

**Securities Act Exemptions/
Private Placements
December 2013**

Securities Act of 1933 – Registration Framework

- § 5 - Must register all transactions absent an exemption from the registration requirements
- § 4 - Transactional exemptions
- § 4(a)(2) - Private Placement Exemption
 - “Transactions by an issuer not involving any public offering.”
- Section 4(a)(1½) exemption evolved in practice
 - Not embedded in the Securities Act
- Lack of access to public capital markets increases importance of exemptions from Section 5 registration requirements

What We Will Cover

- § 4(a)(2)
- Regulation D and the JOBS Act
- Integration
- Regulation A
- Intrastate Offerings
- Rule 701
- Crowdfunding

Section 4(a)(2)

Section 4(a)(2)

- Issuer exemption
 - most utilized issuer exemption
 - application of the private placement exemption, however, has been the subject of significant debate due in large part to the brevity of its wording
 - not a “public offering” has been defined by case law and SEC interpretation and one may look to safe harbors as well
- Transactional exemption
- Restricted securities – securities sold in a private placement may not be resold absent registration or exemption from registration

Exemptions: 4(a)(2) and Ralston-Purina

SEC v. Ralston Purina Co., 346 U.S. 119 (1953)

- Supreme Court confirmed SEC position that offers and sales to a large number of employees by Ralston Purina under its stock plan were not exempt under Section 4(a)(2); provided the following “guidance:”
 - §4(a)(2) exemption focuses on “offerees” and not actual purchasers of the securities.
 - § 4(a)(2) exemption does not depend upon a numerical test; Court rejected SEC argument that extensive number of offerees was sufficient by itself to establish loss of exemption.
 - Availability of §4(a)(2) exemption “*should turn on whether the particular class of persons...need the protection of the [’33] Act*” and whether the offerees “*are shown to be able to fend for themselves.*”
 - Court stated that where offerees do not have “access to the kind of information” that a registration statement would disclose, issuer required to provide same kind of information that otherwise generally would be available in a registration statement.

Safe Harbors

Safe Harbors

- Rules and regulations that set forth conditions the satisfaction of which will ensure that there has not been a public offering
- Regulation D for offerings

Regulation D — Rules 501-508

- Includes
 - Exemption for certain offerings by issuers under \$5 million (Rules 504 and 505)
 - Private placement safe harbor (Rule 506)
- Non-exclusive safe harbor
- § 4(a)(2) still available (to the extent general advertising and general solicitation are not used)

Resale Limitations

- Rule 502(d)
 - “The issuer shall exercise reasonable care to assure that the purchasers of the securities are not underwriters.”
- Reasonable care =
 - Reasonable inquiry of purchasers
 - Written disclosure to purchasers that resale is restricted
 - Legends

Disclosure Requirement

- None mandated for accredited investors or for Rule 504 transactions (< \$1 million)
 - Anti-fraud rules apply
- Mandated for non-accredited investors (Rule 502(b))
 - Generally, registration statement-like disclosure
 - Financial statement requirement varies based on size of transaction

Blue Sky Considerations

- Securities that are sold pursuant to Rule 506 are considered “covered securities” for purposes of Section 18(b)(4)(D) of the Securities Act
 - This means that securities sold in reliance on Rule 506 are exempt from state securities review
- An issuer that relies on Section 4(a)(2) will need to consider state securities requirements

Rule 506 Safe Harbor Requirements

- Rule 506 is the most widely used exemptive rule under Regulation D, accounting for the overwhelming majority of capital raised under Regulation D.
- Traditional requirements of a Rule 506 private placement include:
 - No dollar limit on size of transaction.
 - Unlimited number of accredited investors and no more than 35 unaccredited investors.
 - No general solicitation or advertising (now prohibition against general solicitation has been eliminated for 506(c) offerings).
 - Resale limitations.
 - Disclosure required for non-accredited investors.
 - Form D filing within 15 days of first sale of securities.
 - Good faith effort to comply (Rule 508).

Rule 506 Purchasers

- Accredited Investors (Rule 501)
 - Institutional investors such as banks, S+Ls, broker-dealers, insurance companies, investment companies
 - Corporations or trusts with assets in excess of \$5 million
 - Not formed for purpose of making the investment (look-through rule)
 - Directors and officers of the issuer
 - Individuals with
 - Income > \$200,000 or joint income > \$300,000
 - Net worth or joint net worth > \$1 million*
 - Entity in which all equity owners are accredited investors

* Dodd-Frank Act of 2010 amended definition to eliminate ability of individuals to include the equity value of primary residences in calculation of net worth

Rule 506 Purchasers (cont'd)

- Non-accredited investors
 - Sophistication required
 - Alone or with Purchaser Representative

“Accredited Investor” Reviews

- Dodd-Frank Act provides that, upon enactment and for four years following enactment, the net worth threshold for accredited investor status will be \$1 million, excluding the equity value (if any) of the investor’s primary residence
- One year after enactment, the SEC is authorized to review the definition of the term “accredited investor” (as it is applied to natural persons) and to adopt rules that adjust the definition, except for modifying the net worth threshold
- Four years after enactment, and every four years thereafter, the SEC must review the “accredited investor” definition as applied to natural persons, including adjusting the threshold (although it may not be lowered below \$1 million)

New Accredited Investor Definition

- On December 21, 2011, the SEC adopted final rules, amending the accredited investor standard to reflect the requirements of the Dodd-Frank Act.
- As amended, the new individual net worth standard in the accredited investor definition under rule 215 and rule 501 of Regulation D is:
 - Any natural person whose individual net worth, or joint net worth with that person's spouse, exceeds \$1,000,000.
 - The person's primary residence shall not be included as an asset;
 - Indebtedness that is secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, shall not be included as a liability (except that if the amount of such indebtedness outstanding at the time of the sale of securities exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and
 - Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities shall be included as a liability.

Accredited Investor Definition

- The GAO conducted a study of the “accredited investor” standard recently and considered whether the standard remained useful in assessing whether a prospective investor was financially sophisticated. The GAO study also considered alternatives, such as an investments made standard, a literacy test, etc.
- The accredited investor definition has come under scrutiny given the relaxation of the ban on general solicitation in certain Rule 506 offerings.
- The SEC requested public comment on the “accredited investor” definition recently in connection with its proposal to amend Form D and Regulation D.

No General Solicitation or Advertising

- Prohibition applies to issuer and its agents
- Rule 502(c)
 - No general solicitation or advertising
 - No seminar with attendees invited by general solicitation or advertising
- Importance of preexisting substantive relationship with offerees
- Importance of process safeguards
- The significance of being “in registration”
 - Black Box and Squadron, Elenoff No-Action letters (QIBs and a limited number of institutional accredited investors) and C&DI guidance
- Rule 135c
 - Safe harbor for limited issuer announcement of exempt offering

The JOBS Act: Rule 506 Changes

- The JOBS Act contains various provisions that affect exempt offerings.
- Title II of the JOBS Act directs the SEC to eliminate the ban on general solicitation and general advertising for certain offerings under Rule 506 of Regulation D, provided that the securities are sold only to accredited investors, and under Rule 144A offerings, provided that the securities are sold only to persons who the seller (and any person acting on behalf of the seller) reasonably believes is a QIB.

Title II: SEC Proposal

- On August 29, 2012, the SEC proposed amendments to Rule 506 of Regulation D and Rule 144A under the Securities Act to implement Section 201(a) of the JOBS Act
- There were significant public comments on the proposed amendments
 - Many objected to the SEC's facts-and-circumstances approach to investor verification
 - Concerns were raised regarding the lack of "content" standards in relation to solicitation materials
 - Investor and consumer advocacy groups expressed concerns regarding the lack of investor protection measures
 - Some advocated amending the "accredited investor" standard

Relaxation of the Ban on General Solicitation

- The SEC's final rules implement a bifurcated approach to Rule 506 offerings
 - As proposed, an issuer may still choose to conduct a private offering in reliance on Rule 506(b) without using general solicitation
- In order to implement this approach, the SEC adopted a new paragraph (c) in Rule 506, which permits the use of general solicitation, subject to the following conditions:
 - The issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors;
 - All purchasers of securities must be accredited investors, either because they come within one of the enumerated categories of persons that qualify as accredited investors or the issuer reasonably believes that they qualify as accredited investors, at the time of the sale of the securities; and
 - The conditions of Rule 501 and Rules 502(a) and 502(d) are satisfied

Reasonable Steps to Verify Investor Sales

- The final rule retains the principles-based guidance, highlighting that the inquiry to be undertaken may differ depending on the facts and circumstances. The SEC provides a list of factors to consider:
 - *The nature of the purchaser.* The SEC describes the different types of accredited investors, including broker-dealers, investment companies or business development companies, employee benefit plans, and wealthy individuals and charities
 - *The nature and amount of information about the purchaser.* Simply put, the SEC states that “the more information an issuer has indicating that a prospective purchaser is an accredited investor, the fewer steps it would have to take, and vice versa”
 - *The nature of the offering.* The nature of the offering may be relevant in determining the reasonableness of steps taken to verify status, *i.e.*, issuers may be required to take additional verification steps to the extent that solicitations are made broadly, such as through a website accessible to the general public, or through the use of social media or email

Reasonable Steps to Verify Investor Sales (cont'd)

- The final rule does not provide for a safe harbor; however, it does set out a supplemental non-exclusive list of methods that may be used to satisfy the verification requirement, including:
 - A review of IRS forms for the two most recent years and a written representation regarding the individual's expectation of attaining the necessary income level for the current year;
 - A review of bank statements, brokerage statements, tax assessments, etc. to assess assets, and a consumer report or credit report from at least one consumer reporting agency to assess liabilities;
 - A written confirmation from a registered broker-dealer, RIA, CPA, etc.
 - For existing investors (pre-506(c) effective date), a certification
- The SEC confirmed the view that Congress did not intend to eliminate the existing "reasonable belief" standard Rule 501(a) of the Securities Act or Rule 506 offerings

Reasonable Steps to Verify Investor Sales (cont'd)

- The SEC confirmed that if a person were to supply false information to an issuer claiming status as an accredited investor, the issuer would not lose the ability to rely on the proposed Rule 506(c) exemption for that offering, provided the issuer “took reasonable steps to verify that the purchaser was an accredited investor and had a reasonable belief that such purchaser was an accredited investor”

Relaxation of the Ban on General Solicitation (cont'd)

- In addition to the changes to Rule 506, the SEC also amended Rule 144A to eliminate references to “offer” and “offeree,” and thus require only that the securities are sold to a QIB or to a purchaser that the seller and any person acting on behalf of the seller reasonably believe is a QIB
- Resales of securities pursuant to Rule 144A could be conducted using general solicitation, so long as the purchasers are limited in this manner
- The SEC reiterates that general solicitation in connection with a Rule 144A offering will not be viewed as a “directed-selling effort” in connection with a concurrent Regulation S offering
- The rule amends Form D to add a check box to indicate whether the issuer is relying on Rule 506(c)

Private Offerings

- Title II of the JOBS Act does not modify the statutory private placement exemption, Section 4(a)(2)
- Title II of the JOBS Act and the SEC final rules only affect offerings conducted pursuant to Rule 506(c) and Rule 144A offerings
- The final SEC rules do not amend or modify the requirements relating to existing Rule 506(b)
- The release does not address other communications safe harbors that may be affected by the relaxation of the ban on general solicitation, nor does it address integration issues

Bad Actor Rules

New “Bad Actor” Disqualification

- Unlike Rule 505 of Regulation D, Regulation E and Regulation A, Rule 506 of Regulation D does not currently contain “bad actor” disqualification provisions
 - “Bad actor” disqualification requirements prohibit issuers and others, such as underwriters, placement agents, directors, officers, and shareholders of the issuer, from participating in exempt securities offerings, if they have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws
- The SEC proposed the adoption of “bad actor” provisions in 2007, but did not take final action on that proposal (SEC Rel. No. 33-8828 (Avail. August 3, 2007))
- In May 2011, the SEC proposed amendments to rules promulgated under Regulation D to implement Dodd-Frank Act Section 926’s provision regarding the “bad actors” for Regulation D

Covered Persons

- The amendment adds a new Section 506(d) to Regulation D.
- This new section encompasses disqualification provisions that are substantially similar in their effect to the bad actor disqualification provisions that are currently codified in Rule 262 of Regulation A.
- The provisions are applicable only in the context of Rule 506 offerings. The SEC will address bad actor disqualification provisions for crowdfunded offerings and Regulation A+ (3(b)(2)) offerings in the future.

Covered Persons (cont'd)

- The disqualification provisions apply to the following “covered persons”:
 - The issuer and any predecessor of the issuer or affiliated issuer;
 - Any director, executive officer, other officer participating in the offering process, general partner, or managing member of the issuer;
 - Any beneficial owner of 20 percent or more of any class of the issuer’s voting equity securities, calculated on the basis of voting power;
 - Any investment manager to an issuer that is a fund and any director, executive officer, officer participating in the offering, general partner, or managing member of the manager, as well as any director, executive officer or officer participating in the offering of any such general partner or managing member;
 - Any promoter connected with the issuer in any capacity at the time of the sale;
 - Any person that has been or will be paid, directly or indirectly, remuneration for solicitation of purchasers in a securities offering; or
 - Any director, executive officer, other officer participating in the offering, general partner, or managing member of any compensated solicitor

Disqualifying Events

- The rule includes the following categories of disqualifying events
 - Criminal convictions;
 - Court injunctions and restraining orders;
 - Final orders of certain state regulators (such as securities, banking, and insurance) and federal regulators;
 - The CFTC was added to the list of regulatory agencies;
 - A definition of “final order” was added to Rule 501
 - Commission disciplinary orders relating to brokers, dealers, municipal securities dealers, investment advisers, and investment companies and their associated persons;
 - Certain Commission cease-and-desist orders;
 - Suspension or expulsion from membership in, or suspension or barring from association with a member of, a securities self-regulatory organization (“SRO”);
 - Commission stop orders and orders suspending a Regulation A exemption; and
 - U.S. Postal Service false representation orders

Reasonable Care Exception

- Consistent with the proposed rule, the final rule contains a reasonable care exception that applies if an issuer can establish that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of the presence or participation of a covered person
- Issuer would need to conduct a factual inquiry; the SEC notes that the type of inquiry will depend on the facts and circumstances

Satisfying Reasonable Case Burden

- Issuers will be required to implement new procedures in connection with any Rule 506 offering
 - This may be especially burdensome for private funds that regularly conduct private offerings in reliance on Rule 506
- Issuers may consider:
 - Adding additional questions to D&O questionnaires,
 - Requiring placement agents to complete a questionnaire or provide a representation
 - Require other participants (that may be covered persons) to complete questionnaires or provide representations
 - For funds or other issuers engaged in continuous or delayed offerings, refreshing or updating their diligence

Waivers

- The rule permits the Commission to grant waivers upon a showing of good cause
- The rule does not articulate standards for granting waivers
- The adopting release lists various circumstances that might be relevant to a waiver, such as a change of control, a change of supervisory personnel, absence of notice and an opportunity for hearing, and a relief from a permanent bar for a person who does not intend to apply to reassociate with a regulated entity

Mandatory Disclosures of Triggering Events Pre-Dating Effective Date

- To address the comments relating to the proposed rules, which applied a retrospective approach to disqualifying events, the final rule considers trigger events that occur following the effective date
- However, the rule requires written disclosure of matters that would have triggered disqualification, except that these actions occurred prior to the effective date of the rule
 - Disclosures apply to all Rule 506 offerings
 - Disclosures must be provided “a reasonable time prior to sale”
 - Relief under Rule 508 will not be available for a failure to provide disclosures

Amendment to Form D

- The signature block of current Form D was amended
- The certification was broadened, so that issuers claiming a Rule 506 exemption will confirm that the offering is not disqualified from reliance on the Rule 506 exemption.

Market Impact

Regulation D Offerings

- Contemporaneous with the release of the final rules, the SEC also published an updated study on the private offering market, which showed that Regulation D, and especially Rule 506 offerings, are an extremely important capital-raising alternative
- The relaxation of the ban on general solicitation is likely to make the exemption even more popular; however, many issuers will continue to use Rule 506(b)
- An issuer considering a financing is likely to continue to favor Rule 506 versus other options
 - No information requirements
 - No dollar threshold
 - Covered security (for blue sky purposes)
- If the issuer does not rely on general solicitation, it will still have the Section 4(a)(2) exemption available to it

Weighing the Alternatives

- Private offerings:
 - Already public companies that conduct private offerings (PIPEs) will almost certainly continue to rely on Section 4(a)(2) and Rule 506(b)
 - Likewise, traditional venture and private equity financings may continue to be structured as Rule 506(b) offerings
 - On balance, for these particular offerings, the ability to use general solicitation is unlikely to provide added value, and the issuer would still have the Section 4(a)(2) exemption available to it
 - Generally, the rules are likely to have the greatest impact for private companies and for funds and these entities will weigh carefully the costs/benefits of general solicitation
- Rule 144A
 - It is unlikely that the conduct of Rule 144A offerings will vary much – other than perhaps press releases
 - Rule 144A offerings are likely to become even more popular with institutional investors once FINRA disseminates data on 144As

Weighing the Alternatives (cont'd)

- Issuers at an earlier stage may be more likely to use general solicitation, and these may be issuers that have not retained a financial intermediary
- A third-party verification service will be especially useful in this case given that it likely will be accustomed to handling financial information
 - Consider whether third-party verification service is a registered broker-dealer or a registered investment adviser
 - Conduct diligence regarding the third-party verification service and its procedures
- If the issuer proposes to undertake the verification process on its own, the issuer should implement special procedures and consult with counsel. Counsel will be asked to render a “good private placement” opinion

Using General Solicitation

- In a transaction with a financial intermediary, the issuer, the financial intermediary and their counsel should discuss the types of communications that will be used, and all communications should be approved by the issuer and its counsel
 - This can be covered in the engagement letter and/or the placement agency agreement (if there is one) in a manner similar to that in which market participants address the use of test-the-waters materials or FWPs
- The issuer should establish its own media or communications policy and identify the officers that are permitted to speak on its behalf
 - The issuer will want to ensure that it controls the solicitation process, and that employees and other unauthorized persons are not engaging in general solicitation on its behalf
 - The issuer will want to review its social media policy
 - An issuer that is a private fund or a CPO may be subject to more prescriptive rules relating to the content of the communications

Using General Solicitation (cont'd)

- If a registered broker-dealer is participating in the offering, it will want to ensure that:
 - It has identified the group within the bank that will be involved
 - It has undertaken training to make certain that each member understands the requirements under FINRA Rule 2210 and FINRA Rule 5123
 - Under FINRA Rule 2210, most communications likely to be used in connection with general solicitation will be considered “retail communications”
 - Communications must be fair and balanced
 - Communications will be subject to review, filing with FINRA and recordkeeping requirements
 - It will want to remind bankers of the firm’s social media policy
- FINRA already is focused on Regulation D offerings and recently announced a sweep on social media issues

Using General Solicitation (cont'd)

- If the issuer is a CPO, it (and its principals and adviser) will be subject to
 - CFTC Rule 4.41
 - Communications must not be deceptive
 - The use of any testimonial is subject to special requirements
 - The use of hypothetical performance information is prohibited, subject to certain exceptions
 - NFA Rule 2-29
 - Communications cannot contain any material misstatement or material omission
 - Communication must be fair and balanced, and cannot mention possibility of profit without an equally prominent statement regarding risk of loss

Using General Solicitation (cont'd)

- If the issuer is a private fund, its adviser (if it is a registered investment adviser) will be subject to certain regulations, including Rule 206(4)-1 under the Advisers Act
 - Under 206(4)-1, an investment adviser will violate the Advisers Act's anti-fraud provisions if it publishes, circulates or distributes "any advertisement" that:
 - Refers, directly or indirectly, to "testimonials of any kind concerning the investment adviser" or the investment advice it provides;
 - Refers, directly or indirectly, to past specific recommendations it provides (e.g., "cherry picking"), unless the adviser discloses a list of all recommendations, subject to certain requirements;
 - Represents that a graph, chart or formula, by itself, can be used to determine which securities to buy, without prescribed disclosures;
 - Contains a statement to the effect that a report, analysis or other service will be furnished free of charge, unless it is actually provided entirely free of charge without condition; or
 - That contains any untrue statement of a material fact, or that is otherwise false or misleading.

Using General Solicitation (cont'd)

- If the issuer is a private fund that is relying on an exemption from registration as a commodity pool, such as the “de minimis” exemption, then, the issuer may want to wait for guidance from the CFTC regarding its interpretation of CFTC Rule 4.13

Changes to Offering Procedures

- For any Rule 506 offering, implement changes to address bad actor rule
- Issuers should consider:
 - Adding additional questions to D&O questionnaires;
 - Having 20% or greater shareholders complete questionnaires;
 - Public companies should be able to determine their 20% holders through their public filings (Form 10-K, Form 3 filings, Schedule 13D and 13G filings);
 - Non-public companies should contact their transfer agent and registrar;
 - Requiring placement agents to complete a questionnaire or provide a representation;
 - For example, in a placement agent agreement for a Rule 506 offering, the issuer and the placement agent could make mirror representations that (i) they are not subject to a disqualifying event, have obtained a waiver from disqualification or have fully disclosed any disqualifying event that occurred prior to the effective date of the amendments and (ii) have informed the other party of any event or proceeding that could, with the passage of time, become a disqualifying event;

Changes to Offering Procedures (cont'd)

- Require other participants (that may be covered persons) to complete questionnaires or provide representations; and
- For funds or other issuers engaged in continuous or delayed offerings, refreshing or updating their diligence, such as through bring-down representations, questionnaires and certifications, negative consent letters, periodic re-checking of public databases and other steps, depending on the circumstances;
- Placement agents should consider:
 - Prior to any Rule 506 offering, conducting diligence on issuers and other offering participants so that any disqualifying events that occurred prior to the effectiveness of the amendments can be properly disclosed and determining whether the new representations described above can be made (including discussing the potential impact of any event that, with the passage of time, could become a disqualifying event); and
 - Reviewing Forms U-4, U-5 and U-6 and comparing any events described in those forms to the disqualifying events enumerated in Rule 506(d)(1), in preparation for the possibility of either disclosing such events as pre-effectiveness disqualifying events or to confirm compliance with any of the new representations described above.

Legal Opinions

- In connection with most exempt offerings, issuer's counsel is asked to furnish an opinion that the offering need not be registered under the Securities Act
- There is likely to be some variation in practice at least early in regarding the types of "back-up" certificates or other factual inquiry that firms may need to conduct in order to render this opinion

Regulation D — Summary

	Rule 504	Rule 505	Rule 506(b)	Rule 506(c)
Aggregate Offering Price Limitation	\$1,000,000 (12 mos.)	\$5,000,000 (12 mos.)	Unlimited	Unlimited
Number of Investors	Unlimited	35 plus unlimited accredited	35 plus unlimited accredited	Unlimited; only AIs
Investor Qualifications	None required	None required	Purchaser must be sophisticated (alone or with representative); accredited presumed to be qualified	Accredited investors only
Sales Commissions	Permitted	Permitted	Permitted	Permitted
Limitations on Manner of Offering	Usually no general solicitation permitted	No general solicitation permitted	No general solicitation permitted	General solicitation permitted
Limitations on Resale	Usually restricted	Restricted	Restricted	Restricted
Issuer Qualifications	No Exchange Act reporting “blank-check” or investment companies	No investment companies or issuers disqualified under Regulation A (except upon SEC determination)	None	None
Notice of Sales	5 copies of form D to be filed with SEC within 15 days after first sale (called for by Regulation D, but not required for exemption).			
Information Requirements	None	1. If purchased solely by accredited investors, no information specified.		

Regulation D — Summary (cont'd)

	Rule 504	Rule 505	Rule 506(b)	Rule 506(c)
Information Requirements			<p>2. If purchased by nonaccredited investors,</p> <p>a. nonreporting companies under the Exchange Act must furnish the same kind of information as in a registered offering, or in a Regulation A offering if eligible, but with somewhat modified financial statement requirements;</p> <p>b. reporting companies must furnish (i) specified Exchange Act documents or (ii) information contained in the most recent specified Exchange Act report or Securities Act registration statement on specific forms, plus, in any case, (iii) updating information and limited additional information about the offering.</p> <p>c. Issuers must make available prior to sale:</p> <ul style="list-style-type: none"> i. Exhibits ii. Written information given to accredited investors; iii. Opportunity to ask questions and receive answers; <p>d. Issuers must advise purchasers of the limitations on resale.</p>	N/A --- cannot be sold to nonaccredited investors

Integration

§ 4(a)(2) Remains Available

- The JOBS Act does not amend Section 4(a)(2); it only requires the SEC to amend Rule 506
- SEC Rel. No. 33-4552 (Nov. 6, 1962)
 - Relationship between offerees and issuer
 - Nature, scope, size and manner of offering
- ABA Federal Regulation of Securities Committee, Section 4(2) and Statutory Law, 31 Bus. Law. 485 (1975)
 - Offeree qualification
 - Availability of information
 - Manner of offering
 - Absence of redistribution

Integration

- Prevents circumvention of registration requirements by separating single non-exempt offering into several exempt offerings
- Six-month safe harbor – Rule 502(a)
- SEC's integration doctrine may apply to an offering that otherwise qualifies for an exemption under Regulation D

Integration – Five Factors Test

- Under SEC’s integration doctrine, the following factors (“five factors”) are considered in determining whether one sale of securities by an issuer will be integrated with (*i.e.*, treated as part of the same offering as) a prior or subsequent offer or sale of securities by the issuer:
 - Part of a single financing plan;
 - Issuances of the same class of securities;
 - Sales occur at or about the same time;
 - Same type of consideration is received; and
 - Proceeds will be used for same general purpose.

Integration – Safe Harbors

- Safe harbor for offshore offerings
 - Regulation S (“Reg S”) provides that offshore sales under Reg S generally are not integrated with offerings in the United States.
- Rule 152
 - Provides that the phrase “transactions by an issuer not involving any public offering” contained in Section 4(a)(2) of the Securities Act will be deemed to apply to transactions not involving any public offering at the time of the transactions although the issuer subsequently decides to make a public offering and/or files a registration statement.
 - **Practical application:** If a good private placement is either completed (or abandoned), the transaction will not be integrated with a later public offering of additional securities (or of the abandoned unsold securities), and the five-factor integration test need not be applied.

Integration — Safe Harbors (cont'd)

- Rule 155(b) – Private → Registered
 - Safe harbor for changing a private offering into a registered offering so long as
 - No securities are sold in the private offering,
 - All offering activity is terminated prior to filing the registration statement,
 - The prospectus for the public offering discloses certain information about the private offering. and
 - The registration statement is not filed until at least 30 days after the termination of all offering activity, unless the private offering was made only to accredited or sophisticated investors, in which case the issuer may file immediately after terminating the private offering.

Integration — Safe Harbors (cont'd)

- Rule 155(c) – Registered → Private
 - Safe harbor for abandoning a registered offering and conducting a private offering so long as
 - No securities are sold in the registered offering,
 - The issuer withdraws the registration statement,
 - The private offering does not commence until 30 days after withdrawal of the registration statement,
 - The issuer notifies the private offerees that (1) the offering is not registered, (2) the securities will be restricted, (3) protection under Section 11 of the Securities Act will not be afforded and (4) a registration statement was filed and withdrawn, and
 - The private offering materials disclose any material changes to the issuer's affairs that are material to the investment decision in the private offering.

Integration — No-Action Letters

- **Black Box and Squadron, Ellenoff SEC No-Action Letters**
 - **Facts:** Restructuring involving the following transactions to occur simultaneously:
 - Existing security holders to receive new securities in a private placement in exchange for existing securities,
 - New capital to be raised in a private placement of convertible debentures and
 - New capital to be raised in an initial public offering.
 - **Outcome:** The private placement with existing security holders and the private placement of the convertible debentures need not be integrated with the later public offering because
 - The existing security holders and investors would have entered into their respective agreements prior to the filing of the registration statement and
 - The private placements would be completed prior to the filing given that the obligations to acquire the securities would be subject only to the satisfaction of specified conditions outside of the control of the security holders and investors.

Integration — No-Action Letters (cont'd)

- **Policy**

- If the private placement of the convertible debentures was made only to qualified institutional buyers (“QIBs”) and three or four accredited investors, the private placement need not be integrated with the public offering even if it would not be completed at the time the registration statement was filed.
- If the private placement of the convertible debentures was terminated prior to completion and later there is a registered offering of the debentures based on Rule 152, the abandoned private placement would not be integrated with the public offering.
- The filing of a registration statement is deemed to be the commencement of the public offering.

- **Subsequent Clarifications**

- The SEC later clarified that the number of offerees and purchasers is a factor in evaluating the applicability of the policy and the policy is limited to situations involving QIBs and no more than two or three large institutional accredited investors.

Integration — SEC Interpretive Guidance

- See principally C&DI 139.25, which addresses a side-by-side private offering (under Section 4(a)(2) or Rule 506) with a registered public offering without having to limit the private offering to QIBs and a small number of large institutional accredited investors
- The focus is on how the investors in the private offering are solicited
 - Investors were not identified or contacted in connection with the public offering
 - Investors did not contact the issuer as a result of the general solicitation by means of the registration statement

Integration on 506(c)

- The SEC's final rules do not address any integration or gun-jumping issues that may arise in connection with offerings made in close proximity with one another, such as:
 - An offering made in reliance on Rule 506(c) followed by an offering made pursuant to Rule 506(b)
 - An offering made in reliance on Rule 506(c) that occurs prior to the filing of a registration statement
 - The interaction of such an offering with permissible test-the-waters communications made by an EGC only to institutional accredited investors and QIBs

Proposed Amendments to Private Offerings

Form D

- The proposed rule would require issuers to file an advance notice of sale 15 days before and at the conclusion of an offering
 - Currently, issuers selling securities in Rule 506 offerings must file Form D no later than 15 calendar days after the first sale of securities in the offering
 - As proposed, issuers that intend to engage in a Rule 506 general solicitation would also be required to file Form D at least 15 calendar days before the general solicitation
 - Issuers would be required to update Form D within 30 days of completion of filing

Form D (cont'd)

- The proposed rule would require issuers to provide additional information about the issuer and the offering
 - Currently, Form D requires identifying information about the issuer and related persons, the exemption relied upon, and other facts
 - As proposed, issuers must provide additional information
 - Identification of issuer's website
 - Expanded information on the issuer
 - Offered securities
 - Types of investors in the offering
 - Use of proceeds from the offering
 - Information on types of general solicitation used
 - Methods used to verify accredited investor status of investors

Form D (cont'd)

- The proposed rule would disqualify issuers who fail to file Form D
 - Issuers would be disqualified from using Rule 506 exemption in any new offering if the issuer or its affiliates did not comply with the Form D filing requirements
 - Disqualification would continue for one year, beginning after the required Form D filings are made
 - Cure period available for late Form D filing

Solicitation Materials

- The proposed rules would require issuers to include legends and disclosures in written solicitation materials
 - Rule 509 would require Issuers to include legends or cautionary statements in written general solicitation materials used in Rule 506 offerings
 - Legends intended to inform potential investors that offering is limited to accredited investors and may involve risks
- Failure to include legends and disclosures required by Rule 509
 - Required legends or other disclosures would not be a condition of Rule 506(c) exemption
 - Failure to include Rule 509 legends or other disclosures in any written general solicitation materials would not make Rule 506(c) unavailable for the offering
 - Instead, Rule 507 provides that Rule 506 would not be available if the issuer (or its predecessors or affiliates) is subject to an order, judgment or injunction resulting from failure to comply with Rule 509

Solicitation Materials (cont'd)

- Private funds
 - Would required private funds to include additional legend and disclosures in written general solicitation materials
 - Rule 509(b) would require private funds to disclose that securities offered are not subject to protections of Investment Company Act
 - If general solicitation or general advertising includes performance data, Rule 509(c) would require additional Rule 482-type information
- SEC requests comment on whether it should further restrict manner and content of written general solicitation materials

Solicitation Materials (cont'd)

- Proposed Rule 510T would require issuers relying on Rule 506(c) to file written general solicitation materials with the SEC
 - Filings would be made through SEC intake page on SEC website no later than the date of first use of materials
 - Filing requirement does not apply to oral communications
 - Filings not available to general public
 - Requirement would be temporary, expiring after two years
- Failure to include legends and disclosures required by Rule 510T
 - Compliance with Rule 510T would not be a condition of Rule 506(c) exemption
 - Failure to make required filings would not make Rule 506(c) unavailable for the offering
 - Instead, Rule 507(a) would provide that Rule 506 would not be available if the issuer (or its predecessors or affiliates) is subject to an order, judgment or injunction resulting from failure to comply with Rule 510T

Solicitation Materials (cont'd)

- Rule 156 guidance about misleading statements in sales literature would extend to private funds
 - Currently, Rule 156 provides guidance for information contained in sales literature used by registered investment companies
 - **Amendments to Rule 156 would apply to all private funds, whether or not they engage in a general solicitation**
 - Private funds would be defined as funds that would be investment companies, but for Section 3(c)(1) or Section 3(c)(7)

Other Offering Exemptions

Small Offerings

- § 3(b) authorizes SEC to exempt offerings of < \$5 million during a 12-month period
- **Implementing Rules**
 - Rule 504 of Reg. D (up to \$1 million)
 - Rule 505 of Reg. D (up to \$5 million)
 - Regulation A

Reg A Basics

- Eligible issuers – principal place of business in the United States or Canada, and not subject to Section 13 or Section 15 reporting before the offering and not disqualified
- Primary offerings or secondary offerings (subject to certain limitations)
- Bad actor disqualification
- Offering threshold – currently \$5m per 12-month period, or \$1.5m for selling stockholder (not aggregated with other exempt offerings)
- Requires filing of a Form 1-A Offering Statement and delivery of Offering Statement to investors
- Integration safe harbors – not integrated with subsequent Reg S offerings or 701 offerings or completed exempt offerings (Section 4(a)(2) or Reg D). Other than the safe harbor, one would consider the same five-factor test.

Reg A Basics (cont'd)

- Currently, Regulation A allows for an offering of up to \$5 million of securities of an issuer including up to \$1.5 million of securities offered by selling security holders in any 12-month period.
- Requires filing of a Form 1-A Offering Statement and delivery of Offering Circular to investors.
- Offering communications – under Reg A, an issuer may “test the waters”
- Nature of the securities – the securities sold in reliance on Reg A are not “restricted securities”
- Blue sky
- Liability

Title IV: Offering Exemption

- Title IV of the JOBS Act establishes a new offering exemption similar to Regulation A, the Section 3(b)(2) exemption.
- Under the exemption, an issuer will be able to offer and sell up to \$50 million in securities within a 12-month period without Securities Act registration. The issuer may offer equity securities, debt securities, and debt securities convertible or exchangeable for equity interests, including any guarantees of such securities.
- The SEC Staff is working on proposed rules, although there is no deadline in the JOBS Act for these rules.

Intrastate Offerings

- § 3(a)(11) exempts securities offered and sold only to persons resident in a single state by an issuer incorporated in and doing business in that state
- Rule 147 Safe Harbor
- Practical limitations
 - Strict compliance required
 - Resales limited to state residents until securities come to rest (Rule 147 = 9 mos.)

Rule 701

- Exemption for compensatory issuances by private companies to directors, employees, consultants and advisors
- In any 12-month period, not more than greatest of:
 - \$1 million
 - 15% of total assets
 - 15% of class
- Disclosure required:
 - Written plan or contract
 - Additional disclosure if > \$5 million sold in any 12-month period
- No integration
- Restricted securities but may be resold 90 days after IPO by non-affiliates

Other Registration Exemptions

- Rule 144A
 - Exempts resales of privately placed securities to QIBs
- Regulation S (Rules 901-905)
 - Safe harbor exemption for offshore transactions
- § 3(a)(10)
 - Exemption for securities issued in complete or partial exchange for outstanding securities where the terms of the issuance and exchange are approved in a state fairness hearing
 - Practical alternative to private placement exemption in M&A context

Crowdfunding

- Crowdfunding permits entrepreneur to pool money from individuals who have a common interest and are willing to contribute to a venture
- Crowdfunding may or may not involve the sale of securities
- To the extent the effort involves the sale of securities then the offering must be registered or must rely on an exemption
- A recent enforcement action highlighted this issue

Title III: Crowdfunding

- Title III of the JOBS Act addresses “crowdfunding,” which involves seeking funding over the Internet from a potentially large group of investors putting up relatively small amounts.
- Given the difficulty in relying on existing exemptions from registration for crowdfunding efforts involving the offer and sale of securities, the JOBS Act amended Section 4(a) of the 1933 Act to add a new paragraph (6), which provides a new crowdfunding exemption from SEC registration, as well as preemption from state Blue Sky laws.

Crowdfunding

- Title III provides an exemption that could apply to crowdfunding offerings, to be implemented by SEC rules adopted within 270 days.
- The aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption during the 12-month period preceding the date of the transaction, is not more than \$1,000,000.
- The aggregate amount sold to any investor by the issuer, including any amount sold in reliance on the exemption during the 12-month period preceding the date of the transaction, does not exceed:
 - the greater of \$2,000 or 5 percent of the annual income or net worth of the investor, as applicable, if either the annual income or the net worth of the investor is less than \$100,000; or
 - 10 percent of the annual income or net worth of an investor, as applicable, not to exceed a maximum aggregate amount sold of \$100,000, if either the annual income or net worth of the investor is equal to or more than \$100,000.

Crowdfunding

- The transaction must be conducted through a broker or “funding portal.”
- Information will be filed and provided to investors regarding the issuer and offering, including financial information based on the target amount offered.
- The provision would prohibit issuers from advertising the terms of the exempt offering, other than to provide notices directing investors to the funding portal or broker, and would require disclosure of amounts paid to compensate solicitors promoting the offering through the channels of the broker or funding portal.

Crowdfunding

- Issuers relying on the exemption would need to file with the SEC and provide to investors, no less than annually, reports of the results of operations and financial statements.
- A purchaser in a crowdfunding offering could bring an action against an issuer for rescission in accordance with Section 12(b) and Section 13 of the Securities Act, as if liability were created under Section 12(a)(2) of the Securities Act, in the event that there are material misstatements or omissions in connection with the offering.
- Securities sold on an exempt basis under this provision would not be transferrable by the purchaser for a one-year period beginning on the date of purchase, except in certain limited circumstances.

Crowdfunding

- The exemption would only be available for domestic issuers that are not reporting companies under the Exchange Act and that are not investment companies, or as the SEC otherwise determines is appropriate.
- Bad actor disqualification provisions similar to those required under Regulation A would also be required for exempt crowdfunding offerings.
- Funding portals would not be subject to registration as a broker-dealer, but would be subject to an alternative regulatory regime, subject to SEC and SRO authority, to be determined by rulemaking by the SEC and SRO.

Crowdfunding

- A funding portal is defined as an intermediary for exempt crowdfunding offerings that does not:
 - offer investment advice or recommendations;
 - solicit purchases, sales, or offers to buy securities offered or displayed on its website or portal;
 - compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;
 - hold, manage, possess, or otherwise handle investor funds or securities; or
 - engage in other activities as the SEC may determine by rulemaking.
- The provision preempts state securities laws by making exempt crowdfunding securities “covered securities,” however, some state enforcement authority and notice filing requirements would be retained.
- State regulation of funding portals would also be preempted, subject to limited enforcement and examination authority.

SEC Proposed Rules

- The SEC voted to release proposed rules on October 23, 2013, and these rules are subject to a 90-day comment period.
- The SEC's proposed rules track the statute closely.
- Eligible Issuers: excludes foreign issuers, SEC-reporting companies, 40 Act issuers, issuers with no specific business plan, SPACs and blind pools, and issuers delinquent in their SEC filings.
- Process: offerings must be made through a registered intermediary, and only one intermediary per offering.
- Disclosure requirements: an initial disclosure about the offering on Form C; amendments on Form C to describe natural charges (Form C-A); periodic updates on the offering on C-U; ongoing annual filings on Form C-AR; and a termination notice on Form C-TR.

SEC Proposal

- Financial Statements: An issuer also will be required to prepare financial statements compliant with US GAAP for a period that is the shorter of the two most recently completed fiscal years or since the issuer's inception. The Staff described a phased requirement as to review or audit of these financial statements, which requirements vary depending on the amount that the issuer proposes to raise in the offering. For example, for smaller offerings, the financial statements must be certified by the issuer's chief financial officer; whereas for larger offerings, the financial statements must be audited.
- Ongoing Reporting Requirements: An issuer that completes a crowdfunding offering will be required to file annual reports with the SEC that will be required to include information similar to the information prepared in connection with the offering. The annual report requirement will be applicable until such time as: the issuer becomes subject to Exchange Act reporting; all securities sold in the offering have been retired; or the company winds down its operations.

SEC Proposal (cont'd)

- Funding Portals: Funding portals will be required to undertake certain activities, such as providing investors with educational materials about the risks of crowdfunding; making available information about the issuer on its website; and complying with AML and privacy requirements. The proposed rules incorporate requirements designed to prevent or mitigate conflicts of interest. The proposed rules require regulatory checks on officers, directors, major shareholders of funding portals.
- Funding Portal Framework: The activities of funding portals will be limited to crowdfunding. Funding portals must become members of FINRA and register with the SEC. Funding portals cannot offer investment advice; cannot handle customer funds or securities; or undertake other broker-dealer activities.

SEC Proposal (cont'd)

- Resale Restrictions: Securities sold in a crowdfunding offering will be restricted for one year since securities were offered.
- Bad Actors: The SEC is proposing bad actor rules to prevent bad actors from acting as intermediaries or being associated persons of intermediaries.
- Holder of Record: Holders will be exempt from the Exchange Act Section 12(g) holder of record count.

Intermediary Comparison

	Broker-Dealer	Funding Portal
Regulatory Environment	Well-established SEC and FINRA rules regarding registration and ongoing obligations	A new, “broker-dealer” like framework; subject to both SEC and FINRA oversight
Conduct of Business	Handling customer funds and securities, making recommendations, compensating for sales of securities, etc.	Activities of a funding portal are quite circumscribed. Transaction-based compensation is prohibited. Owning a financial interest in issuers is prohibited. Certain “referral” arrangements with broker-dealers may be permissible.
Costs	Significant registration costs, as well as ongoing compliance costs	Although both the SEC framework and the FINRA framework applicable to funding portals is scaled back (by comparison to the regulation of broker-dealers), funding portals are subject to registration, compliance requirements, and inspection and oversight by both agencies. In addition, funding portals have substantial obligations to issuers and investors and also must comply with AML and privacy regulations.
Availability of Crowdfunding Exemption	Available for issuers using broker-dealer’s platform.	Available for issuers using funding portal’s platform.