

REGISTRATION OF PUBLICLY OFFERED CATTLE- FEEDING PROGRAMS

Adopted on September 17, 1980

PREFACE. Nothing contained in these *Guidelines* shall prevent a securities administrator from considering variations therefrom to be fully justified when viewed in the light of the facts of the entire offering.

PURPOSE. These *Guidelines* have been constructed with a threefold purpose:
To provide for uniform treatment of certain problem areas encountered in the analysis of registration of securities consisting of interests in cattle feeding ventures; by defining terms, establishing maximums and minimums, restrictions, prohibitions and requirements to set out in orderly form a policy which may be adopted by Administrators of States to formulate standards for the evaluation of cattle feeding ventures.
To assure industry that programs with plans of business falling within the bounds of these *Guidelines* are fair and reasonable, and that other plans of business not contemplated herein may be equally fair and reasonable.
To assure public investors that sponsors are adequately capitalized to perform their commitments and that success of the ventures will be fairly shared between investors and sponsors.

DEFINITIONS OF TERMS AS USED IN THE GUIDELINES. The following terms mean:

Affiliate: An affiliate of another person (any entity) means (a) any person directly or indirectly owning, controlling or holding power to vote ten percent or more of the outstanding voting securities of such other person; (b) any person ten percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (c) any person directly or indirectly controlling, controlled by, or under common control with such other person; (d) any officer, director, partner, co-partner, or employee of such other person.

Pay-out: That point at which public investors have received a 100 percent return of their investment, before taxes, and without considering any tax deductions.

Sponsor: Any corporation, partnership or individual which originates, promotes and/or manages a cattle-feeding venture: for example, a general partner in a limited partnership set up for that purpose. An Attorney or accountant who only renders professional advice and services to a cattle-feeding venture shall not be deemed a sponsor only as a result of such advice and services.

Net Assets: Total assets less total liabilities.

Affiliate Dealings: Dealings in which feed is purchased, directly or indirectly, from the sponsor or an affiliate, or cattle are fed in feed lots owned by the sponsor or an affiliate; provided, however, the sale of proprietary feed supplements by an affiliate to independent feed lots shall not be deemed "affiliate dealings" if such sales are at prices

not greater than those in completely unrelated sales.

Custom Feeding: Includes the feeding of all cattle, other than those fed for publicly offered ventures and those fed for the account of the sponsor and/or any affiliate of the sponsor.

Administrator: The State Securities Administrator or Commissioner or other person designated under State law to approve or disapprove the application to register securities for sale in his jurisdiction.

Hedging: The sale of futures against a purchase of spots (cattle or other commodities) or the purchase of futures against commitments for spot purchases. Hedging is a medium through which offsetting commitments are employed to eliminate or minimize the impact of an adverse price movement on inventories or other previous commitments.

Speculation: Frequent movement in and out of the commodity futures market, holding either long or short positions, or both, without corresponding sales or purchases of commodities on the cash market.

Basic Feed Cost: Costs of the ration ingredients, plus the milling charge. This excludes the mark-up charge for yardage and management.

I. THE PLAN OF BUSINESS. The form of the business entity (herein sometimes referred to as the "venture") must be a limited partnership, or such other form of entity as to ensure that liability of public investors will be limited to the amounts of their respective investments, must provide adequate capitalization and investment in the venture by the sponsors and must reasonably assure the flow-through of tax deferral benefits to public investors.

- A. *Experience of Management.* At least one principal of the sponsor must have adequate experience in the cattle feeding business, including buying, selling, feeding and maintenance of beef cattle. Such experience must be of at least five years duration, with three of such years in feed lot operations exceeding 1,000 head capacity, and recently preceding the commencement of the publicly financed venture.
- B. *Capitalization of Sponsor and Investment by Sponsor.*
 - 1. The prospectus must contain audited financial statements of all sponsors which are corporations or partnerships indicating an ability to perform any commitment which is made in regard to the venture.
 - 2. The corporation or partnership; acting as a sponsor, must have a net worth sufficient to meet the requirements of the Ruling Branch of the Internal Revenue Service and have a favorable tax ruling, or an opinion of qualified tax counsel (acceptable to the administrator), assuring flow-through of tax benefits to the public investor.
 - 3. The sponsor must purchase for cash a minimum of \$100,000 in participation interests (which will be treated equally with investments by

public investors) in any entity which offers its cattle feeding interests to the public. If the aggregate offering of the equity (less underwriting discounts and commissions) is less than \$1,000,000, the sponsor may, in lieu of this requirement, purchase 10% of the offering, less underwriting discounts and commissions. In either case, the sponsor's required investment in participation interests may be reduced by 10% for each \$35,000 in tangible net equity possessed by the sponsor. In lieu of the sponsor making the above-described investment (if any is required), such investment may be made by any person or company owning 50% or more of the voting control of the sponsor.

- C. *Compensation.* Compensation to the sponsor (and its affiliates) of a venture is to be limited as follows:
1. All expenses of organizing the venture and selling interests therein to the public, including underwriting discounts and commissions, if any, must be borne solely by the sponsor if the sponsor is to receive up to the full 12Vjj% first year management fee described in Paragraphs 2 and 3 below, but such management fee shall not exceed the *actual* expenses of organizing the venture and selling interests therein to the public. If the publicly-owned venture (limited partnership, etc.) is to pay such expenses, the total of such expenses it shall pay, together with the first year management fee, shall not exceed 12~% of the gross receipts of the public offering.
 2. Ventures Which Do Not Engage in Affiliate Dealings. A maximum of 12Vj% of the dollar amount of gross cash receipts from a public offering is allowable to the sponsor as a "management fee" for the first year of operation. For each year thereafter, 5/8% per month of the venture's net assets is allowable to the sponsor as a management fee. Following pay- out to public investors, the sponsor may participate in the venture's profits in the following ratio: 25% to the sponsor and 75% to the public investors. The sponsor must pay all its administrative and overhead expenses. Other expenses of the limited partnership, including, but not limited to, buying services, transportation, interest on borrowed funds, legal, accounting and reporting expenses, branding and feed cost, where required to be paid by the venture, shall be billed to and paid directly by the venture to facilitate auditing. Veterinary services and medicines may be allocated, where direct billing is impractical.
 3. Ventures Which Engage in Affiliate Dealings. A maximum of 12V,% of the dollar amount of gross cash receipts from a public offering is allowable to the sponsor as a management fee for the first year of operation. Reasonable and competitive feed markups on feed sold to the partnership will be allowable. Basic feed costs shall not exceed those charged to other non-affiliated customers of the feed lot for the same types and grades of such feed nor may they exceed the cost of such types and grades of feed generally prevailing in the locale, at the time of purchase. The mark-up on feed sold to the partnership shall in no event exceed 20% of the basic feed cost. If any "yardage," "per head" or other handling charges of a general nature are to be made, the total of such charges together with the mark-up on feed shall not exceed 20% of the basic feed cost for any feeding cycle. If the sponsor deems it necessary to raise the foregoing limitations as to feed mark-up and handling charges, it may do so only annually and only upon

written notice to investors in the venture at least 60 days prior to the "beginning redemption date" mentioned in Section III.E. of these guidelines. Following pay-out to public investors, the sponsor may participate in the venture's profits in the following ratio: 25% to the sponsor and 75% to the public investors. The sponsor must pay all its administrative and overhead expenses. Other expenses of the limited partnership, including, but not limited to, buying services, transportation, interest on borrowed funds, legal, accounting, and reporting expenses, branding and feed cost, where required to be paid by the venture, shall be billed to and paid directly by the venture to facilitate auditing. Veterinary services and medicines may be allocated, where direct billing is impractical.

4. **Other Fees and Compensation in Ventures Which Engage in Affiliate Dealings.** The prospectus must clearly describe all dealings which the venture will have with the sponsor or its affiliates. Such description must contain a detailed disclosure of the fees to be paid to such parties. In addition, the prospectus must contain a schedule setting out, in summary, all fees and compensation to be paid directly to the sponsor as well as indirect fees to be paid to the sponsor or its affiliates.

D. *Periodic Reports.*

1. The sponsor shall provide periodically, at least quarterly, each public investor with a report which states the current value of his interest (on a cost basis or otherwise) and progress of the venture, in clear and concise terms in accordance with practices in general usage in the industry. Annual audited financial reports and tax information shall be furnished to the investor in a form which may be used in the preparation of the investor's individual income tax return.
2. The information to be provided in such report should comply with Section III.B. of these guidelines, and should include any other pertinent information regarding fixed and variable costs.

E. *Future Exchanges.* Any future exchanges of interests in the venture for common stock or other securities of any other entity shall be made solely upon compliance with applicable securities laws, both Federal and State, and must be in compliance with financial and other requirements generally applicable to initial public offerings by such entities. The public investors must be advised, in the prospectus, that any future exchange offers may not be available to them if the exchange offer fails to meet the registration requirements of the particular jurisdiction in which the investor resides. The sponsor must undertake to continue management, on the same terms, of the interest of investors who do not exchange their interests for interests in the new entity, until orderly liquidation of all cattle in the venture is completed.

F. *Exculpatory Clause.* The sponsor of a venture shall be deemed to be in a fiduciary relationship to the public investors, and the prospectus shall so state. Sponsors and affiliates shall not be exonerated from liability to investors for any losses caused by gross negligence or willful or wanton misconduct.

G. *Insurance and Death Loss.*

1. Casualty insurance or full mortality insurance may be maintained on all cattle

belonging to the venture, in the discretion of the sponsor, and if the best judgment of the sponsor the costs of such insurance are economically feasible.

2. The sponsor, at no additional cost to the venture, must guarantee against death loss above 4% occurring during the term of the venture or upon earlier termination of the management agreement. Such guarantee must include a specified indemnity which will be made at the earlier of termination of the venture or termination of the management agreement. Proof of loss must be produced in order for the sponsor to receive credit toward the 4% (in some manner subject to audit). The sponsor must provide for indemnification for any death loss whatever brought about due to negligence or misconduct on the part of the sponsor and/or its employees.
- H. *Leverage.* A venture may not engage in leveraging in excess of four to one and a limitation of the leveraging to be used must be set out in the prospectus, along with a clear explanation of the risk involved in leveraging.
- I. *Hedging and Speculation.* If the plan of business of the venture includes the purchase or sale of commodities futures contracts, such purchases and sales must be limited in extent and frequency to those instances deemed reasonably necessary to protect the venture against price fluctuations in the cattle or grain market. The purchase or sale of commodities futures contracts may be for the purpose of hedging only and such transactions may not be for purposes of speculation. The public investors must be notified, in writing, at the earliest practicable time (at least monthly) of the terms of any commodity futures contract transactions for the venture.
- J. *Facilities.* Feed lots in which the venture's cattle are to be fed must have a capacity of 5,(XX) head or more. The sponsor must have reasonable assurance that it will have access to feed lots with combined total capacity of 20,000 head or more for feeding of the venture's cattle prior to the public offering. All such feed lots must have available the services of a veterinarian and nutritionist and must keep detailed records of all cattle processed, including the venture's cattle, and all services and goods provided for all cattle in the feed lot, and must agree to make all such records available to the venture's auditors and to the sponsor. In geographic areas where the feed lots of 5,000-head capacity or more are unusual, the numbers mentioned above in this paragraph may be reduced by as much as one half in the administrator's discretion.
- K. *Branding and Accountability of Property.* Cattle belonging to the venture must be clearly distinguishable (branded with the venture's brand) at the earliest practicable time, and not more than 24 hours after placement in the feed lot under normal circumstances. All cattle, feed and funds belonging to the venture 'must-be strictly accounted for, and identified to the extent practicable, throughout the life of the venture. The cost of feed and services to the venture shall not be in any way artificially increased (other than customary, mark-ups mentioned elsewhere herein. See Section 1. C. 3.), which duty the sponsor shall indicate in the prospectus.
- The weighing of all feed and cattle to be sold to the Venture and all cattle to be sold by the venture shall be done on sealed certified scales, certified by the governmental authority (if any) having jurisdiction thereof in the particular locality. The weighing of feed ration upon delivery to the venture's cattle shall be done on certified scales when practicable, and otherwise on truck scales which are daily compared for accuracy with certified scales.

L. *Conflicts of Interest.*

1. The prospectus must fully describe all conflicts of interest between the public investors and the sponsor and its affiliates.
2. No fees, commissions, or other remuneration of any kind may be received by the sponsor or its affiliates, directly or indirectly, in connection with the venture which are not set out and fully disclosed in the prospectus.
3. No fee may be charged the venture upon the sale of venture cattle.
4. The venture's cattle may not be sold to the sponsor or its affiliates, directly or indirectly, except that finished cattle may be sold to an affiliated packer on a dressed carcass basis with payment on the basis of U.S.D.A. quality and yield grades, provided the packer reports to the public investors prices paid for other cattle on the same date and reports the nearest U.S.D.A. Market News Quotations of comparable grade and yield. The venture's cattle may not be purchased from the sponsor or its affiliates, directly or indirectly. When an affiliate acts as a commission buyer, he may be paid commissions on the purchase of cattle for the venture at rates not exceeding those customary in the industry, and may take title to the cattle on behalf of the registered ventures during any necessary interim while pen-size lots are being formed.

II. PLAN OF DISTRIBUTION.

- A. *Minimum Unit.* The minimum investment by a public investor shall be \$5,000 and the initial investment by a public investor shall be no less than \$5,000, all of which must have been paid at the date the venture commences. Assignability of a public investor's interest must be limited so that no assignee (transferee) or assignor (transferor) may hold less than a \$5,000 interest, except by gift, inheritance, or Court decree.
- B. *{Prohibition of Assessment.}* Public investors' interests in a cattle feeding venture may not be assessed (the public investors may not be compelled in any way to make additional capital contributions to the venture).
- C. *Advertising Materials.* Sales of the venture interests must be made by and through a prospectus. Supplementary material must be submitted to the administrator in advance of use, and its use must either be preceded by or accompanied with an effective prospectus. Informational material may, and should be, distributed to public investors already in the venture on a periodic basis.
- D. *Sale of Venture Interests.*
1. Interests may be sold by sponsors and/or registered broker-dealers and/or affiliates of the sponsors. Officers and directors of the sponsors who sell interests must be licensed as broker-dealers when required by statute and may be paid no commission, either directly or indirectly, in any form in connection with the sale of the interests.

2. Compensation to broker-dealers shall be a one time only cash commission. Indeterminate compensation to broker-dealers is prohibited. In the absence of a firm underwriting, warrants or options to broker-dealers are prohibited.
3. The broker-dealer, or the sponsor in the case of direct sales, shall take all action reasonably required to assure that venture interests are sold only to purchasers for whom such interests are suitable.

Judgment of suitability of any particular venture interest for an individual investor shall be based on the financial capacity of the purchaser, including the purchaser's net worth and income tax bracket, after a reasonable inquiry into the purchaser's financial condition and other related and relevant factors as may be appropriate.

The broker-dealer or sponsor shall retain all records necessary to substantiate the fact that interests were sold only to purchasers for whom such securities were suitable. Securities administrators may require broker-dealers or sponsors to obtain from the purchaser a letter justifying the suitability of such investment.

4. Compensation to wholesale dealers must be a cash commission and such commission must be reasonable and fully disclosed.

III. PROSPECTUS AND ITS CONTENTS.

A. *Term of the Venture.* The prospectus must clearly state the period of time for which the venture will operate. Such term may not initially exceed ten years in duration. If the sponsor retains the right to extend the period of the venture beyond the initial term, such right of continuance must be disclosed in the prospectus. No venture shall be formed with a contemplated term of less than three years.

B. *History of Operations and Reporting Requirements.* The sponsor's history of operation shall be fully disclosed, and all fees and remunerations, direct and indirect, received by the sponsor or an affiliate in each publicly-owned venture shall be scheduled. The prospectus must contain a schedule setting out, on an annual or other accounting period basis, the following information for the preceding three-year period or for such shorter period as the sponsor has been engaged in cattle feeding operations:

1. Average purchase weight of feeder cattle, by sex.
2. Average weight into the feed lot, by sex.
3. Average cost per head.
4. Buying commissions paid.
5. Average freight costs into the yard.
6. Average length of time on feed, by sex.
7. Average total cost of gain (per pound); specifying basis of computation of weight gain (pay weight to pay weight or in-weight to pay weight).
8. Average feed cost of gain (per pound); specifying basis of computation of weight gain (pay weight to pay weight or in-weight to pay weight).
9. Average interest rate on borrowed operating capital.
10. Other management or selling charges, if any.
11. Death loss (per cent).
12. Average sales weight, by sex (after 4% shrink at feed lot).

13. Average sales price per cwt, by sex.
14. Average profit or loss per head, by sex (estimated if not known).
15. Average equity investment per head, by sex (estimated if not known).

For ventures which engage in affiliate dealings, the prospectus must set out the above information, for each feed lot, for the following categories:

1. Custom feeding, to the extent such information is known.
2. Cattle fed for the account of the sponsor and/or all affiliates.

The above information shall also be furnished to the public investors in the venture on at least an annual basis.

- C. *Area of Operations.* A general description of the areas in which it is anticipated that the venture's activities will be conducted shall be set out.
- D. *Maximum and Minimum.* The prospectus shall indicate the maximum amount of subscriptions to be sought from the public and the minimum amount of subscriptions necessary to activate the venture. The minimum amount of funds to activate the venture shall be sufficient to accomplish the objectives of the venture, including "spreading the risk" and shall be set out in the prospectus. Any minimum less than \$250,000 will be presumed to be inadequate to spread the risk of the public investors. Provision must be made for the return to public investors of 100% of paid subscriptions in the event that the established minimum to activate the venture is not reached.
- E. *Repurchase of Venture interests.* No representations shall be made that venture interests are readily marketable. Public investors must be allowed to withdraw from the venture on at least an annual basis, following the first full year of operation of the venture. The beginning redemption date for each year shall be specified in the prospectus, and public investors desiring to withdraw shall give written notice to the sponsor at least 30 days prior to such beginning redemption date. As to all cattle owned by the venture on the beginning redemption date, the-withdrawing investor shall have a liquidating interest, and his account will be credited with his pro rata share of the proceeds of sales of all such cattle. As 'soon as practicable after the liquidation of all such cattle, the withdrawing investor shall be paid his pro rata share of such proceeds. A penalty, not to exceed ten per cent of the proceeds credited to his account, may be charged the investor who chooses to withdraw prior to the end of the venture. No penalty may be charged at the termination date. of the venture, nor at any time thereafter if the termination date is extended, nor after the venture has been in existence for five years, whichever time is earlier. The ten per cent penalty for early withdrawal must be credited to the venture.
- F. *Tax Considerations.*
 1. The sponsor of the venture must obtain an Internal Revenue Service ruling, or an opinion of qualified-tax counsel (acceptable to the administrator) stating that' the desired income tax treatment will be accorded the venture.
 2. The prospectus must fully disclose all tax benefits and liabilities associated with investment in the venture. It shall be clearly disclosed in the prospectus that the venture is not a tax shelter.
- G. *Use of Proceeds.* The prospectus must clearly account for the use of the proceeds of the offering. Proposed use should be set out in dollar amounts as well as percentages of the total offering proceeds. Funds to be obtained through leveraging are also subject to these

requirements.

- H. *{Schedule of Investment Examples}* The prospectus may contain, in summary form, a schedule setting forth examples of an investment in a cattle feeding venture. Such schedule must contain three examples: (1) Showing a loss on investment, (2) Showing a break-even on investment, and (3) Showing a profit on investment, commensurate with the loss shown in the first schedule.
- I. *Completeness.* The prospectus must contain all material facts necessary for the public investor to make an investment decision and for the administrator to make a finding after examination as to the fairness of the proposed offering. Any disclosure required by these guidelines to be included in the prospectus, which disclosure is prohibited by the United States Securities and Exchange Commission, may be waived by the administrator.