Client Alert

October 27, 2016

SEC Adopts Final Rules Regarding Intrastate and Regional Offerings

On October 26, 2016, the Securities and Exchange Commission (the "SEC") adopted final rules regarding intrastate and regional offerings, which largely follow the SEC's proposed rules issued on October 30, 2015.[1] The final rules amend Rule 147 ("Rule 147") under the Securities Act of 1933, as amended (the "Securities Act"), to facilitate offerings relying upon recently adopted intrastate crowdfunding exemptions under state securities laws. Rule 147 provides a safe harbor for intrastate offerings exempt from registration pursuant to Section 3(a)(11) of the Securities Act ("Section 3(a)(11)"), which exempts any security offered and sold only to persons resident within a single state or territory by an issuer residing or incorporated in and doing business within such state or territory. As amended, Rule 147 will continue to function as a safe harbor under Section 3(a)(11), though Section 3(a)(11) will still be available as a potential statutory exemption in and of itself. The final rules also establish a new Securities Act exemption, designated Rule 147A, that further accommodates offers accessible to out-of-state residents and companies that are incorporated or organized out-of-state. The final rules also amend Rule 504 ("Rule 504") of Regulation D under the Securities Act ("Regulation D") to (1) increase the aggregate amount of securities that may be offered and sold in any twelve-month period from $1 million to $5 million and (2) disqualify certain bad actors from participating in Rule 504 offerings. In addition, the final rules repeal Rule 505 of Regulation D, which had provided a safe harbor from registration for securities offered and sold in any twelve-month period from $1 million to $5 million.

Amendments to Rule 147

The final rules largely follow the proposed rules, by continuing to require that sales be made only to residents of an issuer's state or territory, redefining "intrastate offering," and easing issuer eligibility requirements. The final rules, however, do not adopt the proposed federal limits on state exemptions.[2] As amended, Rule 147 will continue to function as a safe harbor under Section 3(a)(11), though Section 3(a)(11) will still be available as a potential statutory exemption in and of itself. The final rules also establish a new Securities Act exemption, designated Rule 147A, which is substantially identical to Rule 147 except that it allows (1) offers to be accessible to out-of-state residents and (2) for companies to be incorporated or organized out-of-state. Amended Rule 147 and new Rule 147A will become effective 150 days after publication in the Federal Register.

[1] *See* SEC Release Nos. 33-9973; 34-76319 (Oct. 30, 2015) (hereinafter, the "proposing release") and SEC Release Nos. 33-10238; 34-79161 (Oct. 26, 2016) (hereinafter, the "final release").

[2] The proposed rules included amendments to Rule 147 to limit the availability of the Section 3(a)(11) 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 (1) 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 (2) imposes an investment limitation on investors.

Both new Rule 147A and amended Rule 147 include the following provisions, which we discuss in more detail below:

- A requirement that the issuer has its "principal place of business" in-state and satisfies at least one "doing business" requirement that would demonstrate the in-state nature of the issuer's business;
- A new "reasonable belief" standard for issuers to rely on in determining the residence of the purchaser at the time of the sale of securities;
- A requirement that issuers obtain a written representation from each purchaser as to residency;
- A limit on resales to persons residing within the state or territory of the offering for a period of six months from the date of the sale by the issuer to the purchaser;
- An integration safe harbor that would include any prior offers or sales of securities by the issuer made under another provision, as well as certain subsequent offers or sales of securities by the issuer occurring after the completion of the offering; and
- Legend requirements to offerees and purchasers about the limits on resales.

Principal Place of Business and Doing Business Requirement

Amended Rule 147 and new Rule 147A define an issuer's "principal place of business" (as opposed to its "principal office" as defined in old Rule 147) as the location from which the officers, partners, or managers of the issuer primarily direct, control, and coordinate the activities of the issuer. Under amended Rule 147, issuers that are incorporated or organized under state or territorial law will be deemed a "resident" of a particular state or territory in which they are both incorporated or organized and have their "principal place of business." New Rule 147A(c)(1), however, will rely solely on the principal place of business requirement to determine the state or territory in which the issuer shall be deemed a "resident," not only for corporate issuers, but for all issuers, including issuers that are not organized under any state or territorial law, such as general partnerships.

Under amended Rule 147 and new Rule 147A, issuers that have changed their principal place of business after making sales in an intrastate offering pursuant to amended Rule 147 or new Rule 147A, as applicable, will not be able to conduct another intrastate offering pursuant to either rule in another state for a period of six months from the date of the last sale in the prior state. This is consistent with the duration of the resale limitation period specified in amended Rule 147(e) and new Rule 147A(e), which we discuss in more detail below.

Under amended Rule 147 and new Rule 147A, an issuer is required to meet at least one of the following requirements in order to be considered "doing business" in-state:

- 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 was not included in old Rule 147).

Reasonable Belief Standard

Amended Rule 147(d) and new Rule 147A(d) include a reasonable belief standard for the issuer's determination as to the residence of the purchaser at the time of the sale of the securities. This requirement can be satisfied by (1) the existence of the fact that the purchaser is a resident of the applicable state or territory or (2) 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. Under amended Rule 147 and new Rule 147A, the residence of a purchaser that is a legal entity (i.e., a corporation, partnership, trust, or other form of business organization) is defined as the location where, at the time of the sale, the entity has its principal place of business. Amended Rule 147 and new Rule 147A also define a purchaser's "principal place of business," consistent with the final definition for issuer eligibility purposes.

Limitation on Resales

The final rules amend the limitation on resales in old Rule 147(e) to provide that for a period of six months from the date of the sale by the issuer of a security sold pursuant to the rule, any resale of such security by a purchaser will be made only to persons resident within such state or territory, as determined pursuant to amended Rule 147(d) or new Rule 147A(d), as applicable. The SEC had originally proposed a nine-month period in the proposing release. In addition, compliance with the amended limitation on resales is not required for an issuer relying on amended Rule 147 or new Rule 147A.

Integration

The final rules also align the integration safe harbor in Rule 147 with the integration safe harbor in Rule 251(c) of Regulation A under the Securities Act ("Regulation A"). Under the final rules, offers and sales made pursuant to amended Rule 147 or new Rule 147A will 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 amended Rule 147(h) or new Rule 147A(h);
    - Exempt from registration under Regulation A;
    - Exempt from registration under Rule 701 under the Securities Act;
    - Made pursuant to an employee benefit plan;
    - Exempt from registration under Regulation S under the Securities Act;
    - Exempt from registration under Section 4(a)(6) of the Securities Act; or
    - Made more than six months after the completion of an offering conducted pursuant to amended Rule 147 or new Rule 147A.

Amendments to Rule 504

The final rules adopted by the SEC amend Rule 504 to (1) increase the aggregate amount of securities that may be offered and sold in any twelve-month period from $1 million to $5 million and (2) disqualify certain bad actors from participation in Rule 504 offerings by referencing the disqualification provisions of Rule 506 of Regulation D. In addition, the final rules repeal Rule 505 of Regulation D ("Rule 505"), which had provided a safe harbor from registration for offerings of up to $5 million annually that must be sold solely to accredited investors or no more than 35 non-accredited investors. Amended Rule 504 will become effective 60 days after publication in the Federal Register, and the repeal of Rule 505 will become effective 180 days after publication in the Federal Register.

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