, independent contractors, consultants or otherwise.

I. Principal Stockholders. If shares are held by family members, through corporations or partnerships, or otherwise in a manner that would allow a person to direct or control the voting of the shares (or share in such direction or control - as, for example, a co-trustee) they should be included as being "beneficially owned." An explanation of these circumstances should be set forth in a footnote to the "Number of Shares Now Held."

J. Management Relationships, Transactions and Remuneration. For purposes of Question 39(b), a person directly or indirectly controls an entity if he is part of the group that directs or is able to direct the entity's activities or affairs. A person is presumptively a member of a control group if he is an officer, director, general partner, trustee or beneficial owner of a 10% or greater interest in the entity. In Question 40, the term "Cash" should indicate salary, bonus, consulting fees, non-accountable expense accounts and the like. The column captioned "Other" should include the value of any options or securities given, any annuity, pension or retirement benefits, bonus or profit-sharing plans, and personal benefits (club memberships, company cars, insurance benefits not generally available to employees, etc.). The nature of these benefits should be explained in a footnote to this column.

K. Financial Statements. Attach to the Disclosure Document for the Company and its consolidated subsidiaries, a balance sheet as of the end of the most recent fiscal year. If the Company has been in existence for less than one fiscal year, attach a balance sheet as of the date within 135 days of the date of filing the registration statement. If the first effective date of state registration, as set forth on the Cover Page of this Disclosure Document, is within 45 days after the end of the Company's fiscal year and financial statements for the most recent fiscal year are not available, the balance sheet may be as of the end of the preceding fiscal year and there shall be included an additional balance sheet as of an interim date at least as current as the end of the Company's third fiscal quarter of the most recently

completed fiscal year. Also attach, for the Company and its consolidated subsidiaries and for its predecessors, statements of income and cash flows and statements of changes in stockholders' equity for the last fiscal year preceding the date of the most recent balance sheet being attached, or such shorter period as the Company (including predecessors) has been in existence. In addition, for any interim period between the latest reviewed or audited balance sheet and the date of the most recent interim balance sheet being attached, provide statements of income and cash flows. Financial statements shall be prepared in accordance with generally accepted accounting principles. If the Company has not conducted significant operations, statements of receipts and disbursements shall be included in lieu of statements of income. Interim financial statements may be unaudited. All other financial statements shall be audited by independent certified public accountants; provided, however, that if each of the following four conditions are met, such financial statements in lieu of being audited may be reviewed by independent certified public accountants in accordance with the Accounting and Review Service Standards promulgated by the American Institute of Certified Public Accountants: (a) the Company shall not have previously sold securities by means of an offering involving the general solicitation of prospective investors by means of advertising, mass mailings, public meetings, "cold call" telephone solicitation or any other method directed toward the public, (b) the Company has not been previously required under federal or state securities laws to provide audited financial statements in connection with any sale of its securities, (c) the aggregate amount of all previous sales of securities by the Company (exclusive of debt financings with banks and similar commercial lenders) shall not exceed \$1,000,000, and (d) the amount of the present offering does not exceed \$500,000.

If since the beginning of its last fiscal year the Company has acquired another business, provide a pro forma combined balance sheet as of the end of the fiscal year, and a pro forma combined statement of income as if the acquisition had occurred at the beginning of the Company's last fiscal year, if any of the following exists: (a) the investments in and advances to the acquired business by the Company and its subsidiaries' (other than the acquired business) exceeds 20% of the Company's assets on its consolidated balance sheet at the end of the Company's last fiscal year, (b) the Company's and its subsidiaries' (other than the acquired business') proportionate share of the total assets (after intercompany eliminations) of the acquired business exceeds 20% of the assets on the consolidated balance sheet, or (c) the Company's and its subsidiaries' (other than the acquired business') equity in income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle, of the acquired business exceeds 20% of such income of the Company and its consolidated subsidiaries for the Company's last fiscal year.

The financial statements should reflect all stock splits (including reverse stock splits), stock dividends and recapitalizations even if they have occurred since the date of the financial statements.

V. Exhibits

There shall be filed with the Administrator at the same time as the filing of the Form U-7 copies of each of the following documents to the extent applicable as exhibits to which the Administrator may refer in reviewing the Form U-7 and which will be available for public inspection by any person upon request.

1. Form of Selling Agency Agreement.
2. Company's Articles of Incorporation or other Charter documents and all amendments thereto.
3. Company's By-Laws, as amended to date.

4. Copy of any resolutions by directors setting forth terms and provisions of capital stock to be issued.
5. Any indenture, form of note or other contractual provision containing terms of notes or other debt, or of options, warrants or rights to be offered.
6. Specimen of security to be offered (including any legend restricting resale).
7. Consent to service of process (Form U-2) accompanied by appropriate corporate resolution (Form U-2A).
8. Copy of all advertising or other materials directed to or to be furnished investors in the offering.
9. Form of escrow agreement for escrow of proceeds.
10. Consent to inclusion in Disclosure Document of Accountant's report.
11. Consent to inclusion in Disclosure Document of Tax Advisor's opinion or description of tax consequences.
12. Consent to inclusion in Disclosure Document of any evaluation of litigation or administrative action by counsel.
13. Form of any Subscription Agreement for the purchase of securities in this offering.
14. Opinion of Counsel required in paragraph III. D. of these Instructions.
15. Schedule of residence street addresses of Officers, Directors and principal stockholders.
16. Work Sheets showing computations of responses to Questions 6, 7(a), 8(a), 8(b) and 17(b), using forms attached to these Instructions.

FORM U-7

DISCLOSURE DOCUMENT

(Exact name of Company as set forth in Articles of Incorporation or Charter)

Type of securities offered:

Maximum number of securities offered:

Minimum number of securities offered:

Price per security: \$

Total proceeds: If maximum sold: \$ If minimum sold: \$

(For use of proceeds and offering expenses, see Question Nos. 9 and 10)

Is a commissioned selling agent selling the securities in this offering? Yes No

If yes, what percent is commission of price to public? %.

Is there other compensation to selling agent(s)? Yes No

Is there a finder's fee or similar payment to any person? Yes No (See Question No. 22)
Is there an escrow of proceeds until minimum is obtained? Yes No (See Question No. 26)
Is this offering limited to members of a special group, such as employees of the Company or individuals?
 Yes No (See Question No. 25)

Is transfer of the securities restricted? Yes No (See Question No. 25)

INVESTMENT IN SMALL BUSINESSES INVOLVES A HIGH DEGREE OF RISK, AND INVESTORS SHOULD NOT INVEST ANY FUNDS IN THIS OFFERING UNLESS THEY CAN AFFORD TO LOSE THEIR INVESTMENT IN ITS ENTIRETY. SEE QUESTION NO. 2 FOR THE RISK FACTORS THAT MANAGEMENT BELIEVES PRESENT THE MOST SUBSTANTIAL RISKS TO AN INVESTOR IN THIS OFFERING.

IN MAKING AN INVESTMENT DECISION INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE ISSUER AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

This Company:

- Has never conducted operations.
 - Is in the development stage.
 - Is currently conducting operations.
 - Has shown a profit in the last fiscal year.
 - Other (Specify): _____
- (Check at least one, as appropriate)

This offering has been registered for offer and sale in the following states:

State State File No. Effective Date

THIS DISCLOSURE DOCUMENT CONTAINS ALL OF THE REPRESENTATIONS BY THE COMPANY CONCERNING THIS OFFERING, AND NO PERSON SHALL MAKE DIFFERENT OR BROADER STATEMENTS THAN THOSE CONTAINED HEREIN. INVESTORS ARE CAUTIONED NOT TO RELY UPON ANY INFORMATION NOT EXPRESSLY SET FORTH IN THIS DISCLOSURE DOCUMENT.

This Disclosure Document, together with Financial Statements and other Attachments, consists of a total of _____ pages.

THE COMPANY

1. Exact corporate name:
State and date of incorporation:
Street address of principal office:
Company Telephone Number: ()
Fiscal year: _____
(month) (day)
Person(s) to contact at Company with respect to offering:
Telephone Number (if different from above): ()

RISK FACTORS

2. List in the order of importance the factors which the Company considers to be the most substantial risks to an investor in this offering in view of all facts and circumstances or which otherwise make the offering one of high risk or speculative (i.e., those factors which constitute the greatest threat that the investment will be lost in whole or in part, or not provide an adequate return).

(1) _____

(2) _____

(3) _____

(4) _____

(5) _____

(6) _____

(7) _____

(8) _____

(9) _____

(10) _____

(11) _____

(12) _____

(13) _____

(14) _____

(15) _____

(16) _____

Note: In addition to the above risks, businesses are often subject to risks not foreseen or fully appreciated by management. In reviewing this Disclosure Document potential investors should keep in mind other possible risks that could be important.

BUSINESS AND PROPERTIES

3. With respect to the business of the Company and its properties:
- (a) Describe in detail what business the Company does and proposes to do, including what products or goods are or will be produced or services that are or will be rendered.
 - (b) Describe how these products or services are to be produced or rendered and how and when the Company intends to carry out its activities. If the Company plans to offer a new product(s), state the present stage of development, including whether or not a working prototype(s) is in existence. Indicate if completion of development of the product would require a material amount of the resources of the Company, and the estimated amount. If the Company is or is expected to be dependent upon one or a limited number of suppliers for essential raw materials, energy or other items, describe. Describe any major existing supply contracts.
 - (c) Describe the industry in which the Company is selling or expects to sell its products or services and, where applicable, any recognized trends within that industry. Describe that part of the industry and the geographic area in which the business competes or will compete. Indicate whether competition is or is expected to be by price, service, or other basis. Indicate (by attached table if appropriate) the current or anticipated prices or price ranges for the Company's products or services, or the formula for determining prices, and how these prices compare with those of competitors' products or services, including a description of any variations in product or service features. Name the principal competitors that the Company has or expects to have in

its area of competition. Indicate the relative size and financial and market strengths of the Company's competitors in the area of competition in which the Company is or will be operating. State why the Company believes that it can effectively compete with these and other companies in its area of competition.

Note: Because this Disclosure Document focuses primarily on details concerning the Company rather than the industry in which the Company operates or will operate, potential investors may wish to conduct their own separate investigation of the Company's industry to obtain broader insight in assessing the Company's prospects.

(d) Describe specifically the marketing strategies the Company is employing or will employ in penetrating its market or in developing a new market. Set forth in response to Question 4 below the timing and size of the results of this effort which will be necessary in order for the Company to be profitable. Indicate how and by whom its products or services are or will be marketed (such as by advertising, personal contact by sales representatives, etc.), how its marketing structure operates or will operate and the basis of its marketing approach, including any market studies. Name any customers that account for, or based upon existing orders will account for, a major portion (20% or more) of the Company's sales. Describe any major existing sales contracts.

(e) State the backlog of written firm orders for products and/or services as of a recent date (within the last 90 days) and compare it with the backlog of a year ago from that date.

As of: /_/_\$

(a recent date)

As of: /_/_\$

(one year earlier)

Explain the reason for significant variations between the two figures, if any. Indicate what types and amounts of orders are included in the backlog figures. State the size of typical orders. If the Company's sales are seasonal or cyclical, explain.

(f) State the number of the Company's present employees and the number of employees it anticipates it will have within the next 12 months. Also, indicate the number by type of employee (i.e., clerical, operations, administrative, etc.) the Company will use, whether or not any of them are subject to collective bargaining agreements, and the expiration date(s) of any collective bargaining agreement(s). If the Company's employees are on strike, or have been in the past three years, or are threatening to strike, describe the dispute. Indicate any supplemental benefits or incentive arrangements the Company has or will have with its employees.

(g) Describe generally the principal properties (such as real estate, plant and equipment, patents, etc.) that the Company owns, indicating also what properties it leases and a summary of the terms under those leases, including the amount of payments, expiration dates and the terms of any renewal options. Indicate what properties the Company intends to acquire in the immediate future, the cost of such acquisitions and the sources of financing it expects to use in obtaining these properties, whether by purchase, lease or otherwise.

(h) Indicate the extent to which the Company's operations depend or are expected to depend upon patents, copyrights, trade secrets, know-how or other proprietary information and the steps undertaken to secure and protect this intellectual property, including any use of confidentiality agreements, covenants-not-to-compete and the like. Summarize the principal terms and expiration dates of any significant license agreements. Indicate the amounts expended by the Company for research and development during the last fiscal year, the amount expected to be spent this year and what percentage of revenues research and development expenditures were for the last fiscal year.

(i) If the Company's business, products, or properties are subject to material regulation (including environmental regulation) by federal, state, or local governmental agencies, indicate the nature and extent of regulation and its effects or potential effects upon the Company.

(j) State the names of any subsidiaries of the Company, their business purposes and ownership, and indicate which are included in the Financial Statements attached hereto. If not included, or if included but not consolidated, please explain.

(k) Summarize the material events in the development of the Company (including any material mergers or acquisitions) during the past five years, or for whatever lesser period the Company has been in existence. Discuss any pending or anticipated mergers, acquisitions, spin-offs or recapitalizations. If the Company has recently undergone a stock split, stock dividend or recapitalization in anticipation of this offering, describe (and adjust historical per share figures elsewhere in this Disclosure Document accordingly).

4. (a) If the Company was not profitable during its last fiscal year, list below in chronological order the events which in management's opinion must or should occur or the milestones which in management's opinion the Company must or should reach in order for the Company to become profitable, and indicate the expected manner of occurrence or the expected method by which the Company will achieve the milestones.

Date, or number of
months after

Expected manner of receipt of proceeds,
occurrence or method when should

Event or Milestone of achievement be accomplished

(1)	_____	_____
	_____	_____
	_____	_____
(2)	_____	_____
	_____	_____
	_____	_____
(3)	_____	_____
	_____	_____
	_____	_____
(4)	_____	_____
	_____	_____
	_____	_____
(5)	_____	_____
	_____	_____
	_____	_____

(b) State the probable consequences to the Company of delays in achieving each of the events or milestones within the above time schedule, and particularly the effect of any delays upon the Company's liquidity in view of the Company's then anticipated level of operating costs. (See Question Nos. 11 and 12)

Note: After reviewing the nature and timing of each event or milestone, potential investors should reflect upon whether achievement of each within the estimated time frame is realistic and should assess the consequences of delays or failure of achievement in making an investment decision.

OFFERING PRICE FACTORS

If the securities offered are common stock, or are exercisable for or convertible into common stock, the following factors may be relevant to the price at which the securities are being offered.

5. What were net, after-tax earnings for the last fiscal year? (If losses, show in parenthesis.)

Total \$ _____ (\$ _____ per share)

6. If the Company had profits, show offering price as a multiple of earnings. Adjust to reflect for any stock splits or recapitalizations, and use conversion or exercise price in lieu of offering price, if applicable.

Offering Price Per Share = (price/earnings multiple)

Net After-Tax Earnings Last Year Per Share

7. (a) What is the net tangible book value of the Company? (If deficit, show in parenthesis.) For this purpose, net tangible book value means total assets (exclusive of copyrights, patents, goodwill, research and development costs and similar intangible items) minus total liabilities.

\$ _____ (\$ _____ per share)

If the net tangible book value per share is substantially less than this offering (or exercise or conversion) price per share, explain the reasons for the variation.

(b) State the dates on which the Company sold or otherwise issued securities during the last 12 months, the amount of such securities sold, the number of persons to whom they were sold, any relationship of such persons to the Company at the time of sale, the price at which they were sold and, if not sold for cash, a concise description of the consideration. (Exclude bank debt.)

8. (a) What percentage of the outstanding shares of the Company will the investors in this offering have? (Assume exercise of outstanding options, warrants or rights and conversion of convertible securities, if the respective exercise or conversion prices are at or less than the offering price. Also assume exercise of any options, warrants or rights and conversions of any convertible securities offered in this offering.)

If the maximum is sold: _____%

If the minimum is sold: _____%

(b) What post-offering value is management implicitly attributing to the entire Company by establishing the price per security set forth on the cover page (or exercise or conversion price if common stock is not offered)? (Total outstanding shares after offering times offering price, or exercise or conversion price if common stock is not offered.)

If maximum is sold: \$ _____*

If minimum is sold: \$ _____*

(For above purposes, assume outstanding options are exercised in determining "shares" if the exercise prices are at or less than the offering price. All convertible securities, including outstanding convertible securities, shall be assumed converted and any options, warrants or rights in this offering shall be assumed exercised.)

* These values assume that the Company's capital structure would be changed to reflect any conversions of outstanding convertible securities and any use of outstanding securities as payment in the exercise of outstanding options, warrants or rights included in the calculation. The type and amount of convertible or other securities thus eliminated would be:

_____. These values also assume an increase in cash in the Company by the amount of any cash payments that would be made upon cash exercise of options, warrants or rights included in the calculations. The amount of such cash would be: \$ _____.

Note: After reviewing the above, potential investors should consider whether or not the offering price (or exercise or conversion price, if applicable) for the securities is appropriate at the present stage of the Company's development.

USE OF PROCEEDS

9. (a) The following table sets forth the use of the proceeds from this offering:

If Minimum If Maximum

Sold

Amount % Amount %

Total Proceeds \$ 100% \$ 100%

Less: Offering Expenses

Commissions and Finders Fees

Legal & Accounting

Copying & Advertising

Other (Specify): _____

Net Proceeds from Offering \$ \$

Use of Net Proceeds

\$ % \$ %

Total Use of Net Proceeds \$ 100% \$ 100%

(b) If there is no minimum amount of proceeds that must be raised before the Company may use the proceeds of the offering, describe the order of priority in which the proceeds set forth above in the column "If Maximum Sold" will be used.

Note: After reviewing the portion of the offering allocated to the payment of offering expenses, and to the immediate payment to management and promoters of any fees, reimbursements, past salaries or similar payments, a potential investor should consider whether the remaining portion of his investment, which would be that part available for future development of the Company's business and operations, would be adequate.

10. (a) If material amounts of funds from sources other than this offering are to be used in conjunction with the proceeds from this offering, state the amounts and sources of such other funds, and whether funds are firm or contingent. If contingent, explain.

(b) If any material part of the proceeds is to be used to discharge indebtedness, describe the terms of such indebtedness, including interest rates. If the indebtedness to be discharged was incurred within the current or previous fiscal year, describe the use of the proceeds of such indebtedness.

(c) If any material amount of the proceeds is to be used to acquire assets, other than in the ordinary course of business, briefly describe and state the cost of the assets and other material terms of the acquisitions. If the assets are to be acquired from officers, directors, employees or principal stockholders of the Company or their associates, give the names of the persons from whom the assets are to be acquired and set forth the cost to the Company, the method followed in determining the cost, and any profit to such persons.

(d) If any amount of the proceeds is to be used to reimburse any officer, director, employee or stockholder for services already rendered, assets previously transferred, or monies loaned or advanced, or otherwise, explain:

11. Indicate whether the Company is having or anticipates having within the next 12 months any cash flow or liquidity problems and whether or not it is in default or in breach of any note, loan, lease or other indebtedness or financing arrangement requiring the Company to make payments. Indicate if a significant amount of the Company's trade payables have not been paid within the

stated tradeterm. State whether the Company is subject to any unsatisfied judgments, liens or settlement obligations and the amounts thereof. Indicate the Company's plans to resolve any such problems.

12. Indicate whether proceeds from this offering will satisfy the Company's cash requirements for the next 12 months, and whether it will be necessary to raise additional funds. State the source of additional funds, if known.

CAPITALIZATION

13. Indicate the capitalization of the Company as of the most recent balance sheet date (adjusted to reflect any subsequent stock splits, stock dividends, recapitalizations or refinancings) and as adjusted to reflect the sale of the minimum and maximum amount of securities in this offering and the use of the net proceeds therefrom:

<u>Amount Outstanding</u>	
As of: <u>As Adjusted</u>	
<u>/ / (date) Minimum Maximum</u>	
Debt:	
Short-term debt (average interest rate _____%)	\$ \$ \$
Long-term debt (average interest rate _____%)	\$ \$ \$
Total debt	\$ \$ \$
Stockholders equity (deficit):	
Preferred stock - par or stated value (by class of preferred in order of preferences)	
_____	\$ \$ \$
_____	\$ \$ \$
_____	\$ \$ \$
Common stock--par or stated value	\$ \$ \$
Additional paid in capital	\$ \$ \$
Retained earnings (deficit)	\$ \$ \$
Total stockholders equity (deficit)	\$ \$ \$
Total Capitalization	\$ \$ \$

Number of preferred shares
authorized to be outstanding:

Number of Par Value

Class of Preferred Shares Authorized Per Share

_____ \$ _____
_____ \$ _____
_____ \$ _____

Number of common shares authorized: _____ shares. Par or stated value per share, if
any: \$ _____

Number of common shares reserved to meet conversion requirements or for the issuance upon
exercise of options, warrants or rights: _____ shares.

DESCRIPTION OF SECURITIES

14. The securities being offered hereby are:

- Common Stock
 Preferred or Preference Stock
 Notes or Debentures
 Units of two or more types of securities, composed of:
 Other:

15. These securities have:

Yes No

- Cumulative voting rights
 Other special voting rights
 Preemptive rights to purchase in new issues of shares
 Preference as to dividends or interest
 Preference upon liquidation
 Other special rights or preferences (specify):

Explain:

16. Are the securities convertible? Yes No

If so, state conversion price or formula.

Date when conversion becomes effective: ___/___/___

Date when conversion expires: ___/___/___

17. (a) If securities are notes or other types of debt securities:

(1) What is the interest rate? _____%

If interest rate is variable or multiple rates, describe:

(2) What is the maturity date? ___/___/___

If serial maturity dates, describe:

(3) Is there a mandatory sinking fund? Yes No Describe:

(4) Is there a trust indenture? Yes No

Name, address and telephone number of Trustee

(5) Are the securities callable or subject to redemption?

Yes No Describe, including redemption prices:

(6) Are the securities collateralized by real or personal property?

Yes No Describe:

(7) If these securities are subordinated in right of payment of interest or principal, explain the terms
of such subordination.

How much currently outstanding indebtedness of the Company is senior to the securities in right of
payment of interest or principal? \$ _____.

How much indebtedness shares in right of payment on an equivalent (pari passu) basis?

\$ _____.

How much indebtedness is junior (subordinated) to the securities?

\$ _____.

(b) If notes or other types of debt securities are being offered and the Company had earnings during its last fiscal year, show the ratio of earnings to fixed charges on an actual and pro forma basis for that fiscal year. "Earnings" means pretax income from continuing operations plus fixed charges and capitalized interest. "Fixed charges" means interest (including capitalized interest), amortization of debt discount, premium and expense, preferred stock dividend requirements of majority owned subsidiary, and such portion of rental expense as can be demonstrated to be representative of the interest factor in the particular case. The pro forma ratio of earnings to fixed charges should include incremental interest expense as a result of the offering of the notes or other debt securities.

Last Fiscal Year

Actual Pro Forma

Minimum Maximum

"Earnings" =

"Fixed Charges"

If no earnings,

show "Fixed Charges" only

Note: Care should be exercised in interpreting the significance of the ratio of earnings to fixed charges as a measure of the "coverage" of debt service, as the existence of earnings does not necessarily mean that the Company's liquidity at any given time will permit payment of debt service requirements to be timely made. See Question Nos. 11 and 12. See also the Financial Statements and especially the Statement of Cash Flows.

18. If securities are Preference or Preferred stock:

Are unpaid dividends cumulative? Yes No

Are securities callable? Yes No Explain: _____

Note: Attach to this Disclosure Document copies or a summary of the charter, bylaw or contractual provision or document that gives rise to the rights of holders of Preferred or Preference Stock, notes or other securities being offered.

19. If securities are capital stock of any type, indicate restrictions on dividends under loan or other financing arrangements or otherwise:

20. Current amount of assets available for payment of dividends (if deficit must be first made up, show deficit in parenthesis): \$ _____.

PLAN OF DISTRIBUTION

21. The selling agents (that is, the persons selling the securities as agent for the Company for a commission or other compensation) in this offering are:

Name: Name:

Address: Address:

Telephone No. () Telephone No. ()

22. Describe any compensation to selling agents or finders, including cash, securities, contracts or other consideration, in addition to the cash commission set forth as a percent of the offering price on the cover page of this Disclosure Document. Also indicate whether the Company will indemnify the selling agents or finders against liabilities under the securities laws. ("Finders" are persons who for compensation act as intermediaries in obtaining selling agents or otherwise making introductions in furtherance of this offering.)

23. Describe any material relationships between any of the selling agents or finders and the Company or its management.

Note: After reviewing the amount of compensation to the selling agents or finders for selling the securities, and the nature of any relationship between the selling agents or finders and the Company, a potential investor should assess the extent to which it may be inappropriate to rely upon any recommendation by the selling agents or finders to buy the securities.

24. If this offering is not being made through selling agents, the names of persons at the Company through which this offering is being made:

Name: Name:

Address: Address:

Telephone No. () Telephone No. ()

25. If this offering is limited to a special group, such as employees of the Company, or is limited to a certain number of individuals (as required to qualify under Subchapter S of the Internal Revenue Code) or is subject to any other limitations, describe the limitations and any restrictions on resale that apply:

Will the certificates bear a legend notifying holders of such restrictions?

Yes No

26. (a) Name, address and telephone number of independent bank or savings and loan association or

other similar depository institution acting as escrow agent if proceeds are escrowed until minimum proceeds are raised:

(b) Date at which funds will be returned by escrow agent if minimum proceeds are not raised:

Will interest on proceeds during escrow period be paid to investors?

Yes No

27. Explain the nature of any resale restrictions on presently outstanding shares, and when those restrictions will terminate, if this can be determined:

Note: Equity investors should be aware that unless the Company is able to complete a further public offering or the Company is able to be sold for cash or merged with a public company that their investment in the Company may be illiquid indefinitely.

DIVIDENDS, DISTRIBUTIONS AND REDEMPTIONS

28. If the Company has within the last five years paid dividends, made distributions upon its stock or redeemed any securities, explain how much and when:

OFFICERS AND KEY PERSONNEL OF THE COMPANY

29. Chief Executive Officer: Title:

Name: Age:

Office Street Address:

Telephone No.: () _____

Name of employers, titles and dates of positions held during past five years with an indication of job responsibilities.

Education (degrees, schools, and dates):

Also a Director of the Company? Yes No

Indicate amount of time to be spent on Company matters if less than full time:

30. Chief Operating Officer: Title: _____

Name: _____ Age: _____

Office Street Address: _____

Telephone No.: () _____

Names of employers, titles and dates of positions held during past five years with an indication of job responsibilities.

Education (degrees, schools, and dates):

Also a Director of the Company? Yes No

Indicate amount of time to be spent on Company matters if less than full time:

31. Chief Financial Officer: Title: _____

Name: _____ Age: _____

Office Street Address: _____

Telephone No.: () _____

Names of employers, titles and dates of positions held during past five years with an indication of job responsibilities.

Education (degrees, schools, and dates):

Also a Director of the Company? Yes No

Indicate amount of time to be spent on Company matters if less than full time:

32. Other Key Personnel:

(A) Name: _____ Age: _____

Title: _____

Office Street Address:

Telephone No.: (_____) _____

Names of employers, titles and dates of positions held during past five years with an indication of job responsibilities.

Education (degrees, schools, and dates):

Also a Director of the Company? Yes No

Indicate amount of time to be spent on Company matters if less than full time:

(B) Name: _____ Age: _____

Title: _____

Office Street Address:

Telephone No.: (_____) _____

Names of employers, titles and dates of positions held during past five years with an indication of job responsibilities.

Education (degrees, schools, and dates):

Also a Director of the Company? Yes No

Indicate amount of time to be spent on Company matters if less than full time:

DIRECTORS OF THE COMPANY

33. Number of Directors: _____ If Directors are not elected annually, or are elected under a voting trust or other arrangement, explain:

34. Information concerning outside or other Directors (i.e. those not described above):

(A) Name: _____ Age: _____

Office Street Address:

Telephone No.: (_____) _____

Names of employers, titles and dates of positions held during past five years with an indication of job responsibilities.

Education (degrees, schools, and dates):

(B) Name: _____ Age: _____

Office Street Address:

Telephone No.: (_____) _____

Names of employers, titles and dates of positions held during past five years with an indication of job responsibilities.

Education (degrees, schools, and dates):

(C) Name: _____ Age: _____

Office Street Address:

Telephone No.: (_____) _____

Names of employers, titles and dates of positions held during past five years with an indication of job responsibilities.

Education (degrees, schools, and dates):

35. (a) Have any of the Officers or Directors ever worked for or managed a company (including a separate subsidiary or division of a larger enterprise) in the same business as the Company? Yes No

Explain:

(b) If any of the Officers, Directors or other key personnel have ever worked for or managed a company in the same business or industry as the Company or in a related business or industry, describe what precautions, if any, (including the obtaining of releases or consents from

prior employers) have been taken to preclude claims by prior employers for conversion or theft of trade secrets, know-how or other proprietary information.

(c) If the Company has never conducted operations or is otherwise in the development stage, indicate whether any of the Officers or Directors has ever managed any other company in the start-up or development stage and describe the circumstances, including relevant dates.

(d) If any of the Company's key personnel are not employees but are consultants or other independent contractors, state the details of their engagement by the Company.

(e) If the Company has key man life insurance policies on any of its Officers, Directors or key personnel, explain, including the names of the persons insured, the amount of insurance, whether the insurance proceeds are payable to the Company and whether there are arrangements that require the proceeds to be used to redeem securities or pay benefits to the estate of the insured person or to a surviving spouse.

36. If a petition under the Bankruptcy Act or any State insolvency law was filed by or against the Company or its Officers, Directors or other key personnel, or a receiver, fiscal agent or similar officer was appointed by a court for the business or property of any such persons, or any partnership in which any of such persons was general partner at or within the past five years, or any corporation or business association of which any such person was an executive officer at or within the past five years, set forth below the name of such persons, and the nature and date of such actions.

Note: After reviewing the information concerning the background of the Company's Officers, Directors and other key personnel, potential investors should consider whether or not these persons have adequate background and experience to develop and operate this Company and to make it successful. In this regard, the experience and ability of management are often considered the most significant factors in the success of a business.

PRINCIPAL STOCKHOLDERS

37. Principal owners of the Company (those who beneficially own directly or indirectly 10% or more of the common and preferred stock presently outstanding) starting with the largest common stockholder. Include separately all common stock issuable upon conversion of convertible securities (identifying them by asterisk) and show average price per share as if conversion has occurred. Indicate by footnote if the price paid was for a consideration other than cash and the nature of any such consideration.

Average No. of Shares

Price No. of Held After

Per Shares % of Offering if % of

Class of Shares Share Now Held Total All Securities Sold Total

Name:

Office Street Address:

Telephone No.

(____) _____

Principal occupation:

Name:

Office Street Address:

Telephone No.

(____) _____

Principal occupation:

Average No. of Shares

Price No. of Held After

Per Shares % of Offering if % of

Class of Shares Share Now Held Total All Securities Sold Total

Name:

Office Street Address:

Telephone No.

(____) _____

Principal occupation:

Name:

Office Street Address:

Telephone No.

(____) _____

Principal occupation:

38. Number of shares beneficially owned by Officers and Directors as a group:

Before offering: _____ shares (____% of total outstanding)

After offering: a) Assuming minimum securities sold: _____ shares

(____% of total outstanding)

b) Assuming maximum securities sold: _____ shares

(____% of total outstanding)

(Assume all options exercised and all convertible securities converted.)

MANAGEMENT RELATIONSHIPS, TRANSACTIONS AND REMUNERATION

39. (a) If any of the Officers, Directors, key personnel or principal stockholders are related by blood or marriage, please describe.

(b) If the Company has made loans to or is doing business with any of its Officers, Directors, key personnel or 10% stockholders, or any of their relatives (or any entity controlled directly or indirectly by any of such persons) within the last two years, or proposes to do so within the future, explain. (This includes sales or lease of goods, property or services to or from the Company, employment or stock purchase contracts, etc.) State the principal terms of any significant loans, agreements, leases, financing or other arrangements.

(c) If any of the Company's Officers, Directors, key personnel or 10% stockholders has guaranteed or co-signed any of the Company's bank debt or other obligations, including any indebtedness to be retired from the proceeds of this offering, explain and state the amounts involved.

40. (a) List all remuneration by the Company to Officers, Directors and key personnel for the last fiscal year:

Cash Other

Chief Executive Officer \$ _____ \$ _____
Chief Operating Officer _____
Chief Accounting Officer _____
Key Personnel: _____

Others: _____

Total: \$ _ \$

Directors as a group

(number of persons ____) \$ _____ \$ _____

(b) If remuneration is expected to change or has been unpaid in prior years, explain:

(c) If any employment agreements exist or are contemplated, describe:

41. (a) Number of shares subject to issuance under presently outstanding stock purchase agreements, stock options, warrants or rights: _____ shares (____ % of total shares to be outstanding after the completion of the offering if all securities sold, assuming exercise of options and conversion of convertible securities). Indicate which have been approved by shareholders. State the expiration dates, exercise prices and other basic terms for these securities:

(b) Number of common shares subject to issuance under existing stock purchase or option plans but not yet covered by outstanding purchase agreements, options or warrants: _____ shares.

(c) Describe the extent to which future stock purchase agreements, stock options, warrants or rights must be approved by shareholders.

42. If the business is highly dependent on the services of certain key personnel, describe any arrangements to assure that these persons will remain with the Company and not compete upon any termination:

Note: After reviewing the above, potential investors should consider whether or not the compensation to management and other key personnel directly or indirectly, is reasonable in view of the present stage of the Company's development.

LITIGATION

43. Describe any past, pending or threatened litigation or administrative action which has had or may have a material effect upon the Company's business, financial condition, or operations, including any litigation or action involving the Company's Officers, Directors or other key personnel. State the names of the principal parties, the nature and current status of the matters, and amounts involved. Give an evaluation by management or counsel, to the extent feasible, of the merits of the proceedings or litigation and the potential impact on the Company's business, financial condition, or operations.

FEDERAL TAX ASPECTS

44. If the Company is an S corporation under the Internal Revenue Code of 1986, and it is anticipated that any significant tax benefits will be available to investors in this offering, indicate the nature and amount of such anticipated tax benefits and the material risks of their disallowance. Also, state the name, address and telephone number of any tax advisor that has passed upon these tax benefits. Attach any opinion or any description of the tax consequences of an investment in the securities by the tax advisor.

Name of Tax Advisor:

Address:

Telephone No. (____) _____

Note: Potential investors are encouraged to have their own personal tax consultant contact the tax advisor to review details of the tax benefits and the extent that the benefits would be available and advantageous to the particular investor.

MISCELLANEOUS FACTORS

45. Describe any other material factors, either adverse or favorable, that will or could affect the Company or its business (for example, discuss any defaults under major contracts, any breach of bylaw provisions, etc.) or which are necessary to make any other information in this Disclosure Document not misleading or incomplete.

FINANCIAL STATEMENTS

46. Attach reviewed or audited financial statements for the last fiscal year and unaudited financial statements for any interim periods thereafter. If since the beginning of the last fiscal year the Company has acquired another business the assets or net income of which were in excess of 20% of those for the Company, show pro forma combined financial statements as if the acquisition had occurred at the beginning of the Company's last fiscal year.

The Company does hereby agree to provide to investors in this offering for five years (or such longer period as required by law) hereafter annual financial reports containing a balance sheet as of the end of the Company's fiscal year and a statement of income for said fiscal year, all prepared in accordance with generally accepted accounting principles and accompanied by an independent accountant's report. If the Company has more than 100 security holders at the end of the fiscal year, the financial statements shall be audited.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF CERTAIN RELEVANT FACTORS

47. If the Company's financial statements show losses from operations, explain the causes underlying these losses and what steps the Company has taken or is taking to address these causes.

48. Describe any trends in the Company's historical operating results. Indicate any changes now occurring in the underlying economics of the industry or the Company's business which, in the opinion of Management, will have a significant impact (either favorable or adverse) upon the Company's results of operations within the next 12 months, and give a rough estimate of the probable extent of the impact, if possible.

49. If the Company sells a product or products and has had significant sales during its last fiscal year, state the existing gross margin (net sales less cost of such sales as presented in accordance with generally accepted accounting principles) as a percentage of sales for the last fiscal year: ____%. What is the anticipated gross margin for next year of operations? Approximately _____%. If this is expected to change, explain. Also, if reasonably current gross margin figures are available for the industry, indicate these figures and the source or sources from which they are obtained.

50. Foreign sales as a percent of total sales for last fiscal year: ____%. Domestic government sales as a percent of total domestic sales for last fiscal year: ____%.

Explain the nature of these sales, including any anticipated changes:

SIGNATURES:

A majority of the Directors and the Chief Executive and Financial Officers of the Company shall sign this Disclosure Document on behalf of the Company and by so doing thereby certify that each has made diligent efforts to verify the material accuracy and completeness of the information herein contained. By signing this Disclosure Document, the Chief Executive and Chief Financial Officers agree to make themselves, the Company's books and records, copies of any contract, lease or other document referred to in the Disclosure Document, or any other material contract or lease (including stock options and employee benefit plans), except any proprietary or confidential

portions thereof, and a set of the exhibits to this Disclosure Document, available to each investor prior to the time of investment, and to respond to questions and otherwise confirm the information contained herein prior to the making of any investment by such investor.

The Chief Financial Officer signing this form is hereby certifying that the financial statements submitted fairly state the Company's financial position and results of operations, or receipts and disbursements, as of the dates and period(s) indicated, all in accordance with generally accepted accounting principles consistently applied (except as stated in the notes thereto) and (with respect to year-end figures) including all adjustments necessary for fair presentation under the circumstances.

Chief Executive Officer: Directors:

Title:

Chief Financial Officer:

Title:
