



# State of Utah

DEPARTMENT OF COMMERCE  
Division of Securities

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November 14, 1989

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Re: Application of Rule R177-11-1 to Spin-offs of Subsidiaries  
Request for Interpretive Opinion File # 3903-A02564-17

Dear Mr. Kruse:

This letter is in response to your letter dated August 11, 1989, requesting an interpretive opinion from the Utah Securities Division (the "Division") regarding the application of the Division's Rule R177-11-1 (the "Rule") to the distribution of the securities of the wholly owned corporate subsidiary by its parent corporation to the shareholders of the parent corporation (the "Distribution"). The Division understands the relevant facts to be as follows:

The issuing subsidiary would be wholly owned by a publicly traded corporate parent. The parent would distribute the subsidiary's securities as a partial liquidating dividend to its shareholders so that each would have an interest in the subsidiary proportionate to that held in the parent.

Prior to and at the time of the Distribution, the subsidiary would have only nominal assets and would not be engaged in any active business operations. The primary purpose of the Distribution would be to create a publicly traded entity to serve as a vehicle for a corporate reorganization or acquisition.

The securities of the subsidiary would consist of common stock and possibly warrants. These would be registered with the Securities and Exchange Commission pursuant to the Securities Act of 1933. They would also be registered by coordination with the Division pursuant to § 61-1-9 of the Utah Uniform Securities Act. The exercise of warrants, if any, would be

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subject to post effective amendments to the registration statement.

Finally, no cash would be received from the parent's shareholders as a result of the Distribution. No commission or other direct or indirect remuneration would be paid in connection with the transaction. No broker, dealer, or agent would effect any portion of the transaction.

On the basis of the foregoing facts and for the reasons stated below, it is the informal opinion of the Division that Rule R177-11-1 applies to the proposed transaction.

As set forth in Preliminary Note 2, the purpose of the Rule is ". . . to ensure full disclosure of material information, prohibit offerings which tend to work a fraud on purchasers and prohibit unreasonable amounts of promoters' profits."

#### Full Disclosure

The primary purpose of paragraph (c) of the Rule is to ensure full disclosure of material information to the public regarding the anticipated business operations of the issuer before any public activity in the issuer's securities will be permitted. This is accomplished by, among other things, requiring the issuer to escrow eighty (80%) percent of the net offering proceeds until it has fully disclosed the specific use of the offering proceeds. Paragraph (c) expressly prohibits the issuance, delivery or trading of the issuer's securities until escrow has been released. Escrow can only be released after the subscribers have had an opportunity to consider specific material information regarding the use of the offering proceeds.

The fact that the Distribution does not generate proceeds for the subsidiary or parent does not eliminate the need for full disclosure of material information. Clearly the escrow and rescission requirement would not apply since the offering would not generate any proceeds which could be escrowed or refunded in the event of rescission. However, the requirement that material information be fully disclosed remains. Thus, the material information regarding the subsidiary's anticipated business operations would have to be disseminated to the public before any activity in the public market would be permitted. As a result the issuer (or the registrant, if not the issuer) must merge with an operating company before registering the proposed Distribution. As an alternative, it may register the Distribution subject to appropriate safeguards which prevent its completion until after an appropriate merger partner has been fully disclosed. Either alternativewould in effect "lock-up" the securities until the full

disclosure requirements of the Rule have been satisfied.

Additionally, failure to impose the disclosure requirements of the Rule would permit the privately-held subsidiary to become public and thus enjoy the benefits associated with public status without disclosing material information.

#### Prohibit Unreasonable Promoter Profits

The primary purpose of paragraph (b) of the Rule is to prohibit unreasonable promoter profits. The Division interprets the term "unreasonable promoter profits" to mean, among other things, gain realized by a promoter without exposure to the risks of the public securities market. A promoter who has not invested any of his cash or assets has not exposed himself to the risks of the public securities market. The term "promoter" is not limited to an individual but may include other legal entities or groups of individuals or legal entities.

To accomplish its purpose, paragraph (b) of the Rule requires promoters of corporations to invest the lesser of ten percent of the aggregate offering price or \$50,000. Such investment cannot be in the form of services rendered or indebtedness. It would appear that the drafters of the Rule did not anticipate an offering which would raise nothing or only nominal proceeds. Still, the primary purpose of the Rule remains. Therefore, where no, or only nominal proceeds are raised by the offering, the Division requires the promoter to invest at least \$50,000 and as much as \$75,000 to satisfy the minimum net tangible asset requirement discussed below.

#### Prohibit Offerings Which Tend To Work A Fraud

Blind-pool and blind-pool/blank-check (shell corporation) offerings which do not satisfy the requirements of the Rule tend to work a fraud on the public securities market. See The Report of the Governor's Securities Fraud Task Force, December 1984, page 12. The combined purpose of paragraphs (b), (c) and (d) is to prohibit offerings which tend to work a fraud.

The provision of paragraph (c) which requires that the issuer have a net tangible value of at least \$75,000 after the rescission period has run is intended to give the development stage company a "fighting chance" to succeed in its anticipated business operations. It is the Division's opinion that an issuer with a stated business purpose and relatively significant tangible assets (\$75,000 or more) has an improved chance of succeeding. The Division also believes that an improved chance of business success tends to minimize the potential for fraud.

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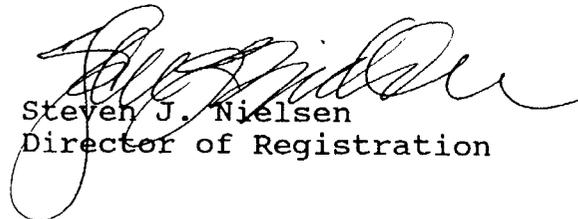
Paragraph (d) requires the issuer (or the registrant where it is not the issuer) to register and bond agents it employs to sell its securities. This requirement is based upon the rationale that the requirement of registration and bond will tend to reduce the involvement of those who may be inclined to participate in fraud. Additionally, it also provides an avenue of recourse for those investors who have fallen victim to securities fraud.

Finally, it is the opinion of the Division that the distribution of the subsidiary's securities to the parent's shareholders comes within the Rule. The term "sell" is defined by § 61-1-13(15)(a) to include "every contract for sale of, contract to sell, or disposition of, a security or interest in a security for value." Section<sup>x</sup> 61-1-13(15)(c)(vi) states that "[a] dividend of a security of another issuer is an offer or sale."

Inasmuch as this opinion is based upon the facts noted above, please note that any different facts or conditions of a material nature might require a different interpretation.

Furthermore this opinion relates only to the referenced transaction and shall have no binding effect on the Utah Securities Division or the Utah Securities Advisory Board with respect to future similar matters.

Sincerely,



Steven J. Nielsen  
Director of Registration

cc: John C. Baldwin  
Utah Securities Division Director