Too Many Exempt Offering Alternatives?

Monday, November 16, 2015, 12:00PM – 1:00PM EST

Presenter:

Anna T. Pinedo, Partner, Morrison & Foerster LLP

1. Presentation

2. Morrison & Foerster LLP Client Alert:
   “Goldilocks, Porridge and General Solicitation”

3. Morrison & Foerster LLP Client Alert:
   “Private Offerings: Questions that Might Frequently be Asked Sometime Soon”

4. Morrison & Foerster LLP Client Alert:
   “Private Offerings: Questions that Might Frequently be Asked Sometime Soon (Part II)”

5. Morrison & Foerster LLP Client Alert:
   “Regulation A+: Final Rules Offer Important Capital Raising Alternatives”

6. Morrison & Foerster LLP Client Alert:
   “Following the Wisdom of the Crowd?”

7. Morrison & Foerster LLP Client Alert:
   “SEC Proposes Rule Changes to Pave the Way for Intrastate and Regional Offerings”
Too Many Exempt Offering Alternatives?
Agenda

• What’s new?
  ▪ Final Regulation Crowdfunding
  ▪ Proposed amendments to Rule 147 and Rule 504

• Overview of other exempt offering alternatives
  ▪ Section 4(a)(2)
  ▪ Rule 506(b)
  ▪ Rule 506(c)
  ▪ Regulation A

• A framework for evaluating the alternatives
Regulation Crowdfunding
Crowdfunding

The “Crowd”

Funding Portal or Broker

Crowdfunding Entrepreneur

• An “all or none” offering.
• No limits on the number or sophistication of investors.
• Issuer information (including financial information) required.
• All offering activities must be conducted through an intermediary.
Crowdfunding

- Title III of the JOBS Act provides an exemption that could apply to crowdfunding offerings.

- The aggregate amount sold to all investors by the issuer should not be more than $1,000,000.
  - This includes any amount sold in reliance on the exemption during the 12-month period preceding the date of the transaction.

- 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, should 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 should be filed and provided to investors regarding the issuer and offering, including financial information based on the target amount offered.
- The provision prohibits issuers from advertising the terms of the exempt offering, other than to provide notices directing investors to the funding portal or broker, and requires disclosure of amounts paid to compensate solicitors promoting the offering through the channels of the broker or funding portal.
Crowdfunding

- A purchaser in a crowdfunding offering can 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 are not transferrable by the purchaser for a one-year period beginning on the date of purchase, except in certain limited circumstances.
- Issuers relying on the exemption need to file with the SEC and provide to investors, no less than annually, reports of the results of operations and financial statements.
- The exemption is 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.
Crowdfunding

- Bad actor disqualification provisions similar to those required under Regulation A would also be required for exempt crowdfunding offerings.
- Funding portals are not 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.
Regulation Crowdfunding

• **Amount of offering**: up to $1 million in a 12-month period through crowdfunding

• **By?** Issuers that are not reporting companies, not funds, and not subject to disqualification

• **Who can invest?** Accredited and non-accredited investors

• **Is there an investor cap?** An investor is subject to an investment limit on amounts invested in any 12-month period through crowdfunding equal to:
  - The greater of: $2,000 or 5% of the lesser of the investor’s annual income or net worth if either annual income or net worth is less than $100,000; or
  - 10% of the lesser of the investor’s annual income or net worth, not to exceed an amount sold of $100,000, if both annual income and net worth are $100,000 or more

• **Is an intermediary required?** Yes. An issuer can only engage in crowdfunding through a broker-dealer or a funding portal, and can use only one intermediary for an offering

• **Manner of offering**: the offering must be conducted only through the platform
Regulation Crowdfunding

- **Offering disclosure requirements**: an issuer that elects to engage in a crowdfunded offering will be required to prepare initial disclosure about the issuer and the offering on Form C

- Form C requirements resemble the Form 1-A requirements for a Regulation A offering and include a discussion of:
  - Use of Proceeds;
  - The Targeted Offering Size;
  - Offering Price;
  - Business;
  - Directors and officers;
  - Beneficial Ownership and Capital Structure;
  - Indebtedness;
  - Related party transactions;
  - Exempt offerings;
  - Risk factors;
  - Transfer restrictions; and
  - Management’s Discussion and Analysis.
Regulation Crowdfunding

• **Financial Statement Requirements**: in addition, a Form C must include certain financial statements prepared in accordance with U.S. GAAP. Audited financial statements must be conducted in accordance either with AICPA standards or PCAOB standards. Requirements depend on the target offering size as follows:
  - **$100,000 or less**: the amount of total income, taxable income and total tax or equivalent line items, as reported on the federal tax forms filed by the issuer for the most recently completed year (if any), certified by the principal executive officer of the issuer, and the financial statements of the issuer, also certified by the principal executive officer. If financial statements of the issuer are available that have either been reviewed or audited by a public accountant independent of the issuer, then, these financial statements must be provided instead of the materials described in the preceding sentence.
  - **More than $100,000 and less than $500,000**: financial statements of the issuer reviewed by a public accountant independent of the issuer. If financial statements of the issuer are available that have been audited by a public accountant independent of the issuer, the issuer must provide those instead of the reviewed statements.
Regulation Crowdfunding

- **More than $500,000**: financial statements of the issuer audited by a public accountant independent of the issuer; provided, however, that for issuers that are first-time issuers, offerings that have a target offering amount of more than $500,000 but not more than $1 million, financial statements of the issuer reviewed by a public accountant independent of the issuer. If audited statements are available, those must be provided instead.
Regulation Crowdfunding

- **Advertising**: an issuer’s ability to advertise or promote the offering is limited to certain offering notices (basic offering details) and certain communications with potential investors made through the platform

- **Intermediary restrictions and requirements**: the intermediary is subject to educational and other obligations and limitations

- **Reporting following the offering**: until an issuer terminates its reporting obligations, it is required to file amendments for material changes (C/A), periodic updates (C-U) and annual filings (C-AR)

- **Transfer restrictions**: securities sold in such an offering are subject to certain transfer restrictions for one year
Rule 147 and Rule 504 and Proposed Amendments
Rule 147

- Section 3(a) of the Securities Act provides an exemption from the registration requirements for “any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory.”
- Section 3(a)(11) provides an exemption provided that:
  - The issuer be incorporated (and resident) and doing business in the state; and
  - The securities are offered and sold to persons resident in the state.
- **Amount of offering:** no limitations on the dollar amount being raised
- **Who can invest:** no limitations on the number or the sophistication of offerees or purchasers
- **Advertising:** no publicity or general solicitation restrictions, except offers and sales may be made only to residents of one state
- **Disclosure requirements:** no specific disclosure requirements apart from the resale restrictions
Rule 147

- Rule 147 is a safe harbor under Section 3(a)(11); if the conditions of the safe harbor have not been satisfied, the 3(a)(11) exemption may still be available.
- Conditions of safe harbor:
  - To be “doing business” in the state, the issuer must derive 80% of its consolidated gross revenues from the state, and have 80% of its consolidated assets located in the state, and use 80% of the net offering proceeds in the state, and have its principal office in the state;
  - The entire offering must be made under the exemption, i.e., no additional offers and sales of securities that would be integrated may be made under any other exemption from registration—integration is determined under the five factor test subject to the rule of thumb that offers and sales made more than 6 months before or after an intrastate offering will not be integrated; and
  - Resales of the securities within nine months of an intrastate offering may only be made to residents of the same state—and the securities must be legended, and transfer restrictions imposed, to reflect this resale restriction.
Proposed amendments to Rule 147

- Rule 147, as it is proposed to be amended, would no longer fall within the statutory parameters of Section 3(a)(11)
- Proposed changes are as follows:
  - eliminate the restriction on offers; allow an issuer to engage in any form of general solicitation
  - continue to require that sales be made only to residents of an issuer’s state or territory, but add a reasonable belief standard to the issuer’s determination of residence of purchaser
  - would eliminate the current requirement in Rule 147 that issuers obtain a written representation from each purchaser as to his or her residence.
  - limit availability of the exemption to offerings that are either registered in the state in which all of the purchasers are resident, or conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a 12-month period and imposes an investment limitation on investors
  - an issuer that changes its principal place of business would not be able to rely on Rule 147 in the new state until such time as the securities sold in reliance on the proposed exemption in the prior state have come to rest in that state (9 months)
  - proposes to align the integration safe harbor in Rule 147 with the recently-adopted integration safe harbor in Rule 251(c) of Regulation A
Proposed amendments to Rule 147

• Determining an issuer’s principal place of business:
  • An issuer’s principal place of business would be defined as the location in which the officers, partners, or managers of the issuer primarily direct, control and coordinate the activities of the issuer
  • In addition to having its principal place of business in-state, the issuer must meet at least one of the following requirements (instead of all requirements as currently specified in Rule 147):
    ▪ the issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in or from the rendering of services within such state or territory;
    ▪ the issuer had at the end of its most recent semi-annual fiscal period prior to the first offer of securities pursuant to the exemption, at least 80% of its consolidated assets located within such state or territory;
    ▪ the issuer intends to use and uses at least 80% of the net proceeds to the issuer from sales made pursuant to the exemption in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; or
    ▪ a majority of the issuer’s employees are based in such state or territory (this fourth prong is proposed to be added to the list)
Current Rule 504

• An exemption pursuant to Section 3(b) of the Securities Act; Section 3(b) authorizes the SEC to exempt from the registration requirements of the Securities Act offerings of securities not exceeding $5 million

• **Amount of offering:** $1 million of securities sold under Rule 504 within a 12-month period, less selling price of other securities sold under another section 3(b) exemption within prior 12 months

• **By?** Issuer cannot be a reporting company, an investment company or a SPAC

• **Who can invest?** Depends on form of offering

• **Is there an investor cap?** No

• **Manner of offering:** a private placement or an offering registered under applicable state laws
  - If it is structured as a private placement, then the issuer cannot use general solicitation or general advertising and must obtain investment representations, impose transfer restrictions, use restrictive legends on the securities, etc.
Current Rule 504

- If it is structured as a state-registered offering, the issuer must comply with state registration requirements ("qualification") in each state where securities are sold, including preparing and delivering a required "substantive disclosure document before sale" to purchasers in all states (whether or not each state requires registration and delivery of a disclosure document), or sell only to "accredited investors" in accordance with available state law exemptions that permit general solicitation and general advertising.

- **Is an intermediary required?** No, although it would be challenging for an issuer to complete a Rule 504 offering as a private placement on its own.

- **Offering disclosure requirements:** as discussed above, these depend on the manner of offering.

- **Reporting following the offering:** none

- **Form D:** issuer must file a Form D
Proposed amendments to Rule 504

The SEC proposes to amend Rule 504:

- to increase the aggregate amount of securities that may be offered and sold in any twelve-month period from $1 million to $5 million
- to disqualify certain bad actors from participation in Rule 504 offerings by referencing the disqualification provisions of Rule 506 of Regulation D

By amending Rule 504, the SEC believes that the proposed changes “would facilitate state efforts to increase the efficiencies associated with the registration of securities offerings in multiple jurisdictions through regional coordinated review programs”
Overview of other Exempt Offering Alternatives
Other alternatives

- We will review the following alternatives:
  - Section 4(a)(2) offering
  - Rule 506(b) offering
  - Rule 506(c) offering
  - Regulation A offering
- We will not discuss Rule 144A given that the Rule 144A market generally is quite different
Section 4(a)(2)

- Transactional exemption
- Issuer exemption
  - most utilized 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
- Restricted securities – securities sold in a private placement may not be resold absent registration or exemption from registration
**Section 4(a)(2)**


- 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.
Section 4(a)(2)

- **Amount of offering**: amount is unlimited
- **By?** any issuer, whether reporting or non-reporting, can rely on Section 4(a)(2)
- **Who can invest?** sophisticated investors who can fend for themselves
- **What is the investor cap?** no applicable cap
- **Is an intermediary required?** effectively, yes, given that the issuer cannot use general solicitation or general advertising; issuer could raise capital from investors with whom it has a pre-existing substantive relationship
- **Manner of offering**: the offering cannot involve general solicitation or general advertising
- **Offering disclosure requirements**: none
- **Reporting following the offering**: none; no requirement to file a Form D
- **Transfer restrictions**: securities will be restricted securities
Section 4(a)(2)

- **Bad actor disqualification**: the disqualification is not applicable to Section 4(a)(2) offerings
- **Manner of offering**: generally, a Section 4(a)(2) offering will involve a placement agent; the placement agent will identify investors. Investors will conduct their own diligence review
- **Documentation**: there may or may not be an offering memorandum; the investors will sign a securities purchase agreement with the issuer; each investor will make payment to the issuer directly generally
- **State blue sky**: the securities are not “covered securities” however given offerings are limited to accredited investors or institutional accredited investors, typically state exemptions will be available
Rule 506 safe harbor

- 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(b)

- “Traditional” Rule 506 offering
- **Amount of offering:** unlimited
- **By?** Rule 506(b) can be used by reporting and non-reporting issuers, so long as issuer and other covered persons are not subject to bad actor disqualification
- **Who can invest?** Accredited investors and a limited number of non-accredited investors; in practice, offerings are limited to accredited investors
- **What is the investor cap?** None.
- **Is an intermediary required?** Not technically required; however, given that the issuer cannot use general solicitation or general advertising; issuer could raise capital from investors with whom it has a pre-existing substantive relationship
- **Manner of offering:** the offering cannot involve general solicitation
- **Reporting following the offering:** filing of a Form D
Rule 506(b)

- **Bad actor disqualification:** the issuer will be required to obtain information from all covered persons
- **Documentation:** there may or may not be an offering memorandum; the investors will sign a securities purchase agreement with the issuer; each investor will make payment to the issuer directly generally
- **State blue sky:** securities sold pursuant to Rule 506(b) are “covered securities”
many “matchmaking portals” rely on rule 506(b) to conduct internet-based offerings solely to accredited investors.

these offerings are structured such that the matchmaking portal makes an offer only to accredited investors with which the portal has established or has a pre-existing substantive relationship.

issuer specific or offering specific information is not generally available and is made available only to “members” or on a password-protected basis to those investors known to the portal.

an accredited investor crowdfunded offering relies on the guidance provided in pre-jobs act no-action letters (iponet, lamp technologies, etc.) and affirmed recently in c&dls on general solicitation, as well as in a recently issued no-action letter, citizensvc.
Rule 506(c)

- Rule 506(c) 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
Rule 506(c)

- Reasonable steps to verify investor status
- Principles-based guidance includes 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
Rule 506(c)

- 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
Rule 506(c)

- **Amount of offering:** unlimited
- **By?** Rule 506(c) can be used by reporting and non-reporting issuers, so long as issuer and other covered persons are not subject to bad actor disqualification
- **Who can invest?** Accredited investors only
- **What is the investor cap?** None
- **Is an intermediary required?** Not technically required; easier for an issuer to conduct a Rule 506(c) offering on its own
- **Manner of offering:** involves general solicitation
- **Reporting following the offering:** filing of a Form D
- **Bad actor disqualification:** the issuer will be required to obtain information from all covered persons
- **Documentation:** there may or may not be an offering memorandum; the investors will sign a securities purchase agreement with the issuer; each investor will make payment to the issuer directly generally
- **State blue sky:** securities sold pursuant to Rule 506(b) are “covered securities”
Regulation A

- The SEC adopted final rules which:
  - Amend and modernize existing Regulation A.
  - Create two tiers of offerings:
    - Tier 1 for offerings of up to $20m ($6m for selling stockholders); or
    - Tier 2 for offerings of up to $50m ($15m for selling stockholders).
  - Set issuer eligibility, disclosure and reporting requirements.
  - Impose additional disclosure and ongoing reporting requirements, as well as an investment limit, for Tier 2 offerings, and, given these investor protection measures, makes Tier 2 offerings exempt from certain blue sky requirements.
  - Became effective June 19, 2015
Regulation A

- **Amount of offering:** Tier 1 up to $20 million in 12-month period, Tier 2 up to $50 million in 12-month period
- **By?** Eligible issuers are non-reporting issuers, organized in and with their principal place of business in the United States or Canada, other than funds, blank check companies, issuers subject to various disqualifications
- **Who can invest?** Accredited and non-accredited investors
- **What is the investor cap?** A non-accredited natural person is subject to an investment limit and must limit purchases to no more than 10% of the greater of the investor’s annual income and net worth, determined as provided in Rule 501 of Regulation D (for non-accredited, non-natural persons, the 10% limit is based on annual revenues and net assets). The investment limit does not apply to accredited investors and will not apply if the securities are to be listed on a national securities exchange at the consummation of the offering
- **Is an intermediary required?** No
- **Manner of offering:** the offering may involve “testing the waters”
Regulation A

- **Offering disclosure requirements:** an issuer must prepare and file with the SEC and have qualified an offering statement on Form 1-A.
- Part I (Notification) requires certain basic information regarding the issuer, its eligibility, the offering details, the jurisdictions where the securities will be offered, and sales of unregistered securities.
- Part II (Offering Circular)
  - Part II contains the narrative portion of the Offering Circular and requires disclosures of basic information about the issuer; material risks; use of proceeds; an overview of the issuer’s business; an MD&A type discussion; disclosures about executive officers and directors and compensation; beneficial ownership information; related party transactions; and a description of the offered securities.
  - This is similar to Part I of Form S-1 and an issuer can choose to comply with Part I of Form S-1 in connection with its Offering Circular.
  - An issuer that chooses to list its securities concurrent with the completion of a Regulation A offering will be required to use Part I of Form S-1 in connection with the Offering Circular
  - Other Tier 2 issuers also are likely to use Part I of Form S-1 as well
Regulation A

- **Financial statement requirements:** differ for Tier 1 and Tier 2 offerings:
  - Tier 1 and Tier 2 issuers must file balance sheets and other required financial statements as of the two most recently completed fiscal year ends, or for such shorter time as they have been in existence, subject to certain exceptions.
  - The financial statements for an issuer in a Tier 2 offering are required to be audited by an independent auditor that need not be PCAOB-registered, except as noted below.
  - An issuer in a Tier 2 offering that seeks to have a class of securities listed on a national securities exchange concurrent with the Regulation A offering must include financial statements audited in accordance with PCAOB standards by a PCAOB-registered firm.
- **Advertising:** an issuer may solicit any investors (not subject to the requirements applicable to EGCs, for example); materials may be used both before and after the offering statement is filed
- **Intermediary restrictions and requirements:** an issuer can conduct a Regulation A offering with or without a financial intermediary
Regulation A

- **Reporting following the offering:** Tier 1 issuers would have no ongoing reporting obligation, other than to file an exit report on Form 1-Z within 30 days after the termination or completion of a Regulation A-exempt offering. Tier 2 issuers will be subject to ongoing reporting. Tier 2 issuers would be required to file:
  - Annual reports on Form 1-K (120 calendar days after the issuer’s fiscal year end);
  - Semi-annual reports on Form 1-SA (90 calendar days after the end of the first six months of the issuer’s fiscal year);
  - Current reports on Form 1-U;
  - Special financial reports on Form 1-K and Form 1-SA; and
  - Exit reports on Form 1-Z.

- **Bad actor disqualification:** the issuer will be required to obtain information from all covered persons

- **State blue sky:** securities sold pursuant to Tier 1 will be subject to state blue sky requirements; securities sold pursuant to Tier 2 will be “covered securities”

- **Transfer restrictions:** securities sold pursuant to Regulation A are not “restricted securities”
Framework for Evaluating Alternatives
Who is the issuer?

- Is the issuer an SEC-reporting company?
  - If so, the issuer will want to limit its focus to Section 4(a)(2), Rule 506(b), and Rule 506(c). Generally, an SEC-reporting company will find it challenging to undertake a Rule 506(c) offering.

- What if the issuer is a private, non-reporting issuer?
  - If the issuer is not an SEC-reporting company and the issuer is domiciled in the United States, the issuer will want to consider Regulation Crowdfunding, intrastate crowdfunding, Rule 504, and Regulation A, in addition to Section 4(a)(2), Rule 506(b), and Rule 506(c).
What are the issuer’s goals?

• Is the issuer principally focused on raising additional capital? If so, how much?
  • As discussed in prior slides, certain offering exemptions are available only for offerings under a specified dollar threshold
  • Can various exemptions be used? Are there integration safe harbors?
• Are there goals beyond merely raising the capital?
  • For example, is the issuer seeking to attract particular types of investors?
  • Who are the investors? Where are the investors?
  • Is the issuer seeking to make itself better known generally by making information about itself available broadly through SEC filings?
  • Is the issuer concerned about liquidity opportunities for existing securityholders? Liquidity opportunities for the new investors?
• Is the contemplated offering only a part of a more comprehensive funding plan?
Who are the potential investors?

• Does the issuer have existing institutional investors?
  • If the issuer is an established company, likely, it will have undertaken prior rounds of financing and will have existing investors, some of which may be venture or private equity investors or angel investors. Such investors may have a strong preference for limiting participation to other institutional or professional investors, and likely will not want to see broad outreach to non-accredited investors that may not be known to the issuer.

• If the issuer is an emerging company, does it want to seek out institutional or strategic investors? Does it want to attract investors from among its customers?
  • Even early stage companies may choose to limit their investor base to institutional accredited investors and accredited investors known to the company or introduced to the company by a financial intermediary (placement agent). There may be strong reasons for doing so—for example, the company may want advice from its institutional investors, may want institutional investors that can serve on the board of directors or board of advisors, or may want to limit the number of holders to professional investors that know the sector and are accustomed to making investments in early stage companies.
Who are the potential investors?

• A company may have some concerns about reaching out to investors with whom it does not have a pre-existing relationship. For example, investors may not be experienced in investing in early stage companies and may have unrealistic expectations or require a level of engagement that distracts management from its responsibilities. The company also may find it challenging to keep track of its investors.

• Consumer product oriented companies, by contrast, may want to have customers among their shareholders.

• A fundamental question, therefore, will be whether the issuer wants to include non-accredited investors in the offering.

  • If the issuer would like to include non-accredited investors, it will be limited to Rule 506(b) or Rule 504 (subject to preparation of certain disclosures), intrastate crowdfunding, Regulation Crowdfunding or Regulation A.

  • In the case of Regulation Crowdfunding and Regulation A, the investor will be subject to investor caps.
Will an intermediary be used?

• Is the issuer reaching out to existing investors? To investors with which the issuer already has a pre-existing relationship? Or seeking to reach potential investors identified by an intermediary or by the issuer?
  • This is closely tied to the type of investor that the issuer would like to identify

• Do the rules require that an intermediary be used?
  • In a crowdfunded offering under Regulation Crowdfunding, an issuer is required to use an intermediary that is either a broker-dealer or a funding portal
  • In offerings without general solicitation, although there is no express requirement to do so, it is very challenging for an issuer to conduct an exempt offering without a financial intermediary
  • In an offering using general solicitation, such as a Rule 506(c) offering or a Regulation A offering, an issuer could undertake the offering without a financial intermediary
  • It will be essential for the issuer to consider whether it engages an intermediary, whether the intermediary is a “matchmaking portal” or other unregistered person (not required to be registered as a broker-dealer), or a broker-dealer

• Why is the issuer selecting a particular type of intermediary?
  • Consider whether a matchmaking portal or other unregistered person will be able to provide the anticipated results
Is general solicitation important?

- Will testing the waters or a widespread campaign be essential to the offering?
  - The issuer should consider carefully whether general solicitation is important—for example, is it necessary in order to reach the customer base? Are the customers likely to be investors?
  - If general solicitation is essential, then, the choices are limited to Regulation Crowdfunding, intrastate crowdfunding, Rule 504 (depending on whether the issuer uses the state registration approach), Rule 506(c), and Regulation A
  - Now, if the issuer wants to use general solicitation and must include non-accredited investors, then, that eliminates Rule 506(c) as an alternative
  - Then, the issuer might want to compare and contrast as among the remaining alternatives, the required offering disclosures and financial statement requirements
  - Is “testing the waters” prior to investing resources in a Tier 1 or Tier 2 Regulation A offering important to the issuer?
What offering disclosures will be used?

- Does the issuer understand the information and disclosure requirements associated with the various exemptions when non-accredited investors are proposed to be included?
- Is the issuer prepared to undertake the preparation of a Form C for an offering made pursuant to Regulation Crowdfunding or of a Form 1-A for a Regulation A offering?
  - An issuer should review closely the offering requirements associated with Form C and/or Form 1-A
  - Both require significant narrative descriptions of the company’s business, management, financial results, and related matters
  - Has the issuer considered the costs associated with the preparation of the required financial statements? Has it engaged accountants to assist?
- Has the issuer considered the ongoing reporting requirements once it has completed the financing?
Rule 506(c), Crowdfunding and Reg A

• These three types of offerings, which have very different requirements, often are incorrectly referred to as “crowdfunding” transactions.
• Of course, all three have in common the ability to use general solicitation and the ability to “test the waters,” but, that’s where the similarities end.
• For an issuer, it will be important to distinguish among the three:
  • In a Rule 506(c) offering, sales may be made only to accredited investors, there is no specific disclosure requirement
  • In a Regulation A offering, whether Tier 1 or Tier 2, the issuer will be required to prepare an offering statement (Form 1-A) and have that offering statement qualified before the offering can commence. Similarly, Regulation Crowdfunding requires the preparation of a Form C. The disclosure requirements as between the two are comparable; however, the offering thresholds are quite different as is the conduct of the offering
Tier 2 of Regulation A versus IPO

- An issuer may consider a Tier 2 Regulation A offering (up to $50 million in proceeds) and do so with or without pursuing a listing on a national securities exchange.
- If an issuer intends to list on an exchange, then, it should take into account that financial statements will be required to be prepared that are PCAOB compliant.
- Once an issuer undertakes a Tier 2 offering with a listing on a national securities exchange, the issuer will become subject to the corporate governance requirements of the exchange, as well as full Sarbanes-Oxley corporate governance requirements (albeit as an “EGC” issuer).
- In many respects, this outcome will be similar to the outcome if the issuer had undertaken a Title I IPO as an EGC.
- There are some important differences to consider.
Integration issues

• An offering cannot be viewed in isolation
• Invariably an offering is just a component of the issuer’s broader funding strategy
• Given volatile markets and the “newness” of many of these offering exemptions, it will be important for an issuer to understand how the issuer can (or if it can) change course if an offering approach is unsuccessful or proves to be undesirable and pursue a different approach
• Also, an issuer will want to think carefully about what’s next....If the issuer intends to pursue another offering within a six-month period, has it considered the integration safe harbors that are available to it?
Introduction

At long last, the U.S. Securities and Exchange Commission (SEC) took action today to implement rules that complied with the JOBS Act mandate to relax the prohibition against general solicitation in certain private offerings of securities. The original SEC proposal from August 2012, proposing amendments to Rule 506 of Regulation D and Rule 144A under the Securities Act, had drawn significant comments. Today’s final rule, as well as the SEC’s proposed rules relating to private offerings discussed below, are likely to generate additional commentary. One might say that this morning’s webcast of the SEC’s open meeting provided a glimpse into the too-hot/too-cold Goldilocks-type debate that will continue to play out over the next few months regarding the appropriate balance between measures that facilitate capital formation and investor protection provisions.

In addition to promulgating rules to relax the ban on general solicitation, which will have a significant market impact, the SEC also adopted the bad actor provisions for Rule 506 offerings that it was required to implement pursuant to the Dodd-Frank Act. The bad actor proposal had been released in 2011, and SEC action had been anticipated on the bad actor proposal for some time. The SEC also approved a series of proposals relating to private offerings that are intended to safeguard investors in the new world of general advertising and general solicitation. All told, will these measures encourage or discourage issuers and their financial intermediaries from availing themselves of the opportunity to use general solicitation? Will this new ability to reach investors with whom neither the issuer nor its intermediary have a pre-existing relationship create serious investor protection concerns? Will the proposed investor protection measures be sufficient to address the concerns of consumer and investor advocacy groups, or will we ultimately see revamped investor accreditation standards?

Below we provide a very brief summary of this morning’s actions. We will supplement this alert with more detailed analysis and commentary once the final rules and the proposal are released.

SEC Adopts Amendments to Rule 506

This morning, the SEC adopted amendments to Rule 506 of Regulation D and Rule 144A under the Securities Act to implement Section 201(a) of the JOBS Act. The SEC adopted new paragraph (c) in Rule 506, which would permit the use of general solicitation and general advertising, 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
categorized 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.

The Staff indicated that “reasonable efforts” to verify investor status will be an objective determination by the
issuer based on the SEC’s principles-based guidance. In its proposed rules, the SEC had noted that “reasonable
efforts” to verify investor status should consider the nature of the purchaser; the nature and amount of
information about the purchaser; and the nature of the offering. In a departure from the proposed rules, the final
rule will provide a non-exclusive list of factors to consider in verifying the accredited investor status of natural
persons. Following the initial proposal, many commenters had advocated that a “safe harbor” be established to
establish legal certainty that the verification process had been sufficiently robust. Including this illustrative list as
part of the rule will likely prove helpful, even if it does not go as far as some commenters had requested.

In addition to the changes adopted to Rule 506, the SEC amended Rule 144A to eliminate references to “offer” and
“offeree,” and as a result Rule 144A will 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. Under this amendment, resales of
securities pursuant to Rule 144A could be conducted using general solicitation, so long as the purchasers are
limited in this manner.

Commissioner Luis Aguilar strongly opposed the new rules, saying he was “saddened and disappointed” that the
new rules did not do more to protect investors.

Bad Actor Rule Proposal

In the same meeting, the SEC explained that it was adopting the bad actor rule in substantially the form in which
it was proposed in May 2011 with certain modifications. The Staff explained that the rule contains modifications
to the categories of persons covered; modifications to the types of actions that are covered; and modifications to
the actions that are covered. In addressing the modifications to the categories of “covered persons,” the Staff
explained that, in certain respects, the categories were being narrowed. For example, the Staff noted that, as
opposed to covering all officers of the issuer, the rule will cover executive officers and officers involved with the
proposed offering. The rule will cover beneficial owners of 20% or more of an issuer’s total shares outstanding.
The Staff noted that investment managers of funds and the principals of such investment managers will be added
as covered persons. The Staff noted that the types of actions covered in the final rule (“disqualifying events”) have
been modified from the proposal in order to include certain SEC cease-and-desist orders related to violations of
anti-fraud provisions and registration requirements, and to add the CFTC to the list of agencies whose final orders
trigger the application of the bad actor rules. The rule also will address one of the most controversial provisions of
the proposal, which is the timing of an action that triggers the application of the bad actor provisions. The rule will
provide for disqualification only in respect of triggering bad acts that occurred after the effective date of the rule,
however, triggering events that occurred prior to the effective date of the rules will need to be disclosed to
investors.

Investor Protection and Information Requirements Proposed

The SEC is proposing rules for comment that will impose a number of investor protection measures in connection
with Rule 506(c) offerings. These include the following: A proposed amendment to Rule 503 in order to
implement additional compliance requirements relating to the filing of a Form D. In connection with a Rule
506(c) offering, an issuer will be required to file a Form D not later than 15 calendar days from the
commencement of general solicitation efforts. In addition, in order to provide the SEC with more information
regarding these types of offerings, the issuer will be required to file a final amendment to the Form D within 30
days after the completion of such an offering. Along the same lines, in order to make additional information available to the SEC, the proposal would revise Form D in order to request additional information in the context of Rule 506(c) offerings. For example, the amended Form would require additional information about the issuer, the offered securities, the use of proceeds of the offering, the types of general solicitation that were used, and the methods used to verify investor status. The Staff also proposes an amendment to Rule 507 in order to promote compliance with the Form D filing requirement by implementing certain disqualification provisions to the extent that the issuer and its affiliates failed to comply with Form D filing requirements. The SEC would have the authority to grant waivers upon a showing of good cause by the issuer. The proposal also would include the introduction of a new Rule 509. Proposed Rule 509 would require an issuer engaging in a Rule 506(c) offering to include certain legends on any written general solicitation materials. The required legends would alert potential investors of the type of offering, that the offering is available only to certain investors, and that the offering may involve certain risks. The proposal also would require that for a temporary period of two years, issuers be required to file with the SEC any written solicitation materials. These materials would not be available to the public. This is intended to permit the SEC to review the types of materials that are being used. The proposal also solicits comment on the definition of “accredited investor” and requests comment on whether there should be additional requirements relating to the communications used in general solicitation.

**Rule 156 Proposal**

The SEC proposed to require private funds making Rule 506(c) offerings to file written general solicitation materials with the SEC on a temporary basis. The filings would be required to apply for a period of two years, and would not be available to the public. The SEC also proposed to amend Rule 156 under the Securities Act of 1933, the anti-fraud rule that applies to sales literature of registered investment companies. The rule amendments would apply the guidance to sales literature of private funds making general solicitations under Rule 506.

Rule 156 prevents registered investment companies from using sales literature that is materially misleading in connection with the offer and sale of securities. The rule provides that sales literature is considered misleading if it (i) contains an untrue statement of a material fact; or (ii) it omits to state a material fact necessary in order to make a statement, in light of the circumstances of its use, not misleading.

Rule 156 provides specific examples of regarding the types of statements in sales literature that the SEC would consider to be misleading. Generally, whether a statement involving a material fact would be misleading depends on the context in which it is made, in light of all pertinent factors, including:

- Other statements being made in connection with the offer or sale of the securities in question;
- The absence of explanations, qualifications limitations or other statements necessary or appropriate to make the statement not misleading; or
- General economic or financial conditions or circumstances.

Rule 156 provides a non-exclusive list of factors concerning representations of past or future investment performance that could be misleading. It also contains examples of when statements about possible benefits connected with or resulting from the services to be provided that do not give equal prominence to discussion of any associated risks.

Rule 156 broadly defines “sales literature,” which generally means any communication (whether in writing, by radio or by television) used to sell or induce the sale of securities of any investment company. Communications between issuers, underwriters and dealers are included in this definition of sales literature if the communication (or the information it contains) can be “reasonably expected” to be communicated to prospective investors in the
offer or sale of securities, or are designed to be employed either in written or oral form in the offer or sale of securities, such as in sales scripts. The definition likely would apply to communications contained in social media.

For a jump start on the JOBS Act, please visit our MoFoJumpstarter blog: [www.mofojumpstarter.com](http://www.mofojumpstarter.com).

Authors

Jay G. Baris  
New York  
(212) 468-8053  
jbaris@mofo.com

Anna T. Pinedo  
New York  
(212) 468-8179  
apinedo@mofo.com

About Morrison & Foerster

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life sciences companies. We’ve been included on The American Lawyer’s A-List for 10 straight years, and Fortune named us one of the “100 Best Companies to Work For.” Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at [www.mofo.com](http://www.mofo.com). © 2013 Morrison & Foerster LLP. All rights reserved.

For more updates, follow Thinkingcapmarkets, our Twitter feed: [www.twitter.com/Thinkingcapmkts](http://www.twitter.com/Thinkingcapmkts).

*Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.*
Private Offerings: Questions that Might Frequently be Asked Sometime Soon

Although the SEC’s final rule relaxing the ban on general solicitation in certain Rule 506 offerings and Rule 144A offerings was highly anticipated, the final rule leaves open or raises a number of interesting questions.

Below, we provide our perspective on a number of these based on the final rule:

**Rule 506 Offerings**

**Can an issuer conduct a contemporaneous Rule 506(b) offering and Rule 506(c) offering?**

Generally, no. If the issuer offers the same security, it would not be possible to prevent the general solicitation used in connection with Rule 506(c) from tainting the contemporaneous Rule 506(b) offering. However, it may be possible to conceive of contemporaneous offerings if the issuer offered different securities, such as a non-convertible preferred stock in one offering and common stock in the other offering, and if the investors in the two offerings were different—for example, preferred stock being offered to an existing venture or private equity investor (or other investors with which the issuer has a pre-existing substantive relationship), while common stock is being offered to a broader range of investors in a separate offering using general solicitation. Rule 502(a) of Regulation D sets forth the traditional “five factor” test that issuers should consider in determining whether offers and sales should be integrated for the purposes of the exemptions under Regulation D.

**Can an issuer conduct a Rule 506(c) offering followed by a Rule 506(b) offering?**

Yes, once a Rule 506(c) offering has been completed, the issuer can conduct a Rule 506(b) offering. As always, with offerings taking place in close proximity to one another, it will be important to undertake an integration analysis. Given that the Rule 506(c) offering involved general solicitation, it will be prudent to let some period of time elapse between the two offerings. Of course, a Rule 506(c) offering can follow a completed Rule 506(b) offering. Rule 502(a) of Regulation D provides a safe harbor from integration of Regulation D offerings made six months before or six months after an offering.

**Can an issuer conducting a Rule 506(c) offering use a press release that does not comply with Rule 135c?**

Yes, since general solicitation and general advertising may be used in a Rule 506(c) offering, the press release announcing the offering need not comply with the restrictions of Rule 135c.
Can an issuer begin an offering as a Rule 506(b) offering and modify the offering, making it a Rule 506(c) offering?

Presumably, an issuer could begin a private offering as a Rule 506(b) offering, and change course and rely on Rule 506(c). On the other hand, an issuer would likely not be able to switch course from a Rule 506(c) offering to a Rule 506(b) offering given the presence of general solicitation or general advertising in connection with the Rule 506(c) offering.

Can an issuer rely on the Section 4(a)(2) exemption in connection with a Rule 506 offering?

An issuer can rely on the Section 4(a)(2) exemption in conjunction with or as an alternative to a Rule 506(b)-exempt offering, because the Rule 506(b) offering involves no general solicitation. However, an issuer cannot rely on the Section 4(a)(2) exemption in connection with a Rule 506(c)-exempt offering, given that general solicitation has been used, and general solicitation of investors would not be consistent with an offering exempt based on Section 4(a)(2) because it is a transaction “by an issuer not involving any public offering. Nothing in Title II of the JOBS Act or the SEC’s rulemaking under Title II changed the analysis as to whether a transaction does not involve a “public offering” under Section 4(a)(2).

In connection with a “traditional” or Rule 506(b) offering, would the issuer be required to undertake investor verification steps beyond those customarily used?

No, where general solicitation is not used, an issuer can rely on traditional means of confirming that investors are accredited investors.

In the context of a Rule 506(c) offering, if an issuer relies on a third-party verification service, is the issuer still responsible for verification?

The issuer must establish a reasonable belief that the investors in the offering are accredited investors. As a result, the issuer must conduct diligence on the third-party service, and seek to understand the process that will be used by the third-party verification service for verification of accredited investor status.

Rule 144A Offerings

Does the use of general solicitation in connection with a traditional Rule 144A offering affect the issuer’s sale to the initial purchaser?

No, the SEC has clarified that even where general solicitation is used in connection with resales under Rule 144A, the private sale made by the issuer to the initial purchaser in reliance on the Section 4(a)(2) exemption is not affected.

Must an issuer conducting a Rule 144A offering comply with Rule 135c in connection with press releases?

No, since general solicitation is permissible, an issuer need not comply with the Rule 135c requirements.

Can general solicitation be used in connection with a Rule 144A/Regulation S offering?

Yes, the SEC’s adopting release notes that a Regulation S offering will not be integrated with a Rule 506(c) or Rule 144A offering. The use of general solicitation will not constitute “directed selling efforts” in respect of the Regulation S offering.
Does the SEC set out a verification process to ascertain QIB status?

No.

*Secondary Transfers*

Can general solicitation be used in connection with resales made in reliance on Rule 4(a)(1-1/2)?

Given that this exemption relies on the interplay of the Section 4(a)(1) and the Section 4(a)(2) exemptions and that the JOBS Act did not amend Section 4(a)(2), general solicitation should not be used in connection with resales made in reliance on Rule 4(a)(1-1/2).

Do the changes to Rule 506 affect exemptions available for resales of restricted securities?

No. The changes to Rule 506(c) would not affect resales, because Rule 506 is available only to issuers.

*Offerings in Close Proximity*

Can an issuer conduct a Rule 506(c) offering in close proximity to its initial public offering?

Issuers and their counsel always have been concerned with “gun jumping” prior to the filing of an IPO registration statement. A private placement made pursuant to Section 4(a)(2)/Rule 506(b) shortly before the filing of an IPO should be considered closely; however, given that such an offering does not involve general solicitation, the risk that the offering would be viewed as “gun jumping” is low. However, an issuer conducting a Rule 506(c) offering in close proximity to the filing of an IPO might be more problematic, given that the general solicitation (especially if the Rule 506(c) offering involves the sale of the same security as that offered in the IPO) may be viewed as “gun jumping.” In the case of emerging growth companies, the JOBS Act specifically permits test-the-waters communications with institutional accredited investors and QIBs prior to or after the filing of a registration statement; however, general solicitation used in a Rule 506(c) offering may also raise concerns for any test-the-waters discussions.

Can an issuer complete a private offering while it is pursuing an IPO?

Yes, through guidance in SEC Release No. 33-8828 (August 3, 2007), no-action letters and C&DIs, the SEC and its Staff has clarified that an issuer that is conducting a public offering may conduct a concurrent private placement provided that, among other things, the issuer has not solicited the offerees in the private placement using the registration statement. Presumably, this analysis is made simpler now that general solicitation may be used in connection with a Rule 506(c) offering. Of course, the longstanding principle still applies that an offering that commences as a private offering must be completed as a private offering, and an offering that commences as a public offering must be completed as a public offering, except in those circumstances specified in Rule 155 (see note 122 in SEC Release No. 33-8828).

Can an issuer use Rule 506(c) in connection with a PIPE transaction?

From time to time, a reporting company may decide to conduct a private placement, or PIPE transaction. An issuer that conducts a PIPE transaction generally relies on the Section 4(a)(2) exemption and the Rule 506 safe harbor. One of the principal advantages associated with a PIPE transaction is that the issuer will not be required to announce the transaction until definitive agreements have been executed. This prevents any investor from “front-running” in anticipation of the offering. The placement agent will have approached potential investors confidentially about the PIPE transaction. An already public company will likely be reluctant to use general solicitation in connection with a PIPE transaction, because announcing the potential private offering may have an
effect on its stock price. Also, once an announcement is made, an issuer may be more reluctant to terminate a deal if the pricing is not favorable. Therefore, it is unlikely that Rule 506(c) will be used.

In a PIPE transaction, the issuer will disseminate a press release announcing the execution of definitive agreements (prior to the filing of a resale registration statement). This press release complies with Rule 135c and does not name the placement agent. If the press release strictly complies with Rule 135c, the issuer can be certain that it will not have conducted a general solicitation and prior to the filing of the resale registration statement can “re-open” the PIPE transaction and sell additional securities in a private placement. Now, perhaps, an issuer and its counsel may be more comfortable with a press release that does not comply with 135c, given that additional interest in the PIPE transaction that results from the filing of the press release would not restrict the issuer from completing an additional private offering in reliance on Rule 506(c).

From time to time, selling stockholders may transfer their securities in a private offering structured as a PIPE transaction. Since this transaction cannot be completed in reliance on Rule 506(c), general solicitation cannot be used.

**How would Rule 152 apply to a private offering completed prior to the filing of a registration statement?**

Rule 152 clarifies that a completed private offering will not be integrated with a subsequent public offering. Generally, issuers that conduct a PIPE transaction, or private offering wherein resale registration rights are offered to the private investors, rely on Rule 152 in connection with the filing of a resale registration statement. When Rule 152 was adopted, the private offering would not have involved a general solicitation. Should the analysis change for Rule 506(c) offerings, where general solicitation is used? It is unclear whether Rule 152 would be available in connection with an offering in which general solicitation is permitted.

**Conclusion**

There are many more scenarios that one can envision will arise in connection with private and public offerings, especially as the lines between private and public continue to blur following the relaxation of the ban on general solicitation. We will update or supplement these questions on our Jumpstarter blog from time to time.
About Morrison & Foerster

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life sciences companies. We’ve been included on The American Lawyer’s A-List for 10 straight years, and Fortune named us one of the “100 Best Companies to Work For.” Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com. © 2013 Morrison & Foerster LLP. All rights reserved.

For more updates, follow Thinkingcapmarkets, our Twitter feed: www.twitter.com/Thinkingcapmkts.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.
Private Offerings: Questions that Might Frequently be Asked Sometime Soon (Part II)

Shortly after the Securities and Exchange Commission (SEC) adopted the final rule relaxing the prohibition against general solicitation in connection with offerings made pursuant to new Rule 506(c) and Rule 144A, we provided our perspective on various interpretative questions that might arise as issuers and financial intermediaries began to avail themselves of the new offering exemption and the ability to communicate more broadly. See http://www.mofo.com/files/Uploads/Images/130723-Private-Offerings.pdf. In this alert, we provide our views on additional questions that we have received from market participants.

The Interplay of Rule 506(b) and Rule 506(c)

If an issuer completed a Rule 506(b) offering to its existing investors and then proposes to commence an offering to new investors in reliance on Rule 506(c), must the issuer go back to the existing investors that participated in the Rule 506(b) offering to obtain additional information in order to satisfy verification requirements?

No. The Rule 506(b) offering is deemed completed, and a new offering is being commenced. Even if one were concerned about the integration of the Rule 506(b) offering and the subsequent Rule 506(c) offering, the issuer would not have had to undertake additional verification steps with respect to its existing investors, beyond confirming that those investors were still “accredited investors.”

Does the requirement to verify the status of investors in a Rule 506(c) offering change the process for establishing a reasonable belief as to accredited investor status for purposes of a Rule 506(b) offering?

No. The process in relation to Rule 506(b) offerings has not changed. An issuer may continue to rely on its (or its financial intermediary’s) pre-existing relationship with investors, and on investor questionnaires and investor representations regarding their status.

Should materials used to market a Rule 506(c) offering include legends similar to those proposed by the SEC in its Release No. 33-9416 (proposing changes to Regulation D, Form D and Rule 156)?

No, the materials do not need to include the legends that were included in the SEC’s proposal relating to Regulation D offerings; however, offering materials used in connection with a private offering should contain clear and prominent legends indicating the private nature of the offering, that, to the extent applicable, the materials are confidential and are being provided by the issuer or its adviser to a recipient and may not be shared, that the securities that are being offered are being offered in an exempt transaction, and that the securities will be “restricted securities” that will be subject to transfer restrictions. It would be permissible to include the legends contemplated by the SEC’s proposed amendments, even though they are not technically required to be included.
The Use of Websites

Can you use general solicitation to garner interest in a site that provides general information about investment opportunities without conducting additional verification?

Yes, general solicitation may be used to promote a site that provides only general information about investments and does not provide access to specific investment opportunities.

Can website providers continue to rely on the SEC Staff’s prior guidance on the use of password-protected internet-based offerings?

Yes, the guidance in IPONet and Lamp Technologies is still relevant. A website provider may want to use general solicitation to attract users to its website, and may provide information that is of general interest and not related to a specific offering on pages that are not subject to password protection and are freely accessible. Prior to providing any visitor or user with access to information about a particular issuer or particular investment opportunity, the website provider can implement investor verification procedures. If only investors that are determined to be “accredited investors” are permitted to access information about an offering, then the issuer can presumably continue to rely on Rule 506(b).

Can matchmaking sites generally advertise and then provide access only to accredited investors without undertaking additional verification steps?

No. Of course, a matchmaking site can continue to make certain opportunities available on a limited basis only to investors that it has previously determined are accredited investors, while making other investments available broadly and conducting additional verification steps.

Use of General Solicitation by Funds

Is it still necessary to impose a waiting period for investments once investors have been qualified to access information about fund offerings?

Yes, to the extent that a fund is engaged in a continuous offering and the fund intends to rely on Rule 506(b), rather than Rule 506(c).

Do the same investor verification rules apply if you use general solicitation but sell only to qualified purchasers?

Presumably, if general solicitation is used, and sales are being made by a fund solely to investors that are “qualified purchasers,” the fund or a financial intermediary acting on its behalf will need to consider carefully the verification procedures that it implements and be certain that the verification procedures will ascertain the investor’s status as a “qualified purchaser” (not just an “accredited investor”). For funds that charge incentive fees, the verification process also must contemplate ascertaining that the investor is a “qualified client.”

How do the general solicitation rules apply to a fund that relies on the CFTC’s de minimis exemption from the commodity pool operator registration requirement or Rule 4.7?

To date, there has been no guidance from the CFTC regarding whether a general solicitation in the context of a Rule 506(c) offering or a Rule 144A offering would be considered “marketing to the public” under the applicable CFTC rules. As a result, funds that rely on these rules should not use general solicitation until guidance has been issued.
**Bad Actor Rule**

Has the SEC provided guidance regarding the implementation of the bad actor disqualification provisions of Rule 506?

The SEC provided some guidance on various aspects of the bad actor rule in a recently issued Small Entity Compliance Guide, available at [http://www.sec.gov/info/smallbus/secg/bad-actor-small-entity-compliance-guide.htm](http://www.sec.gov/info/smallbus/secg/bad-actor-small-entity-compliance-guide.htm). The guide addresses various transition issues and reiterates that the rules affect only sales of securities made on or after September 23, 2013. Sales of securities made before the effective date of the bad actor provisions will not be affected by the disqualification and disclosure requirements, even if such sales are part of an offering that continues after the effective date. Only sales made after the effective date of the amendments will be subject to disqualification and mandatory disclosure.

The guide also addresses disqualifying events that occur while an offering is underway and notes that sales made before the occurrence of the disqualifying event will not be affected by the disqualifying event, but sales made afterward will not be entitled to rely on Rule 506 unless the disqualification is waived or removed, or, if the issuer is not aware of a triggering event, the issuer may be able to rely on the reasonable care exception.

Will the SEC waive the disclosure requirement for bad actor disqualification triggering events that occurred prior to the September 23, 2013 effective date?

The SEC Staff has indicated that it does not have the authority to waive the requirement to disclose bad actor disqualification triggering events that occurred prior to the effective date.

**Content Requirements; Filing Requirements**

Are there any content or filing requirements for written general solicitation materials?

The SEC’s proposal regarding amendments to Regulation D, Form D and Rule 156 is only a proposed rule, and the status of the proposal is unclear; however, there is an existing regulatory framework that is applicable to materials used in connection with an offering of securities.

An issuer will have liability in respect of written general solicitation materials. Any written general solicitation materials should be closely reviewed. Certain types of issuers may be subject to more detailed regulatory requirements. For example, commodity pools are subject to requirements relating to the format and content of written solicitation materials. For more on these, see [http://www.mofo.com/files/Uploads/Images/130920-Rules-for-CPOs.pdf](http://www.mofo.com/files/Uploads/Images/130920-Rules-for-CPOs.pdf). Similarly, issuers that are investment companies are subject to requirements relating to the content of solicitation materials.

To the extent that a broker-dealer is engaged in the offering, the broker-dealer is subject to requirements relating to its communications. Communications must be fair and balanced. This will require careful consideration of the contents of any solicitation materials to ensure that risks are appropriately presented. In addition, broker-dealers are subject to FINRA rules relating to advertising, such as FINRA Rule 2210. Communications that are considered “retail communications” are subject to review, filing and recordkeeping requirements. For more on FINRA Rule 2210, see [http://www.mofo.com/files/Uploads/Images/120627-FINRA-Rule-Governing-Communications.pdf](http://www.mofo.com/files/Uploads/Images/120627-FINRA-Rule-Governing-Communications.pdf). FINRA members also are subject to the requirements of Rule 5123 relating to private offerings, see [http://www.mofo.com/files/Uploads/Images/120615-FINRA-Rule-5123.pdf](http://www.mofo.com/files/Uploads/Images/120615-FINRA-Rule-5123.pdf).
Are there special considerations involved in using social media?

Yes. Issuers should consider carefully the means through which they conduct any general solicitation, and should implement a social media policy. Broker-dealers and registered investment advisers also are subject to specific rules and regulatory guidance relating to their use of social media. We discuss many of the considerations relating to the use of social media in our guide, available here http://www.mofo.com/files/Uploads/Images/130905-Social-Media-Securities-Laws.pdf.

**Documentation Issues**

Should the documentation used in connection with private offerings be updated?

Both issuers and financial intermediaries should consider implementing changes to documents used in connection with a Rule 506 or a Rule 144A offering. For example, an issuer will need to undertake a bad actor inquiry in relation to itself, affiliates, control persons, etc., and will want to obtain representations or a certification from a placement agent or other financial intermediary that the intermediary is not a bad actor and has not engaged in any disqualifying event that requires disclosure. On its part, any financial intermediary that is actively involved in the private offering market will want to undertake its own bad actor compliance process. Engagement letters, purchase agreements and placement agency agreements should be reviewed and provisions may need to be added addressing the bad actor rule; identifying an offering as a Rule 506(b) offering (not using general solicitation) or as a Rule 506(c) offering; addressing the preparation and use of, as well as liability for, any written general solicitation materials. We provide sample provisions at http://us.practicallaw.com/cs/Satellite/usclassic/resource-us/4-537-0305.

For a jump start on the JOBS Act, please visit our MoFoJumpstarter blog: www.mofojumpstarter.com.

**Author**

Anna T. Pinedo  
New York  
(212) 468-8179  
apinedo@mofo.com

**About Morrison & Foerster**

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life sciences companies. We’ve been included on The American Lawyer’s A-List for 10 straight years, and Fortune named us one of the “100 Best Companies to Work For.” Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com. © 2013 Morrison & Foerster LLP. All rights reserved.

For more updates, follow Thinkingcapmarkets, our Twitter feed: www.twitter.com/Thinkingcapmkts.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.
Overview

Yesterday, March 25, 2015, the Securities and Exchange Commission voted unanimously to adopt final rules to implement the rulemaking mandate of Title IV of the JOBS Act by adopting amendments to Regulation A. In December 2013, the SEC had released a proposed rule that essentially retained the current framework of Regulation A and expanded it for larger exempt offerings. The proposed rules were generally well-received. The final rules addresses a number of issues raised by commenters, while retaining substantially the same approach outlined in the proposed rule.

Briefly, by way of background, existing Regulation A provides an exemption from the registration requirements of Section 5 for certain smaller securities offerings by private (non-SEC-reporting) companies. The securities sold in a Regulation A offering are not considered “restricted securities” and are freely transferable. However, the low dollar threshold, the disclosure requirements, and the requirement to comply with state blue sky laws had limited the utility of Regulation A. Other exemptions, such as Rule 506 under Regulation D, which have no dollar threshold, became more popular. Prior to the JOBS Act, a number of market participants advocated amending Regulation A to raise the dollar threshold and legislation to amend and to modernize Regulation A was proposed and considered prior to the emergence of the JOBS Act. In large measure, Title IV of the JOBS Act incorporated many of the provisions that had been addressed in those standalone bills. Section 401 of the JOBS Act amended Section 3(b) of the Securities Act by renumbering it as Section 3(b)(1) and adopting new sections (b)(2) through (b)(5). Pursuant to the JOBS Act additions to Section 3(b), the SEC is authorized to promulgate rules or regulations creating an exemption that is substantially similar to the existing Regulation A for offerings of up to $50 million.

The New Regulation A

As discussed in more detail below, the final rules provide an exemption for U.S. and Canadian companies that are not required to file reports under the Exchange Act to raise up to $50 million in a 12-month period. The final rules create two tiers: Tier 1 for smaller offerings raising up to $20 million in any 12-month period, and Tier 2 for offerings raising up to $50 million. The new rules also make the exemption available, subject to limitations on the amount, for the sale of securities by existing stockholders. The new rules modernize the existing framework under Regulation A by, among other things, requiring that disclosure documents be filed on EDGAR, allowing an issuer to make a confidential submission with the SEC, permitting certain test-the-waters communications, and disqualifying bad actors. The final rules impose different disclosure requirements for Tier 1 and Tier 2 offerings,
with more disclosure required for Tier 2 offerings, including audited financial statements. Tier 1 offerings will be subject to both SEC and state blue sky pre-sale review. Tier 2 offerings will be subject to SEC, but not state blue sky, pre-sale review; however, investors in a Tier 2 offering will be subject to investment limits (except when securities are sold to accredited investors or are listed on a national securities exchange) and Tier 2 issuers will be required to comply with periodic filing requirements, which include a requirement to file current reports upon the occurrence of certain events, semi-annual reports and annual reports. The final rules provide a means for an issuer in a Tier 2 offering to concurrently list a class of securities on a national exchange through a short-form Form 8-A, without requiring the filing of a separate registration statement on Form 10.

**Eligible Issuers**

The new Regulation A exemption, both Tier 1 and Tier 2, will be available to issuers organized in and having their principal place of business in the United States or Canada. The following issuers will be “ineligible” to offer or sell securities under Regulation A:

1. an issuer that is an SEC-reporting company;
2. a blank check company;
3. any investment company registered or required to be registered under the Investment Company Act of 1940 (this includes business development companies); and
4. any entity issuing fractional undivided interests in oil or gas rights, or similar interests in other mineral rights.

The exemption also is not available to: issuers that have not filed with the SEC the ongoing reports required by Regulation A during the two years immediately preceding the filing of a new offering statement, issuers that have had their registration revoked pursuant to an Exchange Act Section 12(j) order that was entered into within five years before the filing of the offering statement and certain bad actors.

**Eligible Securities**

The securities that may be offered under Regulation A are limited to equity securities, including warrants, debt securities and debt securities convertible into or exchangeable into equity interests, including any guarantees of such securities. The final rule excludes asset-backed securities.

**Offering Limitations**

As noted above, an issuer can choose a Tier 1 or a Tier 2 offering. Under Tier 1, an issuer may offer and sell up to $20 million in a 12-month period, of which up to $6 million may constitute secondary sales (except as noted below). Under Tier 2, an issuer may offer and sell up to $50 million in a 12-month period, of which up to $15 million may constitute secondary sales (except as noted below). The final rules set out an approach for calculating the offering limit in the case of convertible or exchangeable securities.

In the issuer's initial Regulation A offering and any Regulation A-exempt offering in the 12 months following that offering price of the particular offering, the selling securityholder component cannot exceed 30% of the aggregate offering. In addition, the final rules distinguish between sales by affiliates and sales by non-affiliates. Following the expiration of the first year following an issuer's initial qualification of a Regulation A offering statement, the limit on secondary sales falls away for non-affiliates only. Notably, the final rule eliminates the current prohibition on resales by affiliates in reliance on the exemption unless the issuer had net income from continuing operations in at least one of the last two years.
**Investment Limitation**

Prior to the amendments, Regulation A did not contain a limit on the amount of securities that may be purchased by an investor. However, to address potential investor protection concerns, the final rules impose an investment limit for Tier 2 offerings. The investment limit will not apply to accredited investors and will not apply if the securities are to be listed on a national securities exchange at the consummation of the offering; otherwise a non-accredited natural person is subject to an investment limit and must limit purchases to no more than 10% of the greater of the investor’s annual income and net worth, determined as provided in Rule 501 of Regulation D (for non-accredited, non-natural persons, the 10% limit is based on annual revenues and net assets).

Investors must be notified of the investment limitations, and may rely on a representation of compliance with the investment limitation from the investor, unless the issuer knew at the time of sale that any such representation is untrue.

**Integration of Offerings**

A Regulation A offering will not be integrated with:

1. prior offers or sales of securities; or
2. subsequent offers or sales of securities that are:
   - registered under the Securities Act, except as provided in Rule 255(e);
   - made in reliance on Rule 701;
   - made pursuant to an employee benefit plan;
   - made in reliance on Regulation S;
   - made pursuant to Section 4(a)(6) of the Securities Act [crowdfunded offerings]; or
   - made more than six months after the completion of the Regulation A offering.

As a result, one could envision an issuer making a private offering under Section 4(a)(2) or Regulation D prior to commencing a Regulation A offering without risking integration of the private offering with the Regulation A offering. An offering made under Regulation A should not be integrated with another exempt offering, provided that each exempt offering complies with the requirements for the exemption that is being relied upon for that particular offering. The final rule also addresses abandoned offerings in much the same way that these are handled by Rule 155, with a 30-day cooling off period.

The SEC reaffirmed guidance that was included in the proposing release which is consistent with the guidance regarding integration provided in Release 33-8828.

**Exchange Act Threshold**

The proposed rule did not exempt securities sold pursuant to Regulation A from the calculation of “holder of record” for purposes of the Section 12(g) Exchange Act threshold. The final rule, however, provides a limited exemption for securities issued in a Tier 2 offering from the Section 12(g) “holder of record” threshold where the issuer is subject to, and current in its, Regulation A periodic reporting obligations. In order to benefit from this conditional exemption, an issuer must: retain the services of a transfer agent and meet requirements similar to
those in the “smaller reporting company” definition (public float of less than $75 million or, in the absence of a float, revenues of less than $50 million, in the most recently completed fiscal year). An issuer that exceeds the Section 12(g) threshold will have a two-year transition period.

**Filing and Delivery Requirements**

Regulation A offering statements must be filed on EDGAR. The Form 1-A has been amended to consist of three parts: Part I, which will be an XML-based fillable form with basic issuer information; Part II, which will be a text file that will contain the disclosure document and financial statements; and Part III, which will be a text file that will contain exhibits and related materials. Periodic reports and any other documents required to be submitted to the SEC in connection with a Regulation A offering must be filed on EDGAR.

As proposed, the final rules adopts an access equals delivery model for Regulation A final offering circulars. In the case where a preliminary offering circular is used to offer securities to potential investors and the issuer is not already subject to the Tier 2 periodic reporting requirements, an issuer and participating broker-dealer will be required to deliver the preliminary offering circular to prospective purchasers at least 48 hours in advance of sales.

**Non-Public Review**

An issuer may submit an offering statement for non-public review by the SEC. As with EGCs, should an issuer opt for confidential review, the offering statement must be filed publicly not less than 21 calendar days before qualification of the offering statement. The timing, in the case of a Regulation A offering, is not tied to an issuer’s road show, but rather to the qualification of the offering statement. The SEC noted specifically that the 21-day public filing period will provide state securities regulators an opportunity to assure filing of offering materials at the state level in advance of an offering under Regulation A.

**Form 1-A**

An issuer that seeks to rely on Regulation A must file and qualify an offering statement. The offering statement is intended to be a disclosure document that provides potential investors with information that will form the basis for their investment decision. A notice of “qualification” is similar to a notice of effectiveness in an SEC-registered offering.

**Part I**

As noted above, Part I requires certain basic information regarding the issuer, its eligibility, the offering details, the jurisdictions where the securities will be offered, and sales of unregistered securities.

**Part II**

Part II contains the narrative portion of the Offering Circular and requires disclosures of basic information about the issuer; material risks; use of proceeds; an overview of the issuer’s business; an MD&A type discussion; disclosures about executive officers and directors and compensation; beneficial ownership information; related party transactions; and a description of the offered securities. This is similar to Part I of Form S-1, and an issuer can choose to comply with Part I of Form S-1 in connection with its Offering Circular. The disclosure requirements will be scaled.

Tier 1 and Tier 2 issuers must file balance sheets and other required financial statements as of the two most recently completed fiscal year ends (or for such shorter time as they have been in existence). U.S. issuers are required to prepare financial statements in accordance with U.S. GAAP. Canadian issuers may
use U.S. GAAP or IFRS as adopted by the IASB. As with EGCs, an issuer may elect to delay implementation of new accounting standards to the extent such standard permit delayed implementation by non-public business entities. The election is a one-time election and must be disclosed.

The financial statements for an issuer in a Tier 1 offering are not required to be disclosed; however, if a Tier 1 issuer already obtained an audit of its financial statement for other purposes and such audit was performed in accordance with U.S. GAAS or the PCAOB standards and the auditors meet the independence standards, then the audited financial statements must be filed.

The financial statements for an issuer in a Tier 2 offering are required to be audited. The audit firm must satisfy the independence standard but need not be PCAOB-registered. The financial statements may be audited in accordance with either U.S. GAAS or PCAOB standards. An issuer in a Tier 2 offering that seeks to have a class of securities listed on a national securities exchange concurrent with the Regulation A offering must include financial statements prepared in accordance with PCAOB standards by a PCAOB-registered firm.

The final rule addresses technical matters, such as the age of the financial statements. Issuers in Tier II offerings are not required to provide financial statements in an interactive data format using XBRL.

Part III

The exhibit requirements in Part III of Form 1-A are maintained, however, the final rule allows for incorporation by reference of exhibits that were previously filed on EDGAR.

Continuous Offerings

The final rule would continue to permit continuous or delayed offerings in certain instances, such as for offerings offered or sold on behalf of selling security holders, securities offered under employee benefit plans; securities pledged as collateral; securities issued upon conversion of other outstanding securities or upon the exercise of options, warrants, or rights, etc.; or securities that are part of an offering which commences within two calendar days after the qualification date, will be offered on an continuous basis, may continue to be offered for a period in excess of 30 days from the date of initial qualification, and will be offered in an amount that, at the time the offering statement is qualified, is reasonably expected to be offered and sold within a period of two years from the initial qualification date. The offerings permitted under Regulation A would be limited in the same manner as under Rule 415; as such, delayed offerings would not be permitted under Regulation A.

Offering Communications

An issuer engaged in a Regulation A offering has substantial flexibility regarding offering communications. An issuer must file solicitation materials with the SEC. Solicitation materials used after an offering circular is filed must be accompanied by the offering circular or include a link to the offering circular. Solicitation materials will be subject to certain legends.

The SEC also confirmed that regularly released factual business communications will not constitute solicitation materials, consistent with the guidance of Rule 169.

Ongoing Reporting Requirements

Currently, Regulation A does not require that issuers file ongoing reports with the SEC, other than a Form 2-A to report sales or termination of sales made under Regulation A. While the final rules rescind Form 2-A, they impose new on-going reporting obligations for certain offerings.
Tier 1 issuers will be required to provide certain information about their Regulation A offerings on a new form, Form 1-Z.

Issuers in Tier 2 offerings will be subject to an ongoing reporting regime. Similar to the ongoing reporting regime that the SEC proposed in connection with issuers that conduct crowdfunded offerings, Tier 2 issuers would be required to file:

- annual reports on Form 1-K;
- semi-annual reports on Form 1-SA;
- current reports on Form 1-U;
- special financial reports on Form 1-K and Form 1-SA; and
- exit reports on Form 1-Z.

The Form 1-K would require disclosures relating to the issuer’s business and operations for the preceding three fiscal years (or since inception if in existence for less than three years); related party transactions; beneficial ownership; executive officers and directors; executive compensation; MD&A; and two years of audited financial statements. The form is required to be filed within 120 calendar days of the issuer’s fiscal year-end.

The semi-annual report would be similar to a Form 10-Q, although it would be subject to scaled disclosure requirements. The semi-annual report is required to be filed within 90 days after the end of the first six months of the issuer’s fiscal year end, commencing immediately following the most recent fiscal year for which full financial statements were included in the offering circular or, if the offering circular included six-month interim financial statements for the most recent full fiscal year, then for the first six months of the following fiscal year.

A current report on Form 1-U will be required to announce fundamental changes in the issuer’s business; entry into bankruptcy or receivership proceedings; material modifications to the rights of securityholders; changes in accountants; non-reliance on audited financial statements; changes in control; changes in key executive officers; and sales of 10 percent or more of outstanding equity securities in exempt offerings. The form must be filed within four business days of the triggering event.

An exit report on Form 1-Z would be required to be filed within 30 days after the termination or completion of a Regulation A-exempt offering.

*Rule 15c2-11, Rule 144 and Rule 144A*

A Tier 2 issuer’s periodic reports will satisfy Exchange Act Rule 15c2-11 broker-dealer requirements relating to the obligation to review information about an issuer in connection with publishing quotations on any facility other than a national securities exchange. However, contrary to commenters’ requests, the final rule does not establish that these reports would constitute “current information” for Rule 144 and Rule 144A purposes. A Tier 2 issuer that voluntarily submits quarterly information in a form consistent with that required for semi-annual information would be able to satisfy the “reasonably current information” and “adequate current public information” requirements.

* Tier 2 Offering with Concurrent Exchange Act Registration*

The final rules facilitate the ability of a Tier 2 issuer to voluntarily register a class of Regulation A securities under the Exchange Act. In the absence of the relief provided in the final rules, an issuer that completed a Regulation A offering and sought to list a class of securities on a national securities exchange would have had to incur the costs and the timing delays associated with preparing and filing a separate registration statement on Form 10. The final
rule permits a Tier 2 issuer that has provided disclosure in Part II of Form 1-A that follows Part 1 of Form S-1 (or for REITs, Form S-11) to file a Form 8-A to list its securities on a national securities exchange. Of course, thereafter, the issuer would be subject to Exchange Act reporting requirements. An issuer that enters the Exchange Act reporting regime in this manner will be an EGC.

**Termination or Suspension of Tier 2 Disclosure Obligations**

Tier 2 issuers would be permitted to terminate or suspend their ongoing reporting obligations on a basis similar to the provisions for suspension or termination of reporting requirements for Exchange Act filers. A Tier 2 issuer that has filed all required ongoing reports for the shorter of: (1) the period since the issuer became subject to such reporting obligations, or (2) its most recent three fiscal years and the portion of the current year preceding the date of filing Form 1-Z (termination or exit form) will be permitted to suspend its reporting obligations at any time after completing reporting for the fiscal year in which the offering statement was qualified. This suspension will be permitted if the securities of each class to which the offering statement relates are held of record by fewer than 300 persons and offers or sales made in reliance on a qualified offering statement are not ongoing. Further, the Regulation A on-going reporting requirements would be automatically suspended if an issuer registers a class of securities under Section 12 of the Exchange Act.

**Bad Actor Disqualification Provisions**

The final rule includes bad actor disqualification provisions that are largely consistent with those included in Rule 506(d).

**State Securities Law Requirements**

As discussed above, one of the most significant concerns regarding the use of the Regulation A exemption has been the requirement to comply with state securities laws. At the time the new rules were proposed, there was no coordinated review process by the states for Regulation A offerings. Although NASAA has now introduced a coordinated review process for Regulation A offerings since the new rules were proposed, the SEC noted that the coordinated review process is relatively new and it remains largely untested.

The final rules provide that Tier 1 offerings will remain subject to state securities law requirements. Consistent with the proposed rules, Tier 2 offerings will not be subject to state review if the securities are sold to “qualified purchasers” or, as provided by statute in the JOBS Act, listed on a national securities exchange. The final rule defines the term “qualified purchaser” in a Regulation A offering to include: all offerees and purchasers in a Tier 2 offering. States will, of course, continue to have authority to require filing of offering materials and enforce anti-fraud provisions in connection with a Tier 2 offering.

**Securities Act Liability**

Sellers of Regulation A securities would have Section 12(a)(2) liability in respect of offers or sales made by means of an offering circular or oral communications that include a material misleading statement or omission. While an exempt offering pursuant to Regulation A is excluded from the operation of Section 11 of the Securities Act, those offerings are subject to the antifraud provisions under the federal securities laws.

**Character of the Securities Sold in a Regulation A Offering**

The securities sold in a Regulation A offering are not considered “restricted securities” under Securities Act Rule 144. As a result, sales of the securities by persons who are not affiliates of the issuer would not be subject to any transfer restrictions under Rule 144. Affiliates, of course, would continue to be subject to the limitations of Rule 144, other than the holding period requirement. This is important to an issuer that would like an active trading
market to develop for its securities following completion of a Regulation A offering. However, the issuer’s securities may not be listed or quoted on a securities exchange without registration under Section 12 of the Exchange Act, and, as a result, there may not be a liquid market for the securities.

Effective Date

The final rules will be effective 60 days following publication in the Federal Register.

FINRA Review

For any public offering of securities, FINRA Rule 5110 prohibits FINRA members and their associated persons from participating in any manner unless they comply with the filing requirements of the rule.¹ Rule 5110 also contains rules regarding underwriting compensation. Rule 5110(b) requires that certain documents and information be filed with and reviewed by FINRA, and these filing and review requirements apply to securities offered under Regulation A.²

Additional Information

We will be supplementing this alert with additional materials, as well as offering various client briefings.

¹ See FINRA Rule 5110.
² See NASD Notice to Members 92-28 (May 1992); see also NASD Notice to Members 86-27 (Apr. 1986).
Summary Charts

Below we provide two charts. The first chart summarizes the provisions of current Regulation A, the final rules governing Tier 1 Offerings under the final rule and the final rules governing Tier 2 Offerings. The second chart provides a summary comparison of various securities exemptions.

<table>
<thead>
<tr>
<th>Offering Limit</th>
<th>Prior Regulation A Exempt Public Offering</th>
<th>Tier 1 of New Regulation A+</th>
<th>Tier 2 of New Regulation A+</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Up to $5 million within the prior 12-month period.</td>
<td>Up to $20 million in a 12-month period.</td>
<td>Up to $50 million in a 12-month period.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>SEC Filing Requirements</th>
<th>Prior Regulation A Exempt Public Offering</th>
<th>Tier 1 of New Regulation A+</th>
<th>Tier 2 of New Regulation A+</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Must file with the SEC a Form 1-A, which is reviewed and qualified by the SEC.</td>
<td>Must file with the SEC a Form 1-A, which must be reviewed and qualified by the SEC.</td>
<td>Must file with the SEC a Form 1-A, which must be reviewed and qualified by the SEC.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Blue Sky Requirements</th>
<th>Prior Regulation A Exempt Public Offering</th>
<th>Tier 1 of New Regulation A+</th>
<th>Tier 2 of New Regulation A+</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Blue sky law compliance is required, without, in many cases, the possibility for a more streamlined “registration by coordination” process.</td>
<td>Blue sky law compliance is required, with the newly implemented NASAA coordinate review process available.</td>
<td>Exempt from state law review, subject to state filing and anti-fraud authority, for offerings to qualified purchasers or where securities are listed on an national securities exchange.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Limitations on Investors</th>
<th>Prior Regulation A Exempt Public Offering</th>
<th>Tier 1 of New Regulation A+</th>
<th>Tier 2 of New Regulation A+</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No limits on investors, except to the extent imposed under state laws.</td>
<td>No limits.</td>
<td>Investment limit applicable for persons who are not accredited investors.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Restrictions on Resale of Securities</th>
<th>Prior Regulation A Exempt Public Offering</th>
<th>Tier 1 of New Regulation A+</th>
<th>Tier 2 of New Regulation A+</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No restrictions on the resale of securities, except to the extent that the securities are held by affiliates.</td>
<td>No restrictions on the resale of securities, except to the extent that the securities are held by affiliates.</td>
<td>No restrictions on the resale of securities, except to the extent that the securities are held by affiliates.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Offering Communications</th>
<th>Prior Regulation A Exempt Public Offering</th>
<th>Tier 1 of New Regulation A+</th>
<th>Tier 2 of New Regulation A+</th>
</tr>
</thead>
<tbody>
<tr>
<td>An issuer may “test the waters” to determine if there is interest in a proposed offering prior to filing the Form 1-A. Sales literature may be used before the filing of the Form 1-A, after filing, and following qualification.</td>
<td>An issuer may “test the waters” to determine if there is interest in a proposed offering prior to filing the Form 1-A. Sales literature may be used before the filing of the Form 1-A, after filing, and following qualification.</td>
<td>An issuer may “test the waters” to determine if there is interest in a proposed offering prior to filing the Form 1-A. Sales literature may be used before the filing of the Form 1-A, after filing, and following qualification.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financial Statement Requirements</th>
<th>Prior Regulation A Exempt Public Offering</th>
<th>Tier 1 of New Regulation A+</th>
<th>Tier 2 of New Regulation A+</th>
</tr>
</thead>
<tbody>
<tr>
<td>A current balance sheet, as well as income statements for a period of two years, as well as any interim period. Financial statements must be prepared in accordance with GAAP but do not have to conform to Regulation S-X and, in most cases, do not have to be audited.</td>
<td>• Audited financial statements only if prepared for other purposes. If audited, then must be audited by an independent accountant, but not required to be PCAOB-registered. • Current balance sheet, income statement for two years, as well as any interim period.</td>
<td>• Audited financial statements required, reviewed by an independent accountant and prepared in accordance with PCAOB standards. • Current balance sheet, income statement for two years, as well as any interim period.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Disqualification Provisions</th>
<th>Prior Regulation A Exempt Public Offering</th>
<th>Tier 1 of New Regulation A+</th>
<th>Tier 2 of New Regulation A+</th>
</tr>
</thead>
<tbody>
<tr>
<td>Felons and bad actors disqualified from the offering in accordance with Securities Act Rule 262.</td>
<td>Felons and bad actors disqualified; Rule 262 updated.</td>
<td>Felons and bad actors disqualified; Rule 262 updated.</td>
<td>Subject to on-going reporting obligation, including a requirement to file: current reports, semi-annual reports; and annual reports, until obligations are terminated or suspended.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Ongoing Reporting</th>
<th>Prior Regulation A Exempt Public Offering</th>
<th>Tier 1 of New Regulation A+</th>
<th>Tier 2 of New Regulation A+</th>
</tr>
</thead>
<tbody>
<tr>
<td>No reporting required after the offering, other than to disclose the use of proceeds.</td>
<td>A termination report required.</td>
<td>A termination report required.</td>
<td>A termination report required.</td>
</tr>
<tr>
<td>Type of Offering</td>
<td>Dollar Limit</td>
<td>Manner of Offering</td>
<td>Issuer and Investor Requirements</td>
</tr>
<tr>
<td>-----------------</td>
<td>--------------</td>
<td>--------------------</td>
<td>----------------------------------</td>
</tr>
<tr>
<td>Section 3(a)(11)</td>
<td>None</td>
<td>No limitation other than to maintain intrastate character of offering.</td>
<td>All issuers and investors must be resident in state. No limitation on number.</td>
</tr>
<tr>
<td>Section 4(a)(2)</td>
<td>None</td>
<td>No general solicitation or general advertising.</td>
<td>All issuers and investors must meet sophistication and access to information test so as not to need protection of registration.</td>
</tr>
<tr>
<td>Rule 504 Regulation D</td>
<td>$1 million within prior 12 months</td>
<td>No general solicitation or general advertising unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sales to accredited investors with general solicitation.</td>
<td>File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.</td>
</tr>
<tr>
<td>Rule 505 Regulation D</td>
<td>$5 million within prior 12 months</td>
<td>Unlimited accredited investors and 35 non-accredited investors.</td>
<td>File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.</td>
</tr>
<tr>
<td>Rule 506 Regulation D</td>
<td>None</td>
<td>No general solicitation or advertising under Rule 506(b). General solicitation and general advertising permitted under Rule 506(c), provided all purchasers are accredited investors.</td>
<td>Under Rule 506(b), unlimited accredited investors and 35 non-accredited investors. Under Rule 506(c), all purchasers must be accredited investors.</td>
</tr>
<tr>
<td>Tier 1 Regulation A</td>
<td>$20 million within prior 12 months, but no more than $6 million by selling security holders.</td>
<td>“Testing the waters” permitted before and after filing Form 1-A. Sales permitted after Form 1-A qualified.</td>
<td>Eligible Issuer No investor requirement.</td>
</tr>
<tr>
<td>Tier 2 Regulation A</td>
<td>$50 million within the prior 12 months, but no more than $15 million by selling security holders.</td>
<td>“Testing the waters” permitted before and after filing Form 1-A. Sales permitted after Form 1-A qualified.</td>
<td>Eligible Issuer No investor requirement; however, investors who are natural persons and are not non-accredited investors are subject to an investment limit.</td>
</tr>
</tbody>
</table>

---

**MOFOJUMPSTARTER**

For a jump start on the JOBS Act, please visit our MoPoJumpstarter blog: [www.mofojumpstarter.com](http://www.mofojumpstarter.com).


**Authors**

Marty Dunn  
Washington, D.C.  
(202) 778-1611  
mdunn@mofo.com

Anna T. Pinedo  
New York  
(212) 468-8179  
apinedo@mofo.com

James R. Tanenbaum  
New York  
(212) 468-8163  
jtanenbaum@mofo.com

**About Morrison & Foerster**

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life sciences companies. We’ve been included on The American Lawyer’s A-List for 11 straight years, and Fortune named us one of the “100 Best Companies to Work For.” Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at [www.mofo.com](http://www.mofo.com). © 2015 Morrison & Foerster LLP. All rights reserved.

For more updates, follow Thinkingcapmarkets, our Twitter feed: [www.twitter.com/Thinkingcapmkt](http://www.twitter.com/Thinkingcapmkt).

*Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.*
In this alert, we provide a detailed overview of the final rules, Regulation Crowdfunding, which will be applicable to crowdfunding offerings conducted in reliance on Section 4(a)(6) of the Securities Act of 1933 as amended (the “Securities Act”), which was added by Title III of the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”), as well as to those intermediaries participating in such offerings. We do not address the proposed FINRA framework applicable to funding portals, which will be covered in a separate alert. All rule references, unless otherwise noted, refer to rules under Regulation Crowdfunding.

We will supplement this alert with a more detailed practical analysis comparing the various new offering exemptions available to issuers as a result of the JOBS Act.

PART ONE: GENERAL REQUIREMENTS

Limit on Capital Raised

Consistent with the statutory limitations, Rule 100(a) provides that an issuer may sell up to $1 million in any 12-month period to investors in an offering made pursuant to the exemption. Of course, an issuer may consider conducting other exempt offerings in close proximity with its crowdfunded offering. In calculating the amounts sold for purposes of the threshold, amounts sold by a predecessor or by an entity under common control with the issuer will be aggregated with the amounts sold by the issuer.

Individual Investment Limits

In the final rules, the Securities and Exchange Commission (the “SEC”) has modified the investor limits from those included in its proposed rules. The final rules make clear that the individual investor limit is an aggregate limit, which applies to all investments made by the individual over a 12-month period in crowdfunded offerings and not to a specific offering.
An investor will be limited to investing:

(1) The greater of: $2,000 or 5% of the lesser of the investor’s annual income or net worth if either annual income or net worth is less than $100,000; or
(2) 10% of the lesser of the investor’s annual income or net worth, not to exceed an amount sold of $100,000, if both annual income and net worth are $100,000 or more.

As we discuss below, the issuer can rely on the intermediary’s calculation of the investment limit; provided that the issuer does not have knowledge that the investor has exceeded, or would exceed, the investment limits as a result of participating in the issuer’s offering.

**Offering through an Intermediary**

An issuer would only be able to engage in an offering through a registered broker-dealer or through a funding portal, and an issuer can only use one intermediary for a particular offering or concurrent offerings made in reliance on the exemption.

The offering must be conducted online only through the intermediary’s platform, so that the “crowd” has access to information and there is a forum for an exchange of information among potential offering participants.

A “platform” is defined as “a program or application accessible via the Internet or other similar electronic communication medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act.”

**Eligible Issuers**

The ability to engage in crowdfunding is not available to all issuers. By statute, the following issuers cannot rely on crowdfunding transactions under Section 4(a)(6):

- issuers not organized under the laws of a state or territory of the United States or the District of Columbia;
- issuers already subject to Securities Exchange Act of 1934, as amended (the “Exchange Act”) reporting requirements;
- investment companies as defined in the Investment Company Act of 1940 (the “Investment Company Act”) or companies that are excluded from the definition of “investment company” under Section 3(b) or 3(c) of the Investment Company Act; and
- any issuer that the Commission, by rule or regulation, determines appropriate.

The final rules also exclude:

- issuers disqualified from relying on Section 4(a)(6), or “bad actors;” and
- issuers that have sold securities in reliance on Section 4(a)(6) and have failed, to the extent required, to make required ongoing reports required by Regulation Crowdfunding during the two-year period immediately preceding the filing of the required new offering statement; and
• any issuer that is a development stage company that has no specific business plan or purpose, or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.

**PART TWO: ISSUER REQUIREMENTS**

**Disclosure Requirements**

The statute sets out a number of required disclosures in any Section 4(a)(6) offering. An issuer that elects to engage in a crowdfunding offering must comply with disclosure requirements, including: an initial disclosure about the offering on Form C, amendments to Form C to report material changes (Form C-A), periodic updates on the offering on Form C-U and ongoing annual filings until a filing obligation is terminated. The annual filing must be made on Form C-AR and a termination notice on Form C-TR.

**Form C**

The Form C would be filed with SEC and the intermediary would post the filing or provide a link to the filing for investors. The Form C must include disclosures relating to the issuer’s business, officers, directors and control persons, use of proceeds, capital structure and financial results, as discussed below in more detail. In many respects, the Form C requirements resemble those for Form 1-A used in connection with Regulation A offerings. The final Form C also includes an optional Q&A format that issuers may elect to use to provide certain disclosures.

Basic issuer information would be required, including: the entity name, the form of entity, the jurisdiction of formation, formation date, address, website, number of employees, the issuer’s website on which an investor can find the issuer’s annual report and the date by which such report will be made available, whether the issuer or any predecessor previously failed to comply with the ongoing reporting requirements of Regulation Crowdfunding. In addition, the form must disclose certain basic information about the intermediary, including: the intermediary’s SEC file number and FINRA CRD number and fees being paid to the intermediary, expressed either as a dollar amount or as a percentage of the offering amount, and a description of the intermediary’s financial interests in the transaction and in the issuer.

In addition, the form will require, among other things, a discussion of:

- **Use of Proceeds**: a specific use or range of possible uses for the offering proceeds, as well as the factors impacting the selection by the issuer of each such use;
- **The Targeted Offering Size**: as discussed further below, the issuer must disclose the maximum offering size and the subscription process;
- **Offering Price**: a description of the price to the public of the securities and a description of how the offered securities were valued;
- **Business**: the form must include a business description, for which no particular format is prescribed;
- **Directors and officers**: each individual’s name, positions held with the issuer and duration in those positions and business experience during the last three years;
Beneficial Ownership and Capital Structure: for principal stockholders, the issuer would be required to identify each shareholder who owns 20% or more of the issuer’s outstanding voting equity securities (calculated as of the most recent practicable date), as well as provide a description of capital stock, including any special voting rights or investor rights;

Indebtedness;

Related party transactions: a description of transactions that involve amounts in excess of 5% of the amount raised by the issuer in crowdfunded offerings in the trailing 12-month period including in the proposed deal;

Exempt offerings: a description of all exempt offerings undertaken during the preceding three years;

Risk factors: a discussion of risks associated with an investment in the securities and with participation in a crowdfunded offering;

Transfer restrictions; and

Management’s Discussion and Analysis: a discussion that covers each period for which financial statements of the issuer are provided, as well as a discussion of material changes or trends known to management.

Financial Statement Requirements

In a change from the proposed rules, the final rules provide some accommodations with respect to financial statement requirements depending upon the target offering size and for first-time issuers.

Based on target offering size, the requirements are as follows:

- **$100,000 or less:** the amount of total income, taxable income and total tax or equivalent line items, as reported on the federal tax forms filed by the issuer for the most recently completed year (if any), certified by the principal executive officer of the issuer, and the financial statements of the issuer, also certified by the principal executive officer. If financial statements of the issuer are available that have either been reviewed or audited by a public accountant independent of the issuer, then, these financial statements must be provided instead of the materials described in the preceding sentence.

- **More than $100,000 and less than $500,000:** financial statements of the issuer reviewed by a public accountant independent of the issuer. If financial statements of the issuer are available that have been audited by a public accountant independent of the issuer, the issuer must provide those instead of the reviewed statements.

- **More than $500,000:** financial statements of the issuer audited by a public accountant independent of the issuer; provided, however, that for issuers that are first-time issuers, offerings that have a target offering amount of more than $500,000 but not more than $1 million, financial statements of the issuer reviewed by a public accountant independent of the issuer. If audited statements are available, those must be provided instead.

Financial statements must be prepared in accordance with U.S. GAAP. Audited financial statements must be conducted in accordance either with American Institute of Certified Public Accountants (“AICPA”) standards (referred to as U.S. GAAS) or Public Company Accounting Oversight Board.
“PCAOB”) standards. These requirements are similar to those applicable for Tier 1 offerings made under Regulation A. A signed audit report must accompany audited financial statements.

During the first 120 days of the issuer’s fiscal year, an issuer may conduct an offering in reliance on Section 4(a)(6) using financial statements for the fiscal year prior to the most recently completed fiscal year if the financial statements for the most recently completed fiscal year are not otherwise available.

Amendments to Form C

An issuer would be required to amend its Form C disclosures using Form C/A for any updates or material changes. The materiality determination is left up to the issuer based on the customary guidance that the SEC considers a material change to be a change that would affect an investor’s investment decision. The issuer must identify on Form C/A whether the amendment is filed to disclose a material change. Investor reconfirmations must be obtained following the occurrence of a material change.

Progress Update

An issuer also is required to file progress updates with the SEC on a Form C-U. Updates are required five days after any of the following milestones: commitments for 50% of the deal are received, commitments for the full deal are received, subscriptions in excess of the initial offering amount will be accepted, or the issuer closes the offering.

Annual Report

An issuer that completes a crowdfunded offering must file with the SEC and post on its website an annual report on Form C-AR along with financial statements of the issuer certified by its principal executive officer within 120 days of the end of the issuer’s fiscal year. The annual report is required to contain the same information required in the offering statement, described above.

Termination of Reporting

An issuer must file with the SEC a Form C-TR to terminate its reporting obligation within five days of the date on which it becomes eligible to do so.

An issuer can terminate its ongoing reporting requirements upon the earliest to occur of the following:

- the issuer is required to file reports under the Exchange Act;
- the issuer has filed at least one annual report and has fewer than 300 holders of record;
- the issuer has filed at least three annual reports and has total assets that do not exceed $10 million;
- the issuer or another party purchases or repurchases all of the securities issued pursuant to Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or
- the issuer liquidates or dissolves in accordance with state law.
Offering Amount and Offering Mechanics

In connection with a proposed offering, the rules contemplate that the issuer would include in its disclosures a discussion of the target or maximum amount to be raised, and a discussion of the subscription or offering process. The description of the subscription process must disclose that investors can cancel their investment up to 48 hours prior to the deadline identified in the offering materials, but if an investor does not cancel the investment, then the investor’s funds will be released to the issuer upon closing.

The intermediary will notify investors when the target offering amount has been met, and if the target offering amount is not met, then no securities will be sold and all funds will be returned to investors. If the target offering amount is met prior to the deadline identified in the offering materials, the issuer must provide five days’ advance notice before closing the offering early. If an investor does not reconfirm the investment commitment after a material change is made to the offering and disclosed on Form C-A, the investment will be cancelled, and the issuer must return the funds to the investor.

Types of Securities Offered

The final rules do not limit the types of securities that may be offered in reliance on Section 4(a)(6). The release notes that an issuer may offer debt securities and discusses the exemption from the requirement to qualify an indenture under the Trust Indenture Act of 1939 (the “Trust Indenture Act”) for any offering exempted by Section 4 of the Securities Act from the provisions of Section 5 of the Securities Act; however, the final rules do not include a specific exemption from Trust Indenture Act requirements for crowdfunded offerings.

Status of Securities

Securities sold in a crowdfunded offering pursuant to the exemption would be subject to transfer restrictions. Pursuant to Rule 501, securities issued in a crowdfunded offering could not be transferred by a purchaser for one year from the date of purchase, except for transfers to: the issuer; an accredited investor; a family member of the purchaser or in estate type transfers; and third parties in an SEC-registered offering.

The statute exempts securities sold in Section 4(a)(6) offerings from the Exchange Act “holder of record” count for the purposes of determining if registration of a class of equity securities is required under Section 12(g). An issuer will be required to establish a means for tracking its shareholders. This may require an early-stage company to engage the services of a transfer agent or other similar service provider in order to monitor its security holders.

Integration

An offering made pursuant to the Section 4(a)(6) exemption will not be integrated with another exempt offering that precedes the crowdfunded offering or that takes place concurrently or subsequently. The issuer must ensure that it has satisfied all of the conditions for the exemption that it is claiming for each such offering. If the issuer is conducting a Rule 506(c) offering (using general solicitation), it must ensure that the Rule 506(c) offerees were not solicited by means of the communications used for the crowdfunded offering.
Restrictions on Advertising and Promotion

The final rules limit the ability of the issuer, as well as the ability of others acting on the issuer’s behalf, to advertise. Pursuant to Rule 204, an issuer is permitted to advertise a Section 4(a)(6)-exempt offering by releasing an offering notice that contains only the following information:

- a statement that the issuer is conducting an offering;
- the name of the intermediary and a link to the intermediary’s offering page;
- the amount of securities offered;
- the nature of the securities;
- the price of the securities;
- the closing date for the offering; and
- the name, address, phone number and website of the issuer;
- the email address of a representative of the issuer; and
- a brief factual description of the issuer’s business.

The adopting release notes that this notice is intended to be similar to tombstone ads permitted under Securities Act Rule 134. The issuer would be able to communicate with potential crowdfunding investors if the communications occur through the platform; however, it should be clear to potential investors which platform communications are being made by the issuer or on the issuer’s behalf.

The final rules do not limit an issuer from being able to continue to engage in regular business communications so long as it does not disclose information about the offering, except as permitted in an offering notice. However, the final rules do not contain an express safe harbor for regularly released business information.

Promoter Compensation

Rule 205 prohibits an issuer from compensating, or committing to compensate, directly or indirectly, a person for advertising or promoting a Section 4(a)(6) offering through the intermediary’s platform, unless the issuer takes reasonable steps to ensure that the person clearly discloses the receipt (past and prospective) of compensation each time that such person makes a promotional communication. A founder or employee of the issuer that engages in promotional activities on the issuer’s behalf through the intermediary’s platform would be required to disclose in each posting that s/he is engaging in those activities on the issuer’s behalf.

The release discusses a number of “reasonable steps” that an issuer can take in order to ensure that promoters disclose the receipt of communication, including, but not limited to, obtaining representations from the promoter and monitoring communications.

PART THREE: INTERMEDIARIES

Title III of the JOBS Act provides that a crowdfunded offering must be made through an intermediary that is either a registered broker-dealer or a funding portal. The intermediary is intended to function as a gatekeeper and, in this role, protect investors from fraud. The SEC’s final rules establish a regulatory framework for these intermediaries. As discussed below, in the case of funding portals, the regulatory framework is a scaled back version of the framework applicable to broker-dealers.
We discuss the final rules in the sequence of an offering and then provide an overview of the registration, compliance and other requirements applicable to intermediaries.

**Conducting a Crowdfunded Offering**

**Single Intermediary**

As discussed above, the final rules require that an offering be made only through one intermediary.

**Financial Interests in Issuer**

Rule 300 prohibits directors, officers or partners (or others having a similar status or performing a similar function) of an intermediary from having any financial interest in an issuer using its services and prohibits such persons from receiving a financial interest in an issuer as compensation for the service provided to or for the benefit of the issuer in connection with the offering. An intermediary cannot have a financial interest in an issuer that is using the intermediary’s platform, unless:

- The intermediary receives the financial interest from the issuer as offering compensation; and
- The financial interest consists of securities of the same class and having the same terms as those sold in the offering.

A “financial interest” in an issuer means a direct or indirect ownership of, or economic interest in, any class of the issuer’s securities.

**Measures to Reduce Risk of Fraud**

Under Rule 301, an intermediary must have a reasonable basis for believing that the issuer is in compliance with relevant regulations and has established means to keep accurate records of holders of the securities it offers. An intermediary could reasonably rely on the issuer’s representations, absent knowledge or other information that would suggest that the representations are not true.

An intermediary must deny access to an issuer if it has a reasonable belief that the issuer or its offering would present a potential for fraud. An intermediary would be required to deny access to its platform to an issuer if the intermediary has a reasonable belief that the issuer, or any of its directors, officers or 20% beneficial owners is subject to a disqualification under Rule 503. An intermediary must conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary, as well as on each of its officers, directors (or any person occupying a similar status or performing a similar function) and 20% beneficial owners.

**Account Opening**

Under Rule 302, no intermediary or associated person may accept an investment commitment until the investor opens an account with the intermediary and the intermediary obtains consent to electronic delivery of materials. An intermediary is required to certain information to each investor, including educational materials, by electronic message with links to information posted on the intermediary’s website.
Educational Materials

Rule 302 requires that in connection with establishing an account, an intermediary deliver educational materials in plain English. Any revised materials must be made available to all investors before accepting any additional investment commitments or effecting any further crowdfunded transactions. The materials must discuss:

- the process for the offering;
- the types of securities sold through the platform and the associated risks;
- the restrictions on resale;
- the offering statement;
- the investment limitations;
- the limitations on an investor’s right to cancel an investment commitment and the circumstances under which an issuer may cancel the commitment;
- the need to consider the appropriateness for the investor of an investment in a crowdfunded offering;
- that following the completion of the offering there may or may not be a continuing relationship between the issuer and the intermediary; and
- that under certain circumstances the issuer may cease its ongoing reporting.

An intermediary also would be required to inform investors that disclosure is required regarding any past or prospective compensation paid to a promoter. An intermediary also must disclose the compensation it will receive in connection with crowdfunded offerings.

Issuer Information

Under Rule 303, an intermediary must make available to the SEC and potential investors not later than 21 days prior to the first day on which securities are sold to any investor any information provided by the issuer under Rules 201 and 203(a).

The information must be made publicly available on the intermediary’s platform, in a manner that reasonably permits a person accessing the platform to save, download or store the information; this information be made publicly available on the intermediary’s platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments; and this information, including any additional information provided by the issuer, remain publicly available on the intermediary’s platform until the offer and sale is completed or cancelled. An intermediary cannot require any person to establish an account with the intermediary in order to receive this information.

Investor Qualifications

Securities Act Section 4A(a)(8) imposes an obligation on intermediaries to make sure no investor exceeds the statutory investment limitations.

The final rules implement this requirement by providing that, before permitting an investor to make an investment commitment on its platform, an intermediary must have a reasonable basis to believe that the investor satisfies the investment limitations discussed above.
The final rules allow reasonable reliance on an investor’s representation to this effect.

**Investor’s Acknowledgment of Risks**

Securities Act Section 4A(a)(4) requires an intermediary to ensure that each investor reviews the educational materials, positively affirms that the investor understands that he or she is risking the loss of the entire investment and that the investor could bear such a loss, and answer questions demonstrating an understanding of the level of risk involved in startups. As discussed above, educational materials must be provided at account opening.

Rule 303 requires that an intermediary, each time before accepting an investment commitment, obtain from the investor a representation that the investor has reviewed the intermediary’s educational materials, understands that the entire investment may be lost and can bear the risk of loss. The intermediary also must ensure each time before accepting an investment commitment that each investor answers questions demonstrating the investor’s understanding that there are restrictions on the investor’s ability to cancel an investment commitment and obtain a return of his or her investment, that it may be difficult for the investor to resell the securities and that the investor should not invest any funds in a crowdfunding offering unless s/he can afford to lose the entire amount of his or her investment.

**Communication Channels**

Rule 303 requires an intermediary to provide, on its platform, channels through which investors can communicate with one another and with representatives of the issuer about offerings made available on the intermediary’s platform, subject to certain conditions.

This is intended to provide a centralized and transparent means for members of the public to share their views and to communicate with the issuer. The intermediary cannot participate in the communications. It can set rules regarding the postings or remove postings that use offensive language.

Communications should be available for public viewing, but the intermediary would only be able to permit those persons who have opened accounts with it to post comments. With each post, a person must disclose whether such person is a promoter or affiliate of the issuer and whether it has been or will be compensated. The intermediary must keep records of these communications.

**Notice of Investment Commitment**

An intermediary, upon receipt of an investment commitment from an investor, must promptly give or send to the investor a notification disclosing: the dollar amount of the commitment, the price of the securities (if known), the name of the issuer and the date and time by which the investor may cancel the investment commitment. Notification would be required to be provided by email or other electronic media and to be documented in accordance with applicable recordkeeping rules.
Maintenance and Transmission of Funds

Securities Act Section 4A(a)(7) requires that an intermediary “ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount.”

An intermediary that is a registered broker must comply with established requirements in Exchange Act Rule 15c2-4 for the maintenance and transmission of investor funds. Investor funds must be held in escrow until the specified contingency occurs (i.e., the targeted amount or the minimum amount is raised), and then the funds would be promptly transmitted to a bank, which has agreed in writing to hold such funds in escrow for the investors and to transmit or return such funds directly to the issuer or to investors, as the case may be. Proceeds are to be transmitted to the issuer only if the target offering amount is met or exceeded.

Because a funding portal cannot receive or handle any funds, it would be required to direct investors to transmit money or other consideration directly to a qualified third party (a registered broker-dealer, a bank, or a credit union) that serves as an escrow agent. A funding portal must promptly direct transmission of funds from the qualified third party to the issuer when the aggregate amount of investment commitments from all investors is equal to or greater than the target amount of the offering and the cancellation period for each investor has expired, but no earlier than 21 days after the date on which the intermediary makes publicly available on its platform the information required to be provided about the issuer and the offering. A funding portal must direct the return of funds to an investor when an investment commitment has been cancelled or the offering is terminated or cancelled.

Confirmation of Transaction

At or before the completion of a transaction, the intermediary is required to give or send each investor a notification, like a confirmation, disclosing the transaction date; the type of security; the price and number of securities purchased; the number of securities sold by the issuer in the transaction; the price at which the securities were sold; certain specified terms of the security (for example, if it is a debt or callable security); and the source and amount of any remuneration received or to be received by the intermediary in connection with the transaction, whether from the issuer or other persons. This notification must be by email or other electronic media and subject to recordkeeping rules.

Completion of Offerings, Cancellations and Reconfirmations

Investors have an unconditional right to cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer’s offering materials. Thereafter, an investor cannot cancel any investment commitments made within the final 48 hours (except in the event of a material change to the offering, as discussed below).

If an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering once the target offering amount is reached, provided that the offering will have remained open for a minimum of 21 days; the intermediary provides notice about the new offering deadline at least five business days prior to the new offering deadline; investors are given the opportunity to reconsider their investment decision and to cancel their investment commitment until
48 hours prior to the new offering deadline; and at the time of the new offering deadline, the issuer continues to meet or exceed the target offering amount.

If there is a material change to the terms of the offering, or the information provided by the issuer regarding the offering, the intermediary must give or send to any potential investors who have made investment commitments notice of the material change, stating that the investor’s investment commitment will be cancelled unless the investor reconfirms his or her commitment within five business days of receipt of the notice. If the investor fails to reconfirm his or her investment within those five business days, the intermediary, within five business days thereafter, must provide or send the investor a notification disclosing that the investment commitment was cancelled, the reason for the cancellation and the refund amount that the investor should expect to receive, and direct the refund of investor funds.

Finally, if an issuer does not complete an offering because the target is not reached or the issuer decides to terminate the offering the intermediary within five business days must give or send to each investor who made an investment commitment a notification disclosing the cancellation of the offering, the reason for the cancellation, the refund amount that the investor should expect to receive, direct the refund of investor funds and prevent investors from making investment commitments with respect to that offering on its platform.

**Intermediate Registration and Other Requirements**

**Registration and SRO Membership**

An intermediary must be registered as a broker-dealer with the SEC under Section 15(b) of the Exchange Act or a funding portal registered with the SEC in accordance with the requirements of Rule 400 and also a member of a national securities association registered under Section 15A of the Exchange Act, which is FINRA.

**Additional Requirements on Funding Portals**

The SEC has established a streamlined registration process under which a funding portal would register with the SEC by filing a form, Form Funding Portal, with information consistent with, but less extensive than, the information required for broker-dealers on Form BD.

A funding portal would register by completing a Form Funding Portal, which includes information concerning the funding portal’s principal place of business, its legal organization and its disciplinary history, if any; business activities, including the types of compensation the funding portal has received and disclosure of its disciplinary history, if any; FINRA membership with any other registered national securities association; and the funding portal’s website address(es) or other means of access.

A funding portal’s registration would become effective the later of (1) 30 calendar days after the date that the registration is received by the SEC; or (2) the date the funding portal is approved for membership in FINRA.

In order to promote transparency, all such Forms Funding Portal will be available publicly.
A funding portal must file an amendment to the Form Funding Portal within 30 days of any of the information in the original form becoming inaccurate for any reason. The final rules require a funding portal to promptly file a withdrawal of registration on Form Funding Portal upon ceasing to operate as a funding portal. The withdrawal would be effective on the later of 30 days after receipt by the SEC after the funding portal is no longer operational within such longer period of time as to which the funding portal consents or within such period of time as to which the SEC, by order, may determine as necessary or appropriate in the public interest or for the protection of investors.

A funding portal can operate multiple website addresses under a single funding portal registration provided that the funding portal discloses on the Form Funding Portal all the website and names under which it does business.

**Non-U.S. Funding Portals**

Entities domiciled or organized outside of the United States (“nonresident funding portals”) are able to act as funding portals; however, they are subject to additional requirements.

There must be an information sharing arrangement in place between the SEC and the competent regulator in the jurisdiction under the laws of which the nonresident funding portal is organized or where it has its principal place of business. In addition, a nonresident funding portal would be required to have an agent for service of process in the United States, as well as an opinion of counsel addressing the ability of the applicant to provide the SEC and the national securities association of which it is a member with prompt access to its books and records and to submit to onsite inspection and examination by the SEC and the national securities association. The nonresident funding portal also would be required to consent that service of any civil action brought by, or notice of any proceeding before, the SEC or any national securities association of which it is a member, in connection with the funding portal’s investment-related business, may be given by registered or certified mail to the nonresident funding portal’s contact person at the main address or mailing address indicated on the form.

**Fidelity Bond**

The proposed rules would have required a fidelity bond, however the final rules do not require a fidelity bond.

**Exemptions from Broker-Dealer Registration and Safe Harbors**

But for the exemption from registration for funding portals that Congress directed in the JOBS Act, a funding portal would be required to register as a broker under the Exchange Act.

The SEC’s final rules exempt an intermediary that is registered as a funding portal from the requirement to register as a broker-dealer under the Exchange Act, although a funding portal would remain subject to the full range of the SEC’s examination and enforcement authority.

A funding portal cannot:

- Offer investment advice or recommendations;
Solicit purchases, sales or offers to buy the securities displayed on its platform;

Compensate employees, agents or other persons for such solicitations based on the sale of securities displayed or referenced on its platform; or

Hold, manage, possess or otherwise handle investor funds or securities.

In addition, the final rules set out certain “permitted activities” of a funding portal.

**Providing Communication Channels:** as noted above, a funding portal should provide a channel for potential investors to communicate about the merits of an offering.

** Highlighting Issuers and Offerings:** a funding portal may highlight a particular offering made through its platform based on objective criteria, such as the type of security, geographic region, industry, etc. Criteria must be objective and cannot be based on investment advice or implicitly endorse an issuer or an offering. The funding portal cannot receive special or additional compensation for highlighting one or more issuers or offerings on its platform.

**Advising Issuers:** a funding portal may advise an issuer on the structure or content of its proposed offering and prepare offering documentation.

**Paying for Referrals:** a funding portal may pay for referrals, subject to various limitations.

**Compensation Arrangements with Registered Broker-Dealers:** a funding portal may enter into arrangements with a broker-dealer pursuant to which they could compensate one another provided such arrangements are not prohibited by the national securities association of which the funding portal is a member.

**Advertising:** a funding portal could advertise its services as well as offerings that are available through its platform, subject to compliance with various requirements.

**Limiting Offerings:** a funding portal can limit the offerings on its platforms (for example, by limiting the offerings to issuers in certain industries, geographies, etc.) without being deemed to be providing investment advice. The criteria would be required to be reasonably designed to result in a broad selection of issuers offering securities through the funding portal’s platform and be applied consistently to all potential issuers and offerings. Criteria must be displayed on the funding portal’s site.

**Compliance Policies and Procedures**

A funding portal is required to implement written policies and procedures designed to achieve compliance with applicable regulations.

A funding portal will be required to comply with the same privacy rules (Regulation S-P, Regulation S-AM, and Regulation S-ID) applicable to broker-dealers.
A funding portal is subject to the SEC’s examination and inspection authority. Also, a funding portal is subject to recordkeeping requirements in order to ensure that there is an audit trail for all crowdfunding transactions and communications.

**Disqualification (“Bad Actor”) Provisions**

Rule 503 sets out bad actor disqualification provisions. The Section 4(a)(6) exemption will not be available for a sale of securities if the issuer, a predecessor of the issuer, an affiliated issuer, any director, officer, general partner or managing member of the issuer, a beneficial owner of 20% or more of the issuer's outstanding voting equity securities, any promoter or solicitor, or any general partner, director, officer or managing member of any such solicitor is subject to a “statutory disqualification.”

**Conclusion**

With the much anticipated crowdfunding rules now adopted, it will be interesting to observe the extent to which the rules will prove useful for issuers and intermediaries in raising small amounts of capital. While the SEC sought to add more flexibility in the final rule within the confines of the statutory directive from Title III of the JOBS Act, the exemption contemplates procedural and informational requirements that will require the significant dedication of resources by the smaller issuers that would likely find the exemption most useful, as well as their intermediaries. We will continue to monitor developments as market practices emerge for issuers and intermediaries.

---

**MOFO Jumpstarter**

For a jump start on the JOBS Act, please visit our MoFoJumpstarter blog: www.mofojumpstarter.com.

---

**Author**

Anna T. Pinedo  
New York  
(212) 468-8179  
apinedo@mofo.com

**About Morrison & Foerster**

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life sciences companies. We’ve been included on *The American Lawyer’s* A-List for 12 straight years, and *Fortune* named us one of the “100 Best Companies to Work For.” Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com. © 2015 Morrison & Foerster LLP. All rights reserved.

For more updates, follow Thinkingcapmarkets, our Twitter feed: www.twitter.com/Thinkingcapmkt.

*Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.*
SEC Proposes Rule Changes to Pave the Way for Intrastate and Regional Offerings

At the same time the Securities and Exchange Commission (the “SEC”) adopted rules implementing Regulation Crowdfunding pursuant to Title III of the Jumpstart Our Business Startups Act (the “JOBS Act”), the agency proposed rule changes that could potentially facilitate intrastate and regional offerings that are subject to state blue sky regulation. In particular, the SEC proposed to modernize Rule 147 under the Securities Act of 1933, as amended (the “Securities Act”), and establish a new exemption to facilitate offerings relying upon recently adopted intrastate crowdfunding exemptions under state securities laws. The SEC also proposed amendments to Rule 504 of Regulation D under the Securities Act to increase the aggregate amount of securities that may be offered and sold in any twelve-month period from $1 million to $5 million and to disqualify certain bad actors from participating in Rule 504 offerings. The SEC indicated in the proposing release that these proposals are “part of the Commission’s efforts to assist smaller companies with capital formation consistent with other public policy goals, including investor protection.”

PROPOSED AMENDMENTS TO RULE 147

Rule 147 is a safe harbor for intrastate offerings exempt from registration pursuant to Securities Act Section 3(a)(11), which exempts “any security which is a part of an issue offered and sold only to persons resident within a single state or territory, where the issuer of such security is a person residing and doing business within, or, if a corporation, incorporated by and doing business within such state or territory.” The proposed amendments would eliminate the restriction on offers, while continuing to require that sales be made only to residents of an issuer’s state or territory. The proposed amendments also would redefine “intrastate offering” and ease issuer eligibility requirements. The SEC proposes to limit the availability of the exemption to offerings that are either registered in the state in which all of the purchasers are resident, or conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors.

The SEC noted that over time it has been observed that the statutory limitation on offers in Section 3(a)(11) and the prescriptive threshold requirements that an issuer must satisfy in order to be considered “doing business” in-state as specified in Rule 147 have combined to limit the availability of the exemption for companies that otherwise might have considered using the exemption in order to conduct intrastate offerings. In particular, these provisions make it difficult to conduct intrastate offerings utilizing the Internet. The SEC also noted that a number of states have adopted and/or enacted crowdfunding provisions, or currently have crowdfunding legislation pending. These state-based crowdfunding provisions generally require that an issuer, in addition to complying with various state-specific requirements to qualify for the exemption, also comply with Section 3(a)(11) and Rule 147. State securities regulators have indicated to the SEC that Section 3(a)(11) and Rule 147 make it difficult for companies to take advantage of these new crowdfunding provisions.
The proposed amendments to Rule 147 would permit an issuer to engage in any form of general solicitation or general advertising, including the use of publicly accessible Internet websites, to offer and sell its securities, so long as all sales occur within the same state or territory in which the issuer’s principal place of business is located, and the offering is registered in the state in which all of the purchasers are resident, or is conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors. The proposed amendments would also define an issuer’s principal place of business (as opposed to its “principal office” as defined in current Rule 147) as the location in which the officers, partners, or managers of the issuer primarily direct, control, and coordinate the activities of the issuer and further require the issuer to satisfy at least one of four threshold requirements discussed below regarding the in-state nature of the issuer’s business. As defined, an issuer would only be able to have a “principal place of business” within a single state or territory and would therefore only be able to conduct an offering pursuant to amended Rule 147 within that state or territory. Further, as proposed, the provisions of Rule 147 regarding legends and mandatory disclosures to purchasers and prospective purchasers would be retained.

Rule 147, as it is proposed to be amended, would no longer fall within the statutory parameters of Section 3(a)(11); therefore, the SEC proposed to amend Rule 147 to create an exemption pursuant to the SEC’s general exemptive authority under Section 28 of the Securities Act. As proposed to be amended, Rule 147 would function as a separate exemption rather than as a safe harbor under Section 3(a)(11), and Section 3(a)(11) would still be available as a potential statutory exemption in and of itself.

Based on its belief that the rules should continue to require that the securities sold in an intrastate offering in one state should come to rest within such state before sales are permitted to out-of-state residents, the SEC proposes to limit the ability of an issuer that has changed its principal place of business to conduct an intrastate offering in a different state until such time as the securities sold in reliance on the proposed exemption in the prior state have come to rest in that state. For this purpose, the SEC proposes that issuers that have changed their principal place of business after making sales in an intrastate offering pursuant to proposed Rule 147 would not be able to conduct an intrastate offering pursuant to proposed Rule 147 in another state for a period of nine months from the date of the last sale in the prior state, which is consistent with the duration of the resale limitation period specified in proposed Rule 147(e), discussed below.

For the purpose of determining the “in-state” nature of the issuer utilizing Rule 147, the rule as proposed would require that, in addition to the requirement that an issuer have its principal place of business in-state, the issuer must meet at least one of the following requirements (instead of all requirements, as currently specified in Rule 147): (i) the issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in or from the rendering of services within such state or territory; (ii) the issuer had at the end of its most recent semi-annual fiscal period prior to the first offer of securities pursuant to the exemption, at least 80% of its consolidated assets located within such state or territory; (iii) the issuer intends to use and uses at least 80% of the net proceeds to the issuer from sales made pursuant to the exemption in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; or (iv) a majority of the issuer’s employees are based in such state or territory (this fourth prong is proposed to be added to the list).
Client Alert

While current Rule 147(d) requires that offers and sales of securities pursuant to the rule be made only to persons resident within the state or territory of which the issuer is a resident, so that the exemption would be lost for the entire offering if securities are offered or sold to one investor that was not in fact a resident of the state, the proposed amendments would add a reasonable belief standard to the issuer’s determination as to the residence of the purchaser at the time of the sale of the securities. An issuer would satisfy this by either the existence of the fact that the purchaser is a resident of the applicable state or territory, or by establishing that the issuer had a reasonable belief that the purchaser of the securities in the offering was a resident of such state or territory. The SEC also proposes to eliminate the current requirement in Rule 147 that issuers obtain a written representation from each purchaser as to his or her residence.

The proposed amendments also would define the residence of a purchaser that is a legal entity (i.e., a corporation, partnership, trust, or other form of business organization) as the location where, at the time of the sale, the entity has its principal place of business. The proposed amendments would define a purchaser’s “principal place of business,” consistent with the proposed definition for issuer eligibility purposes, as the location in which the officers, partners, or managers of the entity primarily direct, control and coordinate the activities of the issuer.

Under current Rule 147(e), “during the period in which securities that are part of an issue are being offered and sold by the issuer, and for a period of nine months from the date of the last sale by the issuer of such securities, all resales of any part of the issue, by any person, shall be made only to persons resident within such state or territory.” This limitation on resales is designed to help ensure that the securities issued in an intrastate offering have come to rest in the state of the offering before any potential redistribution out-of-state. The SEC proposes to amend the limitation on resales in Rule 147(e) to provide that “for a period of nine months from the date of the sale by the issuer of a security sold pursuant to this rule, any resale of such security by a purchaser shall be made only to persons resident within such state or territory, as determined pursuant to paragraph (d) of this rule.” The SEC believes that a nine-month limitation on resales by resident purchasers to non-residents would ensure that the securities purchased by such residents were purchased without a view to further distribution to non-residents. In addition, Rule 147 would be revised so that compliance with Rule 147(e) would not be a condition for the issuer relying on the exemption.

The SEC also proposes to align the integration safe harbor in Rule 147 with the recently adopted integration safe harbor in Rule 251(c) of Regulation A. As proposed, offers and sales made pursuant to Rule 147 would not be integrated with:

- Prior offers or sales of securities; or
- Subsequent offers or sales of securities that are:
  - Registered under the Securities Act, except as provided in Rule 147(h);
  - Exempt from registration under Regulation A;
  - Exempt from registration under Rule 701;
  - Made pursuant to an employee benefit plan;
  - Exempt from registration under Regulation S;
As with Rule 251(c) of Regulation A, the proposed integration safe harbor would expressly provide that any offer or sale made in reliance on the rule would not be integrated with any other offer or sale made either before the commencement of, or more than six months after, the completion of the Rule 147 offering. There would be no presumption that offerings outside the integration safe harbor should be integrated.

The proposing release also indicates that an offering made in reliance on Rule 147 would not be integrated with another exempt offering made concurrently by the issuer, provided that each offering complies with the requirements of the exemption that is being relied upon for the particular offering. Further, consistent with the approach that the SEC took to integration in Rule 251(c), the proposed rules provide that, subject to certain exceptions specified in the rule, offers or sales made in reliance on Rule 147 should not be integrated with subsequent offers or sales that are registered under the Securities Act, or qualified by the SEC pursuant to Regulation A.

PROPOSED REGULATION D AMENDMENTS

Rule 504 of Regulation D currently provides issuers with an exemption from registration for offers and sales of up to $1 million of securities in a twelve-month period, provided that the issuer is not:

- subject to reporting pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”);
- an investment company; or
- a blank check company.

Additionally, Rule 504 imposes conditions for the availability of the exemption, including limitations on the use of general solicitation or general advertising in the offering and the restricted status of securities issued pursuant to the exemption, with limited exceptions in this regard for offers and sales made:

- exclusively in one or more states that provide for the registration of the securities, and require the public filing and delivery to investors of a substantive disclosure document before sale that are made in accordance with state law requirements;
- in one or more states that have no provision for the registration of the securities or the public filing or delivery of a disclosure document before the sale, if the securities have been registered in at least one state that provides for such registration, public filing, and delivery before sale, offers and sales are made in that state in accordance with such provisions, and the disclosure document is delivered before sale to all purchasers (including those in the states that have no such procedure); or
- exclusively according to state law exemptions from registration that permit general solicitation and general advertising so long as sales are made only to “accredited investors” as defined in Rule 501(a) of Regulation D.
Client Alert

Offerings conducted pursuant to Rule 504 must be registered in each state in which they are offered or sold, unless an exemption to state registration is available under state securities laws. Most states require registration of Rule 504 offerings; however, Maine recently adopted a form of state-based crowdfunding that permits the use of general solicitation, but still exempts the issuances of securities from state registration where, in addition to satisfying various state-specific requirements to qualify for the exemption, an issuer also complies with Rule 504 of Regulation D.

The SEC proposes to amend Rule 504 of Regulation D to increase the aggregate amount of securities that may be offered and sold in any twelve-month period from $1 million to $5 million and to disqualify certain bad actors from participation in Rule 504 offerings by referencing the disqualification provisions of Rule 506 of Regulation D. The SEC also seeks public comment on whether additional changes to Rule 504 should be adopted. The SEC noted that if the proposed amendments to Rule 504 were adopted, Rule 505 of Regulation D would become less useful, and, therefore, the SEC requests comment on whether Rule 505 should be retained in its current form or in a modified form, or repealed in its entirety.

The SEC believes that the proposed amendments to Rule 504 could provide state securities regulators with greater flexibility to develop regional coordinated review programs that would rely on Rule 504 at the federal level, given that the proposed changes would increase the maximum amount of capital that could be raised while providing states with assurance that certain bad actors would be excluded from such offerings. The SEC believes that the proposed increase in the offering limitation would increase the flexibility of state securities regulators to set their own state offering limitations and to consider whether any additional requirements should be implemented at the state level. In addition, the SEC believes that the proposed changes "would facilitate state efforts to increase the efficiencies associated with the registration of securities offerings in multiple jurisdictions through regional coordinated review programs."

CONCLUSION

The proposed amendments to Rule 147 and Rule 504 represent the SEC’s first efforts since the enactment of the JOBS Act to address, through rulemaking, some of the other areas of concern for small company capital-raising that were not specified in the JOBS Act. Rather than utilizing preemption of state laws, as was done in Regulation A and Regulation Crowdfunding, the SEC’s proposed amendments recognize the role of state regulation and seek to utilize that regulation as a basis for exempting smaller offerings at the federal level. The proposals further recognize the work of the states in adopting their own crowdfunding exemptions and in coordinating blue sky review efforts.

Contact:

Anna T. Pinedo
(212) 468-8179
apinedo@mofo.com
About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We’ve been included on The American Lawyer’s A-List for 12 straight years, and Fortune named us one of the “100 Best Companies to Work For.” Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.