

**STATEMENT OF POLICY REGARDING UNDERWRITING EXPENSES,
UNDERWRITER'S WARRANTS, SELLING EXPENSES AND SELLING
SECURITY HOLDERS**

Adopted on April 27, 1997; Amended on September 28, 1999 and March 31, 2008

I. INTRODUCTION

This statement of policy applies to all applications to register by coordination and or by qualification.

II. DEFINITIONS

This statement of policy uses the following terms defined in the NASAA *Statement of Policy Regarding Corporate Securities Definitions*.

Administrator
Disclosure Document
Selling Expenses
Underwriter
Underwriting Expenses

III. GROUNDS FOR DENIAL OF SECURITIES REGISTRATIONS

The Administrator may deny the registration of securities if:

- A. The underwriting expenses exceed seventeen percent (17%) of the gross proceeds from the public offering,
- B. The selling expenses of the offering exceed twenty percent (20%) of the gross proceeds from the public offering, or
- C. Selling security holders are offering more than ten percent (10%) of the securities for sale in the public offering.

IV. SELLING SECURITY HOLDERS.

The Administrator may permit a public offering or sale of securities that includes selling security holders offering more than ten percent (10%) of the securities for sale in the public offering if either of the following apply:

- A. The Disclosure Document discloses the amount of selling expenses that the selling security holders will pay.
 - 1. Selling security holders offering at least ten percent (10%) but not more than fifty percent (50%) of the registered securities pay a pro rata share of all selling expenses of the public offering, excluding the legal and accounting

expenses of the public offering, and

2. Selling security holders offering more than fifty percent (50%) of the registered securities pay a pro rata share of all selling expenses of the public offering.

- B. With the exception of Underwriter's or broker-dealer's compensation, the selling security holders have a written agreement with the issuer that was entered into in an arm's-length transaction, under which the issuer agreed to pay all of the selling security holders' selling expenses.

V. **RESTRICTIONS ON WARRANTS GRANTED TO UNDERWRITERS**

Warrants granted to Underwriters are subject to the following restrictions:

- A. The Underwriter must be a managing Underwriter.
- B. The public offering must be either a firmly underwritten offering or a "minimum-maximum" offering. Options or warrants may be issued in a "minimum-maximum" public offering only if:
 1. The options or warrants are issued on a pro rata basis, and
 2. The "minimum" amount of securities has been sold.
- C. The exercise price of the warrants must be at least equal to the public offering price.
- D. The number of shares covered by the Underwriter's options or warrants must not exceed ten percent (10%) of the shares of common stock actually sold in the public offering.
- E. The options or warrants must not be exercisable more than five (5) years after the public offering is completed.
- F. The options or warrants must not be exercisable during the first year after the public offering is completed.
- G. Option or warrants may not be transferred, except:
 1. To partners of the Underwriter, if the Underwriter is a partnership.
 2. To officers and employees of the Underwriter, who are also shareholders of the Underwriter, if the Underwriter is a

corporation, or

3. By will, under the laws of descent and distribution, or by operation of law.

H. The warrant agreement may not allow for a reduction in the exercise price of the options or warrants resulting from the issuer subsequently issuing shares except if the issuer issues shares under:

1. a stock dividend or stock split, or
2. a merger, consolidation, reclassification, reorganization, recapitalization, or sale of assets.

VI. PROHIBITED UNDERWRITING EXPENSES

Underwriting expenses must not include financial consulting or financial advisory agreements with the underwriter payable at the time the services are rendered, provided that the issuer entered into the agreement at least twelve months before the issuer filed the registration statement with the Securities and Exchange Commission.

VII. VALUATION OF UNDERWRITER'S WARRANTS

Formula. The following formula must be used to value Underwriter's warrants:

$$\frac{[165\% \times \text{Aggregate Offering Price}] - (\text{Exercise Price} \times \# \text{ of shares offered to public}) \times \# \text{ shares underlying warrants}}{2} \quad \# \text{ shares offered to the public}$$

$$\frac{A - B \times C}{2 \quad D}$$

where

A equals 165% of the aggregate offering price

B equals the exercise price multiplied by the number of shares offered to the public

C equals the number of shares underlying the warrants, and

D equals the number of shares offered to the public

A Sample Calculation of Value.

1. Assumptions: Public offering of 1,000,000 shares at \$5.00 per share and an Underwriter's warrant of 100,000 shares (10%) at 120% of a \$6.00 public offering price, exercisable starting one year after completion of the public offering.
2. Dollar value of Underwriter's warrant is \$112,500 (\$1,125,000 x .10) = \$112,500 (See below).
3. Percentage value is 2.25% (\$112,500 divided by \$5,000,000).

Calculation of warrant value:

$$\frac{[165\% \times \text{Aggregate Offering Price}] - (\text{Exercise Price} \times \# \text{ of shares offered to public})}{2} \times \frac{\# \text{ shares underlying warrants}}{\# \text{ shares offered to public}}$$

$$\frac{[165\% \times (1,000,000 \text{ shares} \times \$5.00)] - (1,000,000 \times \$6.00)}{2} \times \frac{100,000}{1,000,000}$$

$$\frac{[165\% \times \$5,000,000] - \$6,000,000}{2} \times .10$$

$$\frac{\$8,250,000 - \$6,000,000}{2} \times .10$$

$$\frac{\$2,250,000}{2} \times .10$$