PROGRAM MATERIALS
Program #3330
March 1, 2023

Basics of Private Offering of Securities

Copyright ©2023 by

- **Paul Richter, Esq. - PW Richter PLC**

All Rights Reserved.
Licensed to Celesq®, Inc.

Celesq® AttorneysEd Center
www.celesq.com

5301 North Federal Highway, Suite 150, Boca Raton, FL 33487
Phone 561-241-1919

Basics of Private Offering of Securities

Paul W. Richter
PW Richter plc
3901 Dominion Townes Circle
Richmond, Virginia 23223
Telephone: (703) 725-7299
Email: pwr@pwrichtersec.com

March 1, 2022

Profile of Presenter: Practiced corporate and securities law since 1986 and has worked for a law firm, as in-house general counsel of a public company (NASDAQ quoted), and, since 2001 as a sole practitioner. Practice focus is federal and state securities law (compliance and securities offerings), corporate law, commercial transactions and mergers-and-acquisitions transactions. Clientele consists mostly of small private companies and public companies in various industries located in United States, Hong Kong SAR or People's Republic of China ("China"). L.LM. in Securities Regulation from Georgetown University Law Center, Washington, D.C. and J.D. from George Mason University Law School, Arlington, Virginia. Originator and initial author of *Corporate Anti-Takeover Defenses: The Poison Pill Device* (Thomson Reuters West) and update seven lawyer practice books published by Thomson Reuters West covering securities law, merger and acquisitions, corporate compliance or securities litigation. Licensed in Virginia.

Notice: This presentation is for information purposes only. Neither this presentation nor any of its contents: (1) is investment, financial, accounting, tax or legal advice, or (2) an offer to sell or a solicitation of an offer to purchase any securities. You should not take action based upon this information without consulting legal counsel. This presentation does not create an attorney-client relationship. Presentation speaks only as of the date above. Any sample public filings by a company are presented as examples and not model forms.

1. Introduction: This presentation covers: (1) the basic principles of federal securities regulation of "private" securities offerings (including "limited" and "small" securities offerings) exempt from registration and regulatory review under Section 5 of the Securities Act of 1933 (15 U.S. Code §77a, May 27, 1933, ch. 38, title I, §1, 48 Stat. 74) ("Securities Act") and (2) select "better rule of practice" suggestions for those non-public securities offerings.

A "private offering" or "private placement" is (1) an offering of regulated securities of a company by that company or its authorized agents; (2) in order to typically raise working capital; (3) made to a limited number of prospective investors who are identified by means other than general advertising and general solicitation of the general public and structured to avoid the requirement to register the offering under federal and state securities laws as a "public" securities offering to the public, which registered offering is costly, burdensome, time consuming and exposed to greater potential liability than a private securities offering; and (4) often structured to comply with safe harbor rules to ensure avoidance of making an unregistered (and thereby illegal) "public" offering of the securities.

Historical Notes: Federal securities regulation, as a comprehensive regime, commenced in the 1930's with the enactment of Securities Act, which governs initial distributions or sales of securities by the issuing company, and Securities Exchange Act of 1934 ("Exchange Act"), which governs post-initial trading of securities. Comprehensive state securities regulation had been in existence

since 1890's. It took the Stock Market Crash of 1929 and the Great Depression to motivate Congress to enact a comprehensive regulatory regime that greatly expanded federal regulation and control of securities transactions.

The federal securities regulatory regime is based on adequate disclosure of "material" business and financial information about the issuer of securities and the securities being offered – "material" being information that a reasonable investor would consider important in making a decision about whether to buy, sell or hold the securities. Federal regulation, unlike some states' regulation, is not based on a determination of the merit of the issuer or securities. If the issuer's business is lawful in the jurisdictions in which it operates and the issuer can meet the compliance requirements under federal securities laws and regulations, it is eligible to make the offering. Some states have merit review for certain securities offerings and merit review means the issuer and offering must meet applicable suitability standard, which standards are designed to protect the investing public from financially weak issuers and unduly risky investments.

2. Primary Federal Securities Statutes for Securities Offerings. The following is a summary of the primary federal securities statutes enforced by federal agency tasked with enforcement of federal securities laws –

(a) Securities Act of 1933 – Initial federal securities law that governs the initial distribution of securities – SEC Summary: "Often referred to as the "truth in securities" law, the Securities Act of 1933 has two basic objectives: require that investors receive financial and other significant information concerning securities being offered for public sale; and prohibit deceit, misrepresentations, and other fraud in the sale of securities.

Purpose of Registration. A primary means of accomplishing these goals is the disclosure of important financial information through the registration of securities. This information enables investors, not the government, to make informed judgments about whether to purchase a company's securities. While the SEC requires that the information provided be accurate, it does not guarantee it. Investors who purchase securities and suffer losses have important recovery rights if they can prove that there was incomplete or inaccurate disclosure of important information.
The Registration Process

In general, securities sold in the U.S. must be registered. The registration forms companies file provide essential facts while minimizing the burden and expense of complying with the law. In general, registration forms call for: a description of the company's properties and business; a description of the security to be offered for sale; information about the management of the company; and financial statements certified by independent accountants.

Registration statements and prospectuses become public shortly after filing with the SEC. If filed by U.S. domestic companies, the statements are available on the [SEC public] EDGAR database accessible at www.sec.gov. Registration statements are subject to examination for compliance with disclosure requirements.

Not all offerings of securities must be registered with the Commission. Some exemptions from the registration requirement include: private offerings to a limited number of persons or institutions;

offerings of limited size; intrastate offerings; and securities of municipal, state, and federal governments.

By exempting many small offerings from the registration process, the SEC seeks to foster capital formation by lowering the cost of offering securities to the public."[1]

Presenter Note: EDGAR is the SEC public database showing all public filings made with the SEC by persons and companies (including the extensive business and financial reports filed on Form 10-K, Form 10-Q and Form 8-K by public companies and public securities offerings by companies), federal securities laws, SEC rules and releases, SEC press releases, Commissioner and Staff statements and speeches, SEC Staff guidance, SEC No Action Letters, SEC manuals and a various other useful resources. EDGAR also refers to the separate filing system used by companies and persons to make filings and submissions to the SEC. Information about EDGAR can be found at URL: https://www.sec.gov/edgar/filer-information/how-do-i

(b) National Securities Market Improvement Act of 1996 ("NSMIA")[2]. Summary: NSMIA amended the Securities Act and other federal securities statutes, but for the scope of this presentation, the following amendment by NSMIA is relevant: "In October, 1996, Congress passed a bill titled "The National Securities Markets Improvement Act of 1996" (NSMIA). That bill became law and extensively amended various provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. A new definition was created: "Covered Security", referred to under state securities laws as "Federal Covered Security". **State securities registration requirements were preempted with respect to "Federal Covered Securities".** However, states with filing requirements in place, prior to the adoption of NSMIA may continue to require Notice filings, consisting of filing fees and copies of documents filed with the Securities and Exchange Commission (SEC), except as to securities traded in major securities markets designated in NSMIA and by SEC rules. [*Emphasis added by presenter*]

A summary of the major categories of "Federal Covered Securities" follows:

- Securities listed, or authorized for listing, on the New York or American Stock Exchange, the NASDAQ Stock Market, or on a national exchange which the SEC by Rule determines has listing standards substantially similar to those of the named markets (In January of 1998, the SEC also designated by rule securities listed on the Chicago Board Options Exchange, Tier 1 of the Pacific Exchange, and Tier 1 of the Philadelphia Stock Exchange)
- Securities issued by an open-end mutual fund, closed-end mutual fund, unit investment trust, or face amount certificate company, that is registered under the Investment Company Act of 1940.
- Securities offered pursuant to the provisions of Rule 506 of Regulation D under the Securities Act of 1933.

---

[1] Fast Answers: Laws that Govern Securities Industry, Securities Act of 1933, SEC Website, Oct. 1, 2013, view at URL: https://www.sec.gov/answers/about-laws#secact1933

[2] National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (October 11, 1996).

- Securities offered by a municipal/governmental issuer, unless the issuer is located in the state in which the securities are being offered.
- Securities that are the subject of non-issuer secondary trading transactions under section 18(b)(4)(A) of the federal Securities Act of 1933 (involving reporting companies under section 13 or 15(d) of the Securities Exchange Act of 1934)."[3]

(c) Securities Exchange Act of 1934 [4] – created federal regulator and establish regulation of sale and trading of securities after initial distribution. SEC Summary: "With this Act, Congress created the Securities and Exchange Commission. The Act empowers the SEC with broad authority over all aspects of the securities industry. This includes the power to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory organizations (SROs). The various securities exchanges, such as the New York Stock Exchange, the NASDAQ Stock Market, and the Chicago Board of Options are SROs. The Financial Industry Regulatory Authority (FINRA) is also an SRO.

The Act also identifies and prohibits certain types of conduct in the markets and provides the Commission with disciplinary powers over regulated entities and persons associated with them.

The Act also empowers the SEC to require periodic reporting of information by companies with publicly traded securities.

Companies with more than $10 million in assets whose securities are held by more than 500 owners must file annual and other periodic reports. These reports are available to the public through the SEC's EDGAR database.

Proxy Solicitations. The Securities Exchange Act also governs the disclosure in materials used to solicit shareholders' votes in annual or special meetings held for the election of directors and the approval of other corporate action. This information, contained in proxy materials, must be filed with the Commission in advance of any solicitation to ensure compliance with the disclosure rules. Solicitations, whether by management or shareholder groups, must disclose all important facts concerning the issues on which holders are asked to vote.

Tender Offers. The Securities Exchange Act requires disclosure of important information by anyone seeking to acquire more than 5 percent of a company's securities by direct purchase or tender offer. Such an offer often is extended in an effort to gain control of the company. As with the proxy rules, this allows shareholders to make informed decisions on these critical corporate events.

Insider Trading. The securities laws broadly prohibit fraudulent activities of any kind in connection with the offer, purchase, or sale of securities. These provisions are the basis for many types of disciplinary actions, including actions against fraudulent insider trading. Insider trading is illegal

---

[3] The National Securities Markets Improvement Act of 1996 ("NSMIA"), State of Wisconsin, Department of Financial Institutions, view at URL: https://www.wdfi.org/fi/securities/regexemp/nsmia.htm

[4] 15 U.S.C. §§78a et seq.

when a person trades a security while in possession of material nonpublic information in violation of a duty to withhold the information or refrain from trading.

Registration of Exchanges, Associations, and Others. The Act requires a variety of market participants to register with the Commission, including exchanges, brokers and dealers, transfer agents, and clearing agencies. Registration for these organizations involves filing disclosure documents that are updated on a regular basis.

The exchanges and the Financial Industry Regulatory Authority (FINRA) are identified as self-regulatory organizations (SRO). SROs must create rules that allow for disciplining members for improper conduct and for establishing measures to ensure market integrity and investor protection. SRO proposed rules are subject to SEC review and published to solicit public comment. While many SRO proposed rules are effective upon filing, some are subject to SEC approval before they can go into effect."[5]

(d) Trust Indenture Act of 1939 [6] – SEC Summary: "This Act applies to debt securities such as bonds, debentures, and notes that are offered for public sale. Even though such securities may be registered under the Securities Act, they may not be offered for sale to the public unless a formal agreement between the issuer of bonds and the bondholder, known as the trust indenture, conforms to the standards of this Act."[7]

Congress viewed the bond market as requiring federal regulation in the 1930's and this law was the result of congressional concern. While usually of little concern for most corporate practitioners, this law has importance in that this law "…prohibits any person from selling a note, bond or debenture in a public offering unless it has been issued under an indenture and is qualified under the TIA [Trust Indenture Act of 1939]. Importantly, the TIA specifically mandates that the right of a bondholder to receive payment on such security cannot be impaired without the bondholder's consent. While no one appears to dispute that an impairment of that right would include, for example, revising the terms of an indenture to delay payment of principal, what is less clear is whether impairment also includes the cancellation of a parent guaranty or the stripping of covenants such as those restricting the transfer of valuable company assets such that the bondholders' ability to recover on the bond is severely undercut, whether on the due dates or otherwise."[8] *See*: Sections 316(a) and 316(b) of Trust Indenture Act of 1939; *MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entertainment Corp.*, 80 F.Supp.3d 507, 516 (S.D.N.Y. 2015).

---

[5] Fast Answers: Laws that Govern Securities Industry, Securities Exchange Act of 1934, SEC Website, Oct. 1, 2013, view at URL: https://www.sec.gov/answers/about-laws#secexact1934

[6] 15 U.S.C. § 77aaa et seq.

[7] Fast Answers: Laws that Govern Securities Industry, Trust Indenture Act of 1939, SEC Website, Oct. 1, 2013, view at URL: https://www.sec.gov/answers/about-laws#trustinact1939

[8] "The Trust Indenture Act: What is All the Fuss About?" by Christy Rivera and Marian Baldwin Feurst, Chadbourne & Park LLP, posted Insights, Norton Rose Fulbright, Feb. 22, 2016, view at URL: https://www.nortonrosefulbright.com/en/knowledge/publications/83560b86/the-trust-indenture-act-what-is-all-the-fuss-about

(e) Investment Company Act of 1940 – "Mutual fund act". SEC Summary: "This Act regulates the organization of companies, including mutual funds, that engage primarily in investing, reinvesting, and trading in securities, and whose own securities are offered to the investing public. The regulation is designed to minimize conflicts of interest that arise in these complex operations. The Act requires these companies to disclose their financial condition and investment policies to investors when stock is initially sold and, subsequently, on a regular basis. The focus of this Act is on disclosure to the investing public of information about the fund and its investment objectives, as well as on investment company structure and operations. It is important to remember that the Act does not permit the SEC to directly supervise the investment decisions or activities of these companies or judge the merits of their investments."[9]

(f) Investment Advisers Act of 1940. SEC Summary**:** "This law regulates investment advisers. With certain exceptions, this Act requires that firms or sole practitioners compensated for advising others about securities investments must register with the SEC and conform to regulations designed to protect investors. Since the Act was amended in 1996 and 2010, generally only advisers who have at least $100 million of assets under management or advise a registered investment company must register with the Commission."[10]

(g) Sarbanes-Oxley Act of 2002[11] – Statute in response to the Enron Corp. scandal. SEC Summary: "On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002, which he characterized as "the most far reaching reforms of American business practices since the time of Franklin Delano Roosevelt." The Act mandated a number of reforms to enhance corporate responsibility, enhance financial disclosures and combat corporate and accounting fraud, and created the "Public Company Accounting Oversight Board," also known as the PCAOB, to oversee the activities of the auditing profession. (Please check the Classification Tables maintained by the US House of Representatives Office of the Law Revision Counsel for updates to any of the laws.) You can find links to all Commission rulemaking and reports issued under the Sarbanes-Oxley Act at: http://www.sec.gov/spotlight/sarbanes-oxley.htm."[12]

SEC webpage highlighting SEC rules under SOX and SOX compliance is at URL:
https://www.sec.gov/spotlight/sarbanes-oxley.htm

(h) Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[13] Statute in response to Financial Crisis of 2008. SEC Summary: "The Dodd-Frank Wall Street Reform and

---

[9] Fast Answers: Laws that Govern Securities Industry, Investment Company Act of 1940, SEC Website, Oct. 1, 2013, view at URL: https://www.sec.gov/answers/about-laws#invcoact1940
[10] Fast Answers: Laws that Govern Securities Industry, Investment Advisers Act of 1940, SEC Website, Oct. 1, 2013, view at URL: https://www.sec.gov/answers/about-laws#invcoact1940
[11] Sarbanes Oxley Act of 2002. Pub. L. 107–204, 116 Stat. 745, enacted July 30, 2002) Section 101–109, codified 15 U.S.C. §§7211–7220.

[12] Fast Answers: Laws that Govern Securities Industry, Sarbanes Oxley Act of 2002, SEC Website, Oct. 1, 2013, view at URL: https://www.sec.gov/answers/about-laws#sox2002
[13] Dodd Frank Wall Street Reform Act of 2012. Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o), Pub. L. No. 111-203, 124 Stat. 1376 (2010).

Consumer Protection Act was signed into law on July 21, 2010 by President Barack Obama. The legislation set out to reshape the U.S. regulatory system in a number of areas including but not limited to consumer protection, trading restrictions, credit ratings, regulation of financial products, corporate governance and disclosure, and transparency. (Please check the Classification Tables maintained by the US House of Representatives Office of the Law Revision Counsel for updates to any of the laws.) You can find links to all Commission rulemaking and reports issued under the Dodd Frank Act at: http://www.sec.gov/spotlight/dodd-frank.shtml."[14]

The SEC webpage detailing SEC implementation of this law is at URL:
https://www.sec.gov/spotlight/dodd-frank-act

(i) Jumpstart Our Business Startups Act of 2012.[15] Congressional effort to reduce regulation and facilitate capital raising by companies. SEC Summary: "The Jumpstart Our Business Startups Act (the "JOBS Act") was enacted on April 5, 2012. The JOBS Act aims to help businesses raise funds in public capital markets by minimizing regulatory requirements. The full text of the Act is available at: http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf." [16]

The main impact of the JOBS Act on private securities offerings were: (1) mandated that the SEC adopt Rule 506(c) to eliminate the prohibition against general solicitation and general advertising under Rule 506(c), which is restricted to selling securities to accredited investors and which requires the issuer to take reasonable steps to verify that such purchasers are accredited investors; and (2) to allow general solicitation and general advertising for Rule 144A private placements if the securities are sold only to persons that the seller and any person acting on its behalf reasonably believe is a qualified institutional buyer or "QIB"; (3) created equity form of Crowdfunding under amended Section 4 of the Securities Act; and (4) amended and expanded Regulation A under Section 3(b) of Securities Act to create the two tier offering system – Tier 1 for offerings of $20 million or less and Tier 2 for offerings of $75 million (initially $50 million) or less and pre-empted state securities regulation for Tier 2 offerings (Note: JOBS Act also enhanced investor protection by requiring audited financials for Tier 2 offerings, providing for Section 12(2) of Securities Act liability for material misstatements or omissions and mandating periodic reports under Exchange Act for issuers with qualified offerings under Regulation A.

SEC webpage detailing JOBS Act related materials and rule changes is found at URL:
https://www.sec.gov/spotlight/jobs-act

(j) Private Securities Litigation Reform Act of 1995 ("PSLRA") (15 U.S.C. §78u-4). Congress decided that Federal Rules of Civil Procedure Rule 9(b) did not sufficiently prevent abusive, baseless [class action] lawsuits under federal securities fraud statutes by private litigants and, in

---

[14] Fast Answers: Laws that Govern Securities Industry, Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, SEC Website, Oct. 1, 2013, view at URL: https://www.sec.gov/answers/about-laws#df2010

[15] Public Law 112–106, 126 Stat. 306 (2012)

[16] Fast Answers: Laws that Govern Securities Industry, Jumpstart Our Business Startups Act of 2012, SEC Website, Oct. 1, 2013, view at URL: https://www.sec.gov/answers/about-laws#df2010

response, Congress enacted (over President Clinton's veto) the PSLRA to provide, among other changes to federal securities laws, (i) a safe harbor for "forward looking statements" in filings under the Exchange Act and in securities offering documents and (ii) impose stricter pleading standards in lawsuits alleging federal securities fraud. This safe harbor is important in protecting certain disclosures in offering documents. PSLRA also provides for sanctions for frivolous federal fraud litigation, heightened pleading requirements for federal securities fraud claims and a ban on discovery in a lawsuit until any motion to dismiss based on PSLRA is resolved. Under the safe harbor, statements in SEC filings were not deemed actionable if the statements: (A) concerned immaterial facts; (B) were accompanied by "forward looking statements" cautionary notices sufficient to identify the statements as being subject to the safe harbor; or (C) defendants did not know or had no reason to know that statements were false when made.

Practice Note: "Penny stock" companies may not rely on PSLRA safe harbor (under Section 21E of the Exchange Act and Section 27A of Securities Act), but instead must use the common law "bespoke caution" disclaimers.

The impact of PSLRA has been: "…each allegation requires substantial support in order to be pled with the requisite particularity. Pleading scienter requires similar particularized allegations."[17]

Under PSLRA - "Forward looking statements" are written or oral statements that are:
"(A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;
(B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
(C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;
(D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
(E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
(F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission." (15 U.S.C. §78u-5(i)).

Practice Note – forward looking statement language must be written on a case-by-case basis and relate to the covered statements set forth in the document. Using "cookie cutter" boilerplate is not only unacceptable but will be highlighted for correction by any SEC review and may prove disastrous in any securities fraud litigation by failing to provide the protection of the PSLRA safe harbor. An example, not model, of a forward looking disclaimer in a prospectus for a public securities offering follows and this disclaimer is supplemented by extensive disclosures in the prospectus' Risk Factors section.

[17]"Inside the History and Impact of the PSLRA," by Eric J. Belfi, Michael P. Canty, and Danielle Izzo, Labaton Sucharow, October 26, 2022, view at URL: https://www.labaton.com/blog/inside-the-history-and-impact-of-the-pslra

"SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS. This prospectus contains forward-looking statements about us and our industry that involve substantial risks and uncertainties. All statements other than statements of historical facts contained in this prospectus, including statements regarding our future results of operations or financial condition, business strategy and plans, and objectives of management for future operations, are forward-looking statements. In some cases, you can identify forward-looking statements because they contain words such as "anticipate," "believe," "contemplate," "continue," "could," "estimate," "expect," "intend," "may," "plan," "potential," "predict," "project," "should," "target," "will," or "would" or the negative of these words or other similar terms or expressions.

We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy, and financial needs. These forward-looking statements are subject to known and unknown risks, uncertainties, and assumptions, including risks described in "Risk Factors" and elsewhere in this prospectus, regarding, among other things:

- our financial performance, including our revenues, cost of revenues, operating expenses, and our ability to attain and sustain profitability;
- our ability to attract and retain users;
- our ability to attract and retain advertisers;
- our ability to compete effectively with existing competitors and new market entrants;
- . our ability to successfully expand in our existing markets and penetrate new markets;
- . our ability to effectively manage our growth, and future expenses;
- our ability to maintain, protect, and enhance our intellectual property;
- our ability to comply with modified or new laws and regulations applying to our business;
- our ability to attract and retain qualified employees and key personnel; and
- future acquisitions of or investments in complementary companies, products, services, or technologies.

You should not rely on forward-looking statements as predictions of future events. We have based the forward-looking statements contained in this prospectus primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, results of operations, and prospects. The outcome of the events described in these forward-looking statements is subject to risks, uncertainties, and other factors described in "Risk Factors" and elsewhere in this prospectus. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this prospectus. The results, events, and circumstances reflected in the forward-looking statements may not be achieved or occur, and actual results, events, or circumstances could differ materially from those described in the forward-looking statements.

In addition, statements that "we believe" and similar statements reflect our beliefs and opinions on the relevant subject. These statements are based on information available to us as of the date of this prospectus. And while we believe that information provides a reasonable basis for these statements, that information may be limited or incomplete. Our statements should not be read to indicate that we

have conducted an exhaustive inquiry into, or review of, all relevant information. These statements are inherently uncertain, and investors are cautioned not to unduly rely on these statements.

The forward-looking statements made in this prospectus relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this prospectus to reflect events or circumstances after the date of this prospectus or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions, or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures, or investments."

(k) Fixing America's Surface Transportation Act (2015) (the "FAST Act").[18] While a transportation act, the FAST Act did amend the federal securities laws. The FAST Act's impact on private securities offerings was to codify the court created "Section 4(a)(1½)" exemption (discussed below) as new Section 4(a)(7) of the Securities Act and thereby provide a safe harbor exemption for Section 4(a)(1 ½) exemptions. Issuers may still rely on Section 4(a)(1½) exemption. As noted by one commentator: "Section 4(a)(7) imposes a variety of requirements, including at least two that are fundamentally incompatible with the common use of Section 4(a)(1½) in private offerings of asset-backed securities ("ABS") to institutional accredited investors. Not only must the securities have been outstanding for at least 90 days, but the information required to be provided must include certain financial statements that ABS issuers virtually never prepare. For these reasons, we do not believe that Section 4(a)(7) will find widespread use in the ABS markets."[19]

FAST Act also mandated following disclosure reforms for SEC filings:

- "Simplify disclosure or the disclosure process, including changes that would allow registrants to omit confidential information from most exhibits without filing a confidential treatment request, and changes to Management's Discussion and Analysis that allow for flexibility in discussing historical periods;
- Revise rules or forms to update, streamline or otherwise improve the Commission's disclosure framework by eliminating the risk factor examples listed in the disclosure requirement and revising the description of property requirement to emphasize the materiality threshold;
- Update rules to account for developments since their adoption or last amendment by eliminating certain requirements for undertakings in registration statements; and

[18] Pub. L. No. 114-94, Sec. 72003, 129 Stat. 1312 (2015).
[19] The FAST Act, New Section 4(a)(7), and Section 4(a)(1½)," by Charles A. Sweet, Morgan Lewis & Bockius, LLP., January 4, 2016, view at URL: https://www.morganlewis.com/pubs/2016/01/the-fast-act-new-sections

- Incorporate technology to improve access to information by requiring data tagging for items on the cover page of certain filings and the use of hyperlinks for information that is incorporated by reference and available on EDGAR."[20]

3. Federal Regulator – the SEC. Created by the Exchange Act (Federal Trade Commission enforced the Securities Act until creation of the SEC)**, t**he SEC is tasked with enforcing the federal securities laws and regulations and is an independent regulator governed by five commissioners. The commissioners "are appointed by the President of the United States with the advice and consent of the Senate. Terms last five years and are staggered so that one Commissioner's term ends on June 5 of each year. The Chairman and Commissioners may continue to serve up to approximately 18 months after terms expire if they are not replaced before then. To ensure that the Commission remains non-partisan, no more than three Commissioners may belong to the same political party. The President also designates one of the Commissioners as Chairman, the SEC's top executive."[21] SEC Commissioners tend to be experienced securities-corporate lawyers. The current SEC Chair is Gary Gensler, a "Democrat" Commissioner, who is justifiably regarded as a "pro-regulation" Commissioner. His predecessor was Jay Clayton, a "Republican" Commissioners, who was an advocate of reducing regulatory burdens.

SEC is widely regarded as an aggressive regulator with some of the best legal talent in the U.S. Government. SEC has an excellent training program and SEC Staff Lawyers are generally valued as hires by law firms. Further, it is not unusual for experienced lawyers in private practice to serve as SEC lawyers for a limited period in order to enhance their resumes before returning to private practice.

SEC enforces civil provisions of federal securities laws and regulations and U.S. Department of Justice or "DOJ" enforces criminal provisions of federal securities laws and regulations.

SEC Division of Corporation Finance and Office of Chief Accountant review offering documents for public securities offerings, Regulation A "limited" securities offerings under the Securities Act and periodic filings and proxy filings under the Exchange Act.

SEC Division of Enforcement investigates possible federal securities law violations (including illegal private offerings), recommends enforcement actions to SEC Commissioners for approval, and handles SEC civil litigation and administrative proceedings approved by the SEC Commissioners. U.S. Department of Justice ("DOJ") handles criminal violations of federal securities laws. SEC and DOJ work closely together on investigations and data sharing.

Practice Note: SEC attorneys in Division of Corporation Finance are compliance and examination lawyers with the requisite mindset of a regulator. SEC attorneys in Division of Corporation Finance are trained to refer any suspected federal securities law violations to SEC Division of Enforcement.

---

[20] SEC Adopts Rules to Implement FAST Act Mandate to Modernize and Simplify Disclosure, SEC Press Release No. 2019-38, March 20, 2019, view at URL: https://www.sec.gov/news/press-release/2019-38

[21] Current SEC Commissioners, SEC Web Site, Dec. 29, 2022, view at URL: https://www.sec.gov/about/commissioners

SEC attorneys in Division of Enforcement are litigators pure and simple and have the mindset of litigators. Knowing that difference is important in dealing with the SEC.

SEC Website, which is loaded with valuable public information and resources, is **https://www.sec.gov** (including all public filings by persons and entities – SEC purges old filings from its system per a schedule). SEC Web Site is called "EDGAR" (for Electronic Data Gathering, Analysis, and Retrieval system). EDGAR has a public component for the public to view filings made by persons, firms and entities with the SEC as well as separate system for the filing or submission of required, time-sensitive documents to the SEC. Most SEC filings are filed electronically through EDGAR. *See* URL: https://www.sec.gov/filergroup/announcements

4. Certain Key Concepts in Private Securities Offerings.

(a) Accredited Investor. The regulatory mission of the federal securities laws and regulations is to protect the investing public and maintain orderly public markets for securities. Some members of the investing public do not need the full protection of the federal regulatory regime beyond the anti-fraud protections because these investors possess the sophistication to understand the risks of investment in any security and the financial means to withstand the entire loss of the investment. The importance of the accredited investor in private offerings is that they are not counted towards any numerical limitation of investors in the primary safe harbor rules for private offerings and, when accredited investors are the only investors targeted for a private offering, do not require the mandatory disclosure documents for non-accredited investors.

These privileged investors, called "accredited investors", are listed in Rule 501(a) (17 C.F.R. §230.501(a)):

"(a) Accredited investor. Accredited investor shall mean any person who comes within any of the following categories, or who the issuer reasonably believes comes within any of the following categories, at the time of the sale of the securities to that person:

(1) Any bank as defined in section 3(a)(2) of the Act, or any savings and loan association or other institution as defined in section 3(a)(5)(A) of the Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934; any investment adviser registered pursuant to section 203 of the Investment Advisers Act of 1940 or registered pursuant to the laws of a state; any investment adviser relying on the exemption from registering with the Commission under section 203(l) or (m) of the Investment Advisers Act of 1940; any insurance company as defined in section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that act; any Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; any Rural Business Investment Company as defined in section 384A of the Consolidated Farm and Rural Development Act; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank,

savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;
(2) Any private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940;
(3) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, partnership, or limited liability company, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000;
(4) Any director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer;
(5) Any natural person whose individual net worth, or joint net worth with that person's spouse or spousal equivalent, exceeds $1,000,000;

(i) Except as provided in paragraph (a)(5)(ii) of this section, for purposes of calculating net worth under this paragraph (a)(5):
(A) The person's primary residence shall not be included as an asset;
(B) Indebtedness that is secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, shall not be included as a liability (except that if the amount of such indebtedness outstanding at the time of sale of securities exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and
(C) Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities shall be included as a liability;
(ii) Paragraph (a)(5)(i) of this section will not apply to any calculation of a person's net worth made in connection with a purchase of securities in accordance with a right to purchase such securities, provided that:
(A) Such right was held by the person on July 20, 2010;
(B) The person qualified as an accredited investor on the basis of net worth at the time the person acquired such right; and
(C) The person held securities of the same issuer, other than such right, on July 20, 2010.
Note 1 to paragraph (a)(5): For the purposes of calculating joint net worth in this paragraph (a)(5): Joint net worth can be the aggregate net worth of the investor and spouse or spousal equivalent; assets need not be held jointly to be included in the calculation. Reliance on the joint net worth standard of this paragraph (a)(5) does not require that the securities be purchased jointly.

[Presenter's Note: Dodd-Frank Act changed the calculation of the amount by excluding the value of a person's primary residence. See Net Worth Standard for Accredited Investors, SEC Release No. 33-9287 (Dec. 21, 2011) [76 FR 81793 (Dec. 29, 2011)].

(6) Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse or spousal equivalent in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

(7) Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in §230.506(b)(2)(ii);

(8) Any entity in which all of the equity owners are accredited investors;
Note 1 to paragraph (a)(8):

It is permissible to look through various forms of equity ownership to natural persons in determining the accredited investor status of entities under this paragraph (a)(8). If those natural persons are themselves accredited investors, and if all other equity owners of the entity seeking accredited investor status are accredited investors, then this paragraph (a)(8) may be available.

(9) Any entity, of a type not listed in paragraph (a)(1), (2), (3), (7), or (8), not formed for the specific purpose of acquiring the securities offered, owning investments in excess of $5,000,000;
Note 1 to paragraph (a)(9):
For the purposes this paragraph (a)(9), “investments” is defined in rule 2a51-1(b) under the Investment Company Act of 1940 (17 CFR 270.2a51-1(b)).

(10) Any natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status. In determining whether to designate a professional certification or designation or credential from an accredited educational institution for purposes of this paragraph (a)(10), the Commission will consider, among others, the following attributes:
(i) The certification, designation, or credential arises out of an examination or series of examinations administered by a self-regulatory organization or other industry body or is issued by an accredited educational institution;
(ii) The examination or series of examinations is designed to reliably and validly demonstrate an individual's comprehension and sophistication in the areas of securities and investing;
(iii) Persons obtaining such certification, designation, or credential can reasonably be expected to have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of a prospective investment; and
(iv) An indication that an individual holds the certification or designation is either made publicly available by the relevant self-regulatory organization or other industry body or is otherwise independently verifiable;
Note 1 to paragraph (a)(10):
The Commission will designate professional certifications or designations or credentials for purposes of this paragraph (a)(10), by order, after notice and an opportunity for public comment. The professional certifications or designations or credentials currently recognized by the Commission as satisfying the above criteria will be posted on the Commission's website.

(11) Any natural person who is a “knowledgeable employee,” as defined in rule 3c-5(a)(4) under the Investment Company Act of 1940 (17 CFR 270.3c-5(a)(4)), of the issuer of the securities being offered or sold where the issuer would be an investment company, as defined in section 3 of such act, but for the exclusion provided by either section 3(c)(1) or section 3(c)(7) of such act;

(12) Any "family office," as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1):
(i) With assets under management in excess of $5,000,000,
(ii) That is not formed for the specific purpose of acquiring the securities offered, and
(iii) Whose prospective investment is directed by a person who has such knowledge and experience in financial and business matters that such family office is capable of evaluating the merits and risks of the prospective investment; and

(13) Any "family client," as defined in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 (17 CFR 275.202(a)(11)(G)-1)), of a family office meeting the requirements in paragraph (a)(12) of this section and whose prospective investment in the issuer is directed by such family office pursuant to paragraph (a)(12)(iii).
(b) Affiliate. An affiliate of, or person affiliated with, a specified person shall mean a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified.
(c) Aggregate offering price. Aggregate offering price shall mean the sum of all cash, services, property, notes, cancellation of debt, or other consideration to be received by an issuer for issuance of its securities. Where securities are being offered for both cash and non-cash consideration, the aggregate offering price shall be based on the price at which the securities are offered for cash. Any portion of the aggregate offering price attributable to cash received in a foreign currency shall be translated into United States currency at the currency exchange rate in effect at a reasonable time prior to or on the date of the sale of the securities. If securities are not offered for cash, the aggregate offering price shall be based on the value of the consideration as established by bona fide sales of that consideration made within a reasonable time, or, in the absence of sales, on the fair value as determined by an accepted standard. Such valuations of non-cash consideration must be reasonable at the time made."

Expansion of List of Accredited Investor: SEC expanded the definition of "accredited investor" on August 26, 2020, effective December 8, 2020, in order to expand the utility of Rule 506(b) and Rule 506(c) as capital raising vehicles. [22] The SEC Fact Sheet for the expansion of the definition of "accredited investor" reflects the then Republican SEC Chair's push to make SEC rules more accommodating to companies seeking to raise capital and minimize regulatory burdens. One can expect the category of professionals to be expanded in the future.

The SEC Fact Sheet and Press Release:

"August 26, 2020 - The Securities and Exchange Commission today adopted amendments to the "accredited investor" definition, one of the principal tests for determining who is eligible to participate in our private capital markets. Historically, individual investors who do not meet specific income or net worth tests, regardless of their financial sophistication, have been denied the opportunity to invest in our multifaceted and vast private markets. The amendments update and improve the definition to more effectively identify institutional and individual investors that have the knowledge and expertise to participate in those markets.

---

[22] SEC Release Nos. 33-10824; 34-89669; File No. S7-25-19, Aug. 26, 2020, view at URL: https://www.sec.gov/rules/final/2020/33-10824.pdf

"Today's amendments are the product of years of effort by the Commission and its staff to consider and analyze approaches to revising the accredited investor definition," said Chairman Jay Clayton. "For the first time, individuals will be permitted to participate in our private capital markets not only based on their income or net worth, but also based on established, clear measures of financial sophistication. I am also pleased that we have expanded and updated the list of entities, including tribal governments and other organizations, that may qualify to participate in certain private offerings."

The amendments allow investors to qualify as accredited investors based on defined measures of professional knowledge, experience or certifications in addition to the existing tests for income or net worth. The amendments also expand the list of entities that may qualify as accredited investors, including by allowing any entity that meets an investments test to qualify.

*** * ***

FACT SHEET

Updating the Accredited Investor Definitions

Aug. 26, 2020

The Securities and Exchange Commission adopted amendments to update and improve the definition of "accredited investor" in the Commission's rules and the definition of "qualified institutional buyer" in Rule 144A under the Securities Act of 1933. The amendments to the accredited investor definition add new categories of qualifying natural persons and entities and make certain other modifications to the existing definition. The amendments to the qualified institutional buyer definition similarly expand the list of eligible entities under that definition.

Background. These amendments are part of the Commission's ongoing effort to simplify, harmonize, and improve the exempt offering framework, thereby expanding investment opportunities while maintaining appropriate investor protections and promoting capital formation.

In June 2019, the Commission requested public comment on its Concept Release on Harmonization of Securities Offering Exemptions. In the Concept Release, the Commission requested comments on possible approaches to amending the accredited investor definition, which is a central component of several exemptions from registration, including Rules 506(b) and 506(c) of Regulation D, and plays an important role in other federal and state securities law contexts. The Concept Release was preceded by a Commission staff report issued in December 2015 on the accredited investor definition, which examined the background and history of the definition and considered comments and recommendations on amending the definition.

After taking into account the views expressed by members of the public and recommendations over the years from various Commission advisory committees and the annual SEC Government-Business Forum on Small Business Capital Formation, the Commission proposed in December 2019 to amend the accredited investor definition. In March 2020, the Commission continued the harmonization effort by proposing amendments to the exempt offering framework.

Highlights. The amendments revise Rule 501(a), Rule 215, and Rule 144A of the Securities Act. The amendments to the accredited investor definition in Rule 501(a):

- add a new category to the definition that permits natural persons to qualify as accredited investors based on certain professional certifications, designations or credentials or other credentials issued by an accredited educational institution, which the Commission may designate from time to time by order. In conjunction with the adoption of the amendments, the Commission designated by order holders in good standing of the Series 7, Series 65, and Series 82 licenses as qualifying natural persons. This approach provides the Commission with flexibility to reevaluate or add certifications, designations, or credentials in the future. Members of the public may wish to propose for the Commission's consideration additional certifications, designations or credentials that satisfy the attributes set out in the new rule;
- include as accredited investors, with respect to investments in a private fund, natural persons who are "knowledgeable employees" of the fund;
- clarify that limited liability companies with $5 million in assets may be accredited investors and add SEC- and state-registered investment advisers, exempt reporting advisers, and rural business investment companies (RBICs) to the list of entities that may qualify;
- add a new category for any entity, including Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that own "investments," as defined in Rule 2a51-1(b) under the Investment Company Act, in excess of $5 million and that was not formed for the specific purpose of investing in the securities offered;
- add "family offices" with at least $5 million in assets under management and their "family clients," as each term is defined under the Investment Advisers Act; and
- add the term "spousal equivalent" to the accredited investor definition, so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

The amendment to Rule 215 replaces the existing definition with a cross reference to the definition in Rule 501(a).

The amendments expand the definition of "qualified institutional buyer" in Rule 144A to include limited liability companies and RBICs if they meet the $100 million in securities owned and invested threshold in the definition. The amendments also add to the list any institutional investors included in the accredited investor definition that are not otherwise enumerated in the definition of "qualified institutional buyer," provided they satisfy the $100 million threshold.

The Commission also adopted conforming amendments to Rule 163B under the Securities Act and to Rule 15g-1 under the Exchange Act."[23]

Rule 506(c) offerings are restricted to accredited investors and this rule allows general solicitation and general advertising as long as the issuer takes "reasonable steps to verify" all investors are accredited investors. Rule 506(c)(2)(ii) sets forth non-exclusive and non-mandatory verification methods:

---

[23] SEC Press Release and Fact Sheet, SEC Press Release No. 2020-191, Aug 26, 2020, view at URL: https://www.sec.gov/news/press-release/2020-191

"ii) Verification of accredited investor status. The issuer shall take reasonable steps to verify that purchasers of securities sold in any offering under paragraph (c) of this section are accredited investors. The issuer shall be deemed to take reasonable steps to verify if the issuer uses, at its option, one of the following non-exclusive and non-mandatory methods of verifying that a natural person who purchases securities in such offering is an accredited investor; provided, however, that the issuer does not have knowledge that such person is not an accredited investor:
(A) In regard to whether the purchaser is an accredited investor on the basis of income, reviewing any Internal Revenue Service form that reports the purchaser's income for the two most recent years (including, but not limited to, Form W-2, Form 1099, Schedule K-1 to Form 1065, and Form 1040) and obtaining a written representation from the purchaser that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year.
(B) In regard to whether the purchaser is an accredited investor on the basis of net worth, reviewing one or more of the following types of documentation dated within the prior three months and obtaining a written representation from the purchaser that all liabilities necessary to make a determination of net worth have been disclosed:
(1) With respect to assets: Bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments, and appraisal reports issued by independent third parties; and
(2) With respect to liabilities: A consumer report from at least one of the nationwide consumer reporting agencies;
(C) Obtaining a written confirmation from one of the following persons or entities that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the prior three months and has determined that such purchaser is an accredited investor:
(1) A registered broker-dealer;
(2) An investment adviser registered with the Securities and Exchange Commission;
(3) A licensed attorney who is in good standing under the laws of the jurisdictions in which he or she is admitted to practice law; or
(4) A certified public accountant who is duly registered and in good standing under the laws of the place of his or her residence or principal office;[end]"

As noted by one commentator: "The SEC also reiterated its view that an issuer's "reasonable steps" standard under Rule 506(c) may not be substantially different from the "reasonable belief" standard under Rule 506(b). For example, an issuer's receipt of a representation from an investor as to its accredited investor status could meet the "reasonable steps" requirement if the issuer reasonably takes into consideration a prior substantive relationship with the investor or other facts that make the accredited status apparent. However, requiring an investor to simply "check a box" on a questionnaire or subscription agreement, by itself, is not sufficient unless the issuer or its agent has additional information that reasonably supports the purchaser's accredited investor status."[24]

[24] "New Verification Method To Determine "Accredited" Status in Securities Act Rule 506(c) Offerings," by Alicja Biskupska-Haas, Tracie Ingrasin and Marina G. Richter, O'Melveny & Myers, LLP, February 9, 2021, view at URL: https://www.omm.com/resources/alerts-and-publications/alerts/new-verification-method-in-rule-506c-offerings/

Rule 506(c) in practice requires verification of investor status and then issuance of offering documents to verified accredited investors. Some issuers use an online questionnaire and supporting document list and then provide verified accredited investors with code to access offering documents.

Rule 506(c)(2)(ii)(E)) does permit the following concession: "(E) In regard to any person that the issuer previously took reasonable steps to verify as an accredited investor in accordance with this paragraph (c)(2)(ii) [which sets out the requirement to use "reasonable steps to verify" accredited investor status and non-exclusive verification methods for natural persons], so long as the issuer is not aware of information to the contrary, obtaining a written representation from such person at the time of sale that he or she qualifies as an accredited investor. A written representation under this method of verification will satisfy the issuer's obligation to verify the person's accredited investor status for a period of five years from the date the person was previously verified as an accredited investor."

Rule 506(c) securities should qualify as "federally covered" securities under NSMIA.

(b) Integration.[25] The integration doctrine, which had its genesis in 1933,[26] comes into play where separate transactions in securities might constitute part of the same offering for purposes of analyzing whether the registration provisions of the 1933 Act apply. In other words, is the issuer evading the registration requirements by artificially splitting what is in reality a single offering to make it appear that an exemption applies when no exemption for that offering was intended? If no exemption is available, the unregistered transaction would be in violation of Section 5. The integration doctrine is not always easy for securities lawyers to apply to offerings as all the particular facts and circumstances for each offering must be analyzed.

2020 Revision of Integration Framework. The SEC revamped its integration of securities offering framework on November 2, 2020.[27] The various integration rules of the Securities Act of 1933 ("Securities Act") were replaced by new Rule 152 (17 C.F.R. §230.152) of the Securities Act, which changes expressly permits concurrent private and public securities offerings. As one commentator stated about the new integration framework: "The SEC adopted new Rule 152 in order to simplify the rules for determining when an issuer's private and public offerings might be "integrated," or considered part of the same offering, thereby requiring registration of the private offering. The rules regarding integration currently include a patchwork of SEC rules, staff guidance and market practice that has evolved over decades. New Rule 152 offers both a number of specified safe harbors from integration and, where no safe harbor is available, a principles-based approach to determine whether an exemption from registration is available for a particular offering. As a result, the new rules will make it easier for an issuer to commence a private

---

[25] This section (b) Integration is reproduced from §6:7. Integration Rule (Rule 152 and Rule 155), 24A Securities Pub. & Priv. Offerings §6:7 (2d ed.), by William M. Prifti, updated by presenter, Paul W. Richter, West Publishing, 2022. All the footnotes in quotes are not reproduced.
[26] Sec. Act Release No. 97, 1933 WL 2080 (Dec. 28, 1933).
[27] SEC Release Nos. 33-10884; 34-90300; IC-34082; File No. S7-05-20, Nov. 2, 2020, effective March 15, 2021, view at URL: https://www.sec.gov/rules/final/2020/33-10884.pdf

offering after a public one (or vice versa); this will be especially true where the issuer has a substantive pre-existing relationship with the purchasers."[28]

Rule 152 replaces prior version of Rule 152 as well as Rule 155; Rule 251(c) (Regulation A), Rule 502(a) (Regulation D), Rule 147(g) and Rule 147A(g). Rule 152 is based on a general principle of integration focused on facts and circumstances. It also allows four non-exclusive safe harbors that are based on common integration issues. New Rule 152(b)(1) provides that any securities offering that is made more than 30 calendar days before the commencement of or after the termination or completion of any other offering will not be integrated with the other securities offering. There is a caveat to the foregoing: If the initial private securities offering permits general solicitation for investors, then the issuer must have a reasonable basis for believing that neither the issuer nor its promoters solicited investors by general solicitation for the follow up private placements that does not allow general solicitation and the issuer had a pre-existing, substantive relationship with the investors. The issue of "pre-existing, substantive relationships" is commented on below.

Under the new framework, it is now clear that an issuer can conduct public and private offerings at the same time and can conduct concurrent private offerings—subject to complying with all requirements of the private securities offerings.

Table 1 below is an SEC summary of integration principle and Table 2 is an SEC summary of the four non-exclusive safe harbors.

Table 1[29] Integration Principle in new Rule 152(b)5[33]

General Principle of Integration	If the safe harbors in Rule 152(b) do not apply, in determining whether two or more offerings are to be treated as one for the purpose of registration or qualifying for an exemption from registration under the Securities Act, offers and sales will not be integrated if, based on the particular facts and circumstances, the issuer can establish that each offering either complies with the registration requirements of the Securities Act, or that an exemption from registration is available for the particular offering.
Application of the General Principle to an exempt offering prohibiting general solicitation 17 CFR 230.152(a)(1) ("Rule 152(a)(1)")	The issuer must have a reasonable belief, based on the facts and circumstances, with respect to each purchaser in the exempt offering prohibiting general solicitation, that the issuer (or any person acting on the issuer's behalf) either: (i) Did not solicit such purchaser through the use of commencement of the exempt offering prohibiting general solicitation; or (ii) Established a substantive relationship with such purchaser prior to the commencement of the exempt offering prohibiting general solicitation.
Application of the General	In addition to satisfying the requirements of the particular exemption relied on,

[28] "SEC simplifies Private Offering Rules," by Davis Polk & Wardwell, LLP, Nov. 6, 2020, view at URL: https://www.davispolk.com/sites/default/files/sec-simplifies-private-offering-rules.pdf.
[29] SEC Releases Nos. 33-10884; 34-90300; IC-34082; File No. S7-05-20, Nov. 2, 2020, effective March 15, 2021, pg. 15.

Principle to concurrent exempt offerings that each allow general solicitation— 17 CFR 230.152(a)(2) ("Rule 152(a)(2)")	general solicitation offering materials for one offering that include information about the material terms of a concurrent offering under another exemption may constitute an offer of the securities in such other offering, and therefore the offer must comply with all the requirements for, and restrictions on, offers under the exemption being relied on for such other offering, including any legend requirements and communications restrictions.

[Table 2]:[30] Overview of the Integration Safe Harbors in New Rule 152[34]

Safe Harbor 1 17 CFR 230.152(b)(1) ("Rule 152(b)(1)")	Offerings made more than 30 calendar days before or after any other offering would not be integrated with that offering, as long as the issuer reasonably believes that for each purchaser in the exempt offering, the issuer either: • did not solicit such purchaser through a general solicitation, or • had previously established a substantive relationship with such purchaser prior to the exempt offering.
Safe Harbor 2 17 CFR 230.152(b)(2) ("Rule 152(b)(2)")	Offers and sales made in compliance with Rule 701 (pursuant to an employee benefit plan) or in compliance with Regulation S (for offshore offerings) would not be integrated with other offerings.
Safe Harbor 3 17 CFR 230.152(b)(1) ("Rule 152(b)(3)")	An offering for which a registration statement has been filed would not be integrated with an earlier private offering if the registered offering is made subsequent to: • a terminated or completed private offering for which general solicitation is not permitted; • a terminated or completed private offering for which general solicitation is permitted (i.e., a Rule 506(c) or Rule 144A offering) that was made only to qualified institutional buyers and institutional accredited investors; or • a private offering that was terminated or completed more than 30 calendar days prior to the commencement of the registered offering.
Safe Harbor 4 17 CFR 230.152(b)(1) ("Rule 152(b)(4)")	Offers and sales made in reliance on an exemption for which general solicitation is permitted would not be integrated with a prior private offering that has been terminated or completed.

Integration Principle in new Rule 152(b)[31] [33]. General Principle of Integration. If the safe harbors in Rule 152(b) do not apply, in determining whether two or more offerings are to be

[30] SEC Release Nos. 33-10884; 34-90300; IC-34082; File No. S7-05-20, Nov. 2, 2020, effective March 15, 2021, pg. 16.

treated as one for the purpose of registration or qualifying for an exemption from registration under the Securities Act, offers and sales will not be integrated if, based on the particular facts and circumstances, the issuer can establish that each offering either complies with the registration requirements of the Securities Act, or that an exemption from registration is available for the particular offering. Application of the General Principle to an exempt offering prohibiting general solicitation. The issuer must have a reasonable belief, based on the facts and circumstances, with respect to each purchaser in the exempt offering prohibiting general solicitation, that the issuer (or any person acting on the issuer's behalf) either: (i) Did not solicit such purchaser through the use of commencement of the exempt offering prohibiting general solicitation; or 17 CFR 230.152(a)(1) ("Rule 152(a)(1)")(ii) Established a substantive relationship with such purchaser prior to the commencement of the exempt offering prohibiting general solicitation. Application of the General Principle to concurrent exempt offerings that each allow general solicitation—17 CFR 230.152(a)(2) ("Rule 152(a)(2)"). In addition to satisfying the requirements of the particular exemption relied on, general solicitation offering materials for one offering that include information about the material terms of a concurrent offering under another exemption may constitute an offer of the securities in such other offering, and therefore the offer must comply with all the requirements for, and restrictions on, offers under the exemption being relied on for such other offering, including any legend requirements and communications restrictions.

In footnotes to the above summary tables, the SEC noted that: [33] "Revised introductory language has been added to new Rule 152 clarifying that the plan or scheme to evade the registration requirements language applies to the entire rule, and not just the safe harbors, as proposed. Specifically, the new introductory language states that because of the objectives of Rule 152 and the policies underlying the Securities Act, the provisions of the rule will not have the effect of avoiding integration for any transaction or series of transactions that, although in technical compliance with the rule, is part of a plan or scheme to evade the registration requirements of the Securities Act";[32][5] and [34] "No integration analysis under Rule 152(a) is required if any of the non-exclusive safe harbors in Rule 152(b) apply. In addition, the revised introductory language to new Rule 152 clarifies that the plan or scheme to evade the registration requirements language encompasses the entire rule, including the safe harbors".[33][6]

Substantive, Pre-Existing Relationship. With respect to existence of a substantive pre-existing relationship, which is one of the requirements for Regulation D private securities offerings banning general solicitation and advertising, one commentator noted that: "In terms of what constitutes a pre-existing, substantive relationship, the SEC confirmed in the adopting release that "the existence of such a relationship prior to the commencement of an offering is one means, but not the exclusive means, of demonstrating the absence of general solicitation in a Regulation D offering." Accordingly, an offer of the issuer's securities to a person with whom the issuer, or

[31] SEC Releases Nos. 33-10884; 34-90300; IC-34082; File No. S7-05-20, Nov. 2, 2020, effective March 15, 2021, pp. 15–16.
[32] SEC Release Nos. 33-10884; 34-90300; IC-34082; File No. S7-05-20, Nov. 2, 2020, effective March 15, 2021, pg. 15.
[33] SEC Release Nos. 33-10884; 34-90300; IC-34082; File No. S7-05-20, Nov. 2, 2020, effective March 15, 2021, pg. 16.

a person acting on its behalf, has a pre-existing substantive relationship would not constitute general solicitation, so long as the relationship was established prior to commencement of the offering … A “pre-existing” relationship is one that an issuer or, alternatively, a person acting on the issuer's behalf has formed with an offeree *before* commencement of the offering. SEC staff interpretations of whether a “pre-existing, substantive relationship” can be established on the issuer's behalf have generally been based on procedures established by broker-dealers for their clients as part of their suitability determinations. However, whether or not there is a sufficient relationship to avoid the risk of general solicitation will depend on the particular facts and circumstances; it does not depend on the third party in question being an investment adviser or broker-dealer … A “substantive” relationship is one in which the issuer (or a person acting on its behalf) has sufficient information to evaluate, and does, in fact, evaluate, an offeree's financial circumstances and sophistication in determining the offeree's status as an eligible investor. Self-certification alone (*e.g.*, by checking a box on an investor questionnaire or subscription agreement), without knowledge of a person's financial circumstances or sophistication, is insufficient to form a “substantive” relationship … An issuer may develop its own pre-existing, substantive relationships with offerees, but it may be difficult to do so in the absence of a prior business relationship or a recognized legal duty to the offerees. According to the adopting release, examples of investors with which an issuer may have a pre-existing, substantive relationship include: (a) the issuer's existing or prior investors; (b) investors in prior deals of the issuer's management; (c) friends or family of the issuer's control persons; and (d) if the issuer relies on third parties, clients with which an investment adviser, broker-dealer or other person on the issuer's behalf has established such a substantive relationship.”[34][7]

The revised integration framework also addressed the start and end of securities offerings. As stated by the SEC: “Existing rules under the Securities Act do not clearly define commencement or completion with respect to exempt and registered offerings, although several rules state when exempt offerings under Regulation A [177] and Regulation Crowdfunding terminate under certain circumstances, [178] as well as when registered offerings terminate.[179]”[35]

Under Rule 152(c) and Rule 152(d) (17 C.F.R. § 230.152(c), 152(d)), the SEC adopted the following guidance on commencement and end of securities offerings:

“New Rule 152(c) provides a non-exclusive list of factors to consider in determining when an offering will be deemed to be commenced for purposes of both the general principle of integration in Rule 152(a) and the safe harbors in Rule 152(b). Specifically, regardless of the type of offering, new Rule 152(c) states that an offering of securities will be deemed to be commenced for purposes of Rule 152 at the time of the first offer of securities in the offering by the issuer or its agents, and includes a non-exclusive list of factors that should be considered in determining when an offering is deemed to be commenced. The list of factors covers registered

[34] “Overview of New Securities Act Rule 152 on Integration*,”* by *Alicja Biskupska-Haas, Esq. and Marina G. Richter, Esq.,* O'Melveny & Myers, LLP, February 21, 2021, view at URL: https://www.omm.com/resources/alerts-and-publications/alerts/overview-of-new-securities-act-rule-152-on-integration/.

[35] SEC Release Nos. 33-10884; 34-90300; IC-34082, pg. 61.

and exempt offerings, noting that an issuer or its agents may commence an offering in reliance on:

> • Rule 241, on the date the issuer first made a generic offer soliciting interest in a contemplated securities offering for which the issuer has not yet determined the exemption under the Securities Act under which the offering of securities would be conducted;
> • Section 4(a)(2), Regulation D, or Rule 147 or 147A, on the date the issuer first made an offer of its securities in reliance on these exemptions;
> • Regulation A, on the earlier of the date the issuer first made an offer soliciting interest in a contemplated securities offering in reliance on Rule 255, or the public filing of a Form 1-A offering statement;
> • Regulation Crowdfunding, on the earlier of the date the issuer first made an offer soliciting interest in a contemplated securities offering in reliance on new Rule 206, or the public filing of a Form C offering statement; and
> • A registration statement filed under the Securities Act for:
> ○ A continuous offering that will commence promptly on the date of initial effectiveness, on the date the issuer first filed its registration statement for the offering with the Commission, or
> ○ A delayed offering, on the earliest date on which the issuer or its agents commenced public efforts to offer and sell the securities, which could be evidenced by the earlier of the first filing of a prospectus supplement with the Commission describing the delayed offering, or the issuance of a widely disseminated public disclosure, such as a press release, confirming the commencement of the delayed offering.

Due to their non-public nature, communications between an issuer, or its agents and underwriters, and QIBs and IAIs, including those that would qualify for the safe harbor in 17 CFR 230.163B ("Rule 163B"), will not be considered as the commencement of a registered public offering for purposes of new Rule 152. In contrast, the commencement of private communications between an issuer, or its agents, including private placement agents, and prospective investors in an exempt offering in which general solicitation is prohibited, such as under Rule 506(b) or Section 4(a)(2), may be considered as the commencement of the non-public exempt offering for purposes of new Rule 152, if such private communication involves an offer of securities."[36]

(c) Extraterritorial Reach of U.S. Securities Laws. In terms of SEC enforcement actions, the SEC has memorandum of understanding or "MOUs" with many foreign securities regulators and these MOUs provide basis for U.S.-foreign cooperation in securities investigations and enforcement – *See* SEC Web Page at URL:
https://www.sec.gov/about/offices/oia/oia_coopfactsheet

In the U.S. Supreme Court decision in *Morrison v. National Australian Bank Ltd.* held that the anti-fraud provision in Section 10(b) applied to "transactions in securities listed on [U.S.]

[36] SEC Release Nos. Nos. 33-10884; 34-90300; IC-34082, Nov. 2, 2020, pp. 66–68.

domestic exchanges" and "domestic transactions in other securities" – "clear test". [37] *Morrison* did not provide clear guidance on what is a "domestic transactions" of the clear test.

Under Dodd-Frank Act, which was enacted just after the *Morrison* decision, the federal district courts have jurisdiction over actions brought by the SEC or DOJ for violations of the anti-fraud securities laws "involving either: (1) significant conduct in the U.S. in furtherance of the violation, "even if the securities transaction occurs outside the United States and involves only foreign investors"; or (2) "conduct occurring outside the United States that has a foreseeable substantial effect within the United States." This two-part test effectively mirrored the "conduct-and-effects" test the Supreme Court rejected in *Morrison* [*Morrison v. National Australian Bank Ltd.,* 561 U.S. 247 (2010)]" just prior to enactment of Dodd Frank Act." [38] Dodd Frank Act did not completely override *Morrison*, but rather Dodd Frank Act provided that "the antifraud provisions of the federal securities laws apply extraterritorially when the "conduct-and-effects" test is met in [SEC] enforcement actions. The transactional test described by the Supreme Court in *Morrison* will continue to apply in private actions alleging violations of the securities laws, and as a result market participants could face different results in enforcement and private actions related to the same transactions. The *Scoville* decision [*SEC v. Scoville*, 913 F.3d 1204 (2019)]therefore makes it even more difficult for market participants to predict whether transactions with foreign components could subject them to liability under the U.S. securities laws."[39]

In *Cavello Bay Reinsurance Ltd. v. Stein,*[40] Second Circuit sought to bring clarity to the "domestic transaction" issue. In *Cavello*, the transaction was a purchase of securities made by a Bermudan corporation in a private offering by a Bermudan holding company. While certain aspects of the sale of securities occurred in New York, the requisite contractual "meeting of minds" occurred in Bermuda for contract purposes.[41] The Court in *Cavello* stated: (1) "Here, the transaction arguably took place in the United States. Cavello Bay argues that the subscription agreement became binding when it was signed in New York; Spencer Capital argues that it became binding under New York law only when sent to Bermuda and received there. The particulars of this case illustrate how locating the "meeting of the minds" can be arranged or confused by the parties, or can become enmeshed in state contract law. Absolut Activist, 677 F.3d at 68 (quotation omitted). Here, the place of transaction is difficult to locate, and impossible

---

[37] "Tenth Circuit Holds Federal Securities Laws Apply Extraterritorially In Enforcement Actions," by Jayant W. Tambe, Ryan J. Andreoli and Cealagh P. Fitzpatrick, Jones Day Reavis & Pogue, LLP, Feb. 2019 Commentary, view at URL: https://www.jonesday.com/en/insights/2019/02/tenth-circuit-holds-federal-securities-laws-apply
[38] "Tenth Circuit Holds Federal Securities Laws Apply Extraterritorially In Enforcement Actions," by Jayant W. Tambe, Ryan J. Andreoli and Cealagh P. Fitzpatrick, Jones Day Reavis & Pogue, LLP, Feb. 2019 Commentary.
[39] *Ibid*.
[40] *Cavello Bay Reinsurance Ltd. v. Stein*, No. 20-1371-cv (2d Cir Jan. 25, 2021).
[41] "Second Circuit Reaffirms that Federal Securities Laws Do Not Apply to Predominantly Foreign Transactions," by Jonathan E. Richman and Julia D. Alonzo, Proskauer Rose LLP, posted in National Law Review, view at URL: https://www.natlawreview.com/article/second-circuit-reaffirms-federal-securities-laws-do-not-apply-to-predominantly, January 26, 2021.

to do without making state law."[42] and (2) "The claims here are based on a private agreement for a private offering between a Bermudan investor (Cavello Bay) and a Bermudan issuer (Spencer Capital). Cavello Bay purchased restricted shares in Spencer Capital in a private offering. The shares reflect only an interest in Spencer Capital, and they are listed on no U.S. exchange and are not otherwise traded in the United States. Their main link to the United States is the subscription agreement's restriction clause requiring Cavello Bay to register the shares with the SEC (or meet an exemption) should Cavello Bay wish to resell them. While that clause may set up a future invocation of U.S. law, it operates as a mere contractual impediment to resale, conditioning resale on the invocation of U.S. law by a party that has made the purchase in a way that avoids regulation by the United States. Cavello Bay provides no reason to think an SEC registration requirement—contingent and future—triggers some U.S. interest or other interest that the statute is meant to protect (the designation of New York law too is neither here nor there)."[43]

5. SEC Summary of Private/Limited/Small Securities Offering Exemptions from Registration under Section 5 of the Securities Act.

Reference Chart. Attachment One contains an SEC-produced chart of the private, limited and small securities offerings exemptions from registration of a securities offering under Section 5 of the Securities Act. This is a handy quick reference chart but nothing more than a quick reference chart for general requirements.

Unless a company wishes to make a public securities offering to the public, the company will try to qualify for an exemption from registration of the offering under Section 5 of the Securities Act in order to: (1) avoid the significant cost and delay in selling the securities; (2) the regulatory review and scrutiny of a review of the offering documents; and (3) increased liability exposure of a registered public securities offering (including the lethal Section 12(a)(2) of the Securities Act liability for material misstatements or omissions in the prospectus for a registered, public offering). Section 12(a)(1) of the Securities Act creates a civil cause of action for the offer and sale of securities in violation of Section 5 of Securities Act – an illegal public offering.

The following is a more detailed summary of the primary exemptions from registering a securities offering – which supplements the chart in Attachment One.

(a) Section 4(a)(2) of Securities Act. This section provides a statutory exemption for "transactions by an issuer not involving any public offering." The problem here is that "public offering" is not defined in the statute or in any rule – outside of a registered public offering complying with Section 5 and Section 10 of the Securities Act, what is a "public offering" is determined by a case by case analysis using case law, SEC rules and policies, SEC Enforcement policies and practices and common practices – include ascertaining whether an exemption from registration of the offering is available.

[42] *Cavello Bay Reinsurance Ltd.*, pp. 169–170.
[43] *Cavello Bay Reinsurance Ltd.*,, pg. 174.

Although Section 4(a)(2) has the "quicksand" of a lack of certainty that it covers the offering at hand, case law and SEC enforcement practices has established that this statutory exemption requires at least:

(i) sophisticated investor who has access to the same information as one would find in a Securities Act registration statement – as disclosed in a Form S-1 Registration Statement for initial public securities offerings;
(ii) number of offerees – this exemption should not be relied upon for an offering seeking numerous investors or as part of an ongoing capital raise. Section 4(a)(2) offering should be limited to isolated sales of securities to one or two investors and (here is where you must often see Section 4(a)(2) as a standalone exemption) when a major public company, like an Apple or Amazon, sells large amounts of debt securities to a large institutional investor that frequently purchases securities (like an insurance company) in a single transaction.
(iii) no intent to resell or distribute the securities to evade the registration requirements of public offerings – further, there should be no special or extensive (including no general solicitation or adverting – and both terms have a broad meaning) to offer and sell the securities.

The SEC states about Section 4(a)(2) in investor advisements: "To qualify for this exemption, which is sometimes referred to as the "private placement" exemption, the purchasers of the securities must:

- either have enough knowledge and experience in finance and business matters to be "sophisticated investors" (able to evaluate the risks and merits of the investment), or be able to bear the investment's economic risk
- have access to the type of information normally provided in a prospectus for a registered securities offering and
- agree not to resell or distribute the securities to the public

In general, public advertising of the offering, and general solicitation of investors, is incompatible with the private placement exemption….The precise limits of the private placement exemption are not defined by rule. As the number of purchasers increases and their relationship to the company and its management becomes more remote, it is more difficult to show that the offering qualifies for this exemption. If your company offers securities to even one person who does not meet the necessary conditions, the entire offering may be in violation of the Securities Act."[44]

(b) Rule 506(b) of Regulation D as promulgated under Section 4(a)(2) of Securities Act. Promulgated as a safe harbor exemption under Section 4(a)(2) – which provides far more certainty of the existence of an exemption from registration requirements than Section 4(a)(2). Rule 506(b) is by far the one exemption under which the vast majority of capital is raised in private offerings – typically the offering is made only to accredited investors (as defined in Rule 501(a) of Regulation D - 17 C.F.R. §230.501(a)). According to the SEC:

[44] Section 4(a)(2) – Private Placements – Rule 506(b), SEC, Oct. 28, 2022, view at URL: https://www.sec.gov/education/smallbusiness/exemptofferings/rule506b

Table 5: Overview of amounts raised in the exempt market in 2019 (*599, 600, 601*)

Exemption	Amounts Reported or Estimated as Raised in 2019
Rule 506(b) of Regulation D	**$ 1,492 billion**
Rule 506(c) of Regulation D	$ 66 billion
Regulation A: Tier 1	$ 0.044 billion
Regulation A: Tier 2	$ 0.998 billion
Rule 504 of Regulation D	$ 0.228 billion
Regulation Crowdfunding	$ 0.062 billion
Other exempt offerings	$ 1,167 billion [Section 4(a)(2); Regulation S; Rule 144A]

Footnotes to Table:
599 Unless otherwise indicated, information in this release on Regulation D, Regulation A, and Regulation Crowdfunding offerings is based on analyses by staff in the Commission's Division of Economic Risk and Analysis of data collected from SEC filings.
600 "Other exempt offerings" includes Section 4(a)(2), Regulation S, and Rule 144A offerings. The data used to estimate the amounts raised in 2019 for other exempt offerings includes: (1) offerings under Section 4(a)(2) of the Securities Act that were collected from Thomson Financial's SDC Platinum, which uses information from underwriters, issuer websites, and issuer Commission filings to compile its Private Issues database; (2) offerings under Regulation S that were collected from Thomson Financial's SDC Platinum service; and (3) resale offerings under Rule 144A that were collected from Thomson Financial SDC New Issues database, Dealogic, the Mergent database, and the Asset-Backed Alert and Commercial Mortgage Alert publications, to further estimate the exempt offerings under Section 4(a)(2) and Regulation S. We include amounts sold in Rule 144A resale offerings because those securities are typically issued initially in a transaction under Section 4(a)(2) or Regulation S but generally are not included in the Section 4(a)(2) or Regulation S data identified above. These numbers are accurate only to the extent that these databases are able to collect such information and may understate the actual amount of capital raised under these offerings if issuers and underwriters do not make this data available. The data on Rule 144A debt offerings from Mergent is available only through the end of August 2019. We have extrapolated the data to obtain a full calendar year.
601 This table includes offerings by pooled investment funds. Information on Regulation D offerings, including offerings under Rule 504 and Rule 506, is based on staff analysis of data from Form D filings on EDGAR. The amount raised is based on the amounts reported as "Total amount sold" in all Form D filings (new filings and amendments) on EDGAR. Subsequent amendments to a new filing were treated as incremental fundraising and recorded in the calendar year in which the amendment was filed. It is likely that the reported data on Regulation D offerings underestimates the actual amount raised through these offerings. First, Rule 503 of Regulation D requires issuers to file a Form D no later than 15 days after the first sale of securities, but a failure to file the notice does not invalidate the exemption. Accordingly, it is possible that some issuers do not file Form D for offerings relying on Regulation D. Second, underreporting could also occur because a Form D may be filed prior to completion of the offering, and our rules do not require issuers to amend a Form D to report the total amount sold on completion of the offering or to reflect additional amounts offered if the aggregate offering amount does not exceed the original offering size by more than 10 percent.

The reason for the popularity of Rule 506(b) is that if the offering is restricted to "accredited investors" (as defined in Rule 501(a) of Regulation D – 17 C.F.R. §230.501(a)), then the issuer can privately sell an unlimited amount of securities to a large number of accredited investors without extensive mandated disclosure requirements or regulatory review (a Form D filing being the only federal filing requirement) – this is the least burdensome exemption with the greatest latitude.

The SEC summary description of Rule 506(b) is: "Rule 506(b) of Regulation D is considered a "safe harbor" under Section 4(a)(2). It provides objective standards that a company can rely on to meet the

requirements of the Section 4(a)(2) exemption. Companies conducting an offering under Rule 506(b) can raise an unlimited amount of money and can sell securities to an unlimited number of accredited investors. An offering under Rule 506(b), however, is subject to the following requirements:

- no general solicitation or advertising to market the securities
- securities may not be sold to more than 35 non-accredited investors (all non-accredited investors, either alone or with a purchaser representative, must meet the legal standard of having sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment)

If non-accredited investors are participating in the offering, the company conducting the offering:

- must give any non-accredited investors disclosure documents that generally contain the same type of information as provided in Regulation A offerings (the company is not required to provide specified disclosure documents to accredited investors, but, if it does provide information to accredited investors, it must also make this information available to the non-accredited investors as well)
- must give any non-accredited investors financial statement information specified in Rule 506 and
- should be available to answer questions from prospective purchasers who are non-accredited investors

Purchasers in a Rule 506(b) offering receive "restricted" A company is required to file a notice with the Commission on Form D within 15 days after the first sale of securities in the offering. Although the Securities Act provides a federal preemption from state registration and qualification under Rule 506(b), the states still have authority to require notice filings and collect state fees.

Rule 506(b) offerings are subject to "bad actor disqualification." (see "Bad Actor" below in Section 6(n))[45]

Offers and sales of securities can be made to up to 35 non-accredited investors in a Rule 506(b) offering, but that offer and sale triggers the disclosure requirements in Rule 502(b)(1) and (2) (17 C.F.R. §230.502(b)(1),(2)), which disclosures must be made a "reasonable" time prior to offer and sale of the securities and consist of following financial disclosures mandated in Rule 502(b)(2):

"(b) Information requirements - (1) When information must be furnished. If the issuer sells securities under § 230.506(b) to any purchaser that is not an accredited investor, the issuer shall furnish the information specified in paragraph (b)(2) of this section to such purchaser a reasonable time prior to sale. The issuer is not required to furnish the specified information to purchasers when it sells securities under § 230.504, or to any accredited investor.

---

[45] Private Placements – Rule 506(b), SEC, Oct. 28, 2022, view at URL: https://www.sec.gov/education/smallbusiness/exemptofferings/rule506b

Note: When an issuer provides information to investors pursuant to paragraph (b)(1), it should consider providing such information to accredited investors as well, in view of the anti-fraud provisions of the federal securities laws.

(2) Type of information to be furnished. (i) If the issuer is not subject to the reporting requirements of section 13 or 15(d) of the Exchange Act, at a reasonable time prior to the sale of securities the issuer shall furnish to the purchaser, to the extent material to an understanding of the issuer, its business and the securities being offered:
(A) Non-financial statement information. If the issuer is eligible to use Regulation A (§230.251-263), the same kind of information as would be required in Part II of Form 1-A (§239.90 of this chapter). If the issuer is not eligible to use Regulation A, the same kind of information as required in Part I of a registration statement filed under the Securities Act on the form that the issuer would be entitled to use.
(B) Financial statement information - (1) Offerings up to $20,000,000. The financial statement information required by paragraph (b) of Part F/S of Form 1-A. Such financial statement information must be prepared in accordance with generally accepted accounting principles in the United States (US GAAP). If the issuer is a foreign private issuer, such financial statements must be prepared in accordance with either US GAAP or International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). If the financial statements comply with IFRS, such compliance must be explicitly and unreservedly stated in the notes to the financial statements and if the financial statements are audited, the auditor's report must include an opinion on whether the financial statements comply with IFRS as issued by the IASB.
(2) Offerings over $20,000,000. The financial statement information required by paragraph (c) of Part F/S of Form 1-A (referenced in § 239.90 of this chapter). If the issuer is a foreign private issuer, such financial statements must be prepared in accordance with either US GAAP or IFRS as issued by the IASB. If the financial statements comply with IFRS, such compliance must be explicitly and unreservedly stated in the notes to the financial statements and the auditor's report must include an opinion on whether the financial statements comply with IFRS as issued by the IASB."

Further, in terms of verification of "accredited investor" status, the issuer must have a reasonable belief that the investor is at the time of sale, not before or after, an "accredited investor."

With respect to "accredited investors," they are deemed to possess the sophistication (either personally or through representatives or employees) of the risks of an investment and financial wherewithal to withstand the loss of an entire investment and, consequently, as not needing the protections of the disclosure regime imposed by federal securities regulation. The anti-fraud provisions of federal securities laws in respect of offer and sale of securities is always available to all investors.

The SEC states about accredited investors: accredited investor requirement for investor suitability "is to ensure that all participating investors are financially sophisticated and able to fend for themselves or sustain the risk of loss, thus rendering less necessary the protections that come from a registered offering. An individual is an accredited investor if they:

-earned income that exceeded $200,000 (or $300,000 together with a spouse or spousal equivalent) in each of the prior two years, and reasonably expects the same for the current year, OR

- has a net worth over $1 million, either alone or together with a spouse or spousal equivalent (excluding the value of the person's primary residence and any loans secured by the residence (up to the value of the residence)), OR

- are a broker or other financial professional holding certain certifications, designations or credentials in good standing, including a Series 7, 65 or 82 license.

A spousal equivalent means a cohabitant occupying a relationship generally equivalent to that of a spouse.

Any non-accredited investors in the offering must be financially sophisticated or, in other words, have sufficient knowledge and experience in financial and business matters to evaluate the investment. This financial sophistication requirement may be satisfied by having a purchaser representative for the investor who satisfies the criteria. An investor engaging a purchaser representative should pay particular attention to any conflicts of interest the representative may have, such as having a financial interest in the offering or separately being compensated by the issuer.

If the issuer offers securities to non-accredited investors, the issuer must disclose certain information about itself, including its financial statements. If selling only to accredited investors, the issuer has discretion as to what to disclose to investors. Any information provided to accredited investors also must be provided to non-accredited investors

Issuers relying on the Rule 506(b) exemption may not generally solicit their offerings. However, the Rule 506(c) exemption permits the issuer to generally solicit or advertise for potential investors. As a result, you may see an investment opportunity advertised through the Internet, social media, seminars, print, or radio or television broadcast. Only accredited investors, however, are allowed to purchase in generally solicited offerings under Rule 506(c), and the issuer will have to take reasonable steps to verify your accredited investor status." [46]

(c) Rule 506(c) of Regulation D. As required under Section 201(a) of the Jumpstart Our Business Startups Act (the "JOBS Act"),[47] and adopted as of September 23, 2013 and in an attempt to make it easier to raise capital in private placements, Rule 506(c) has not proven popular in comparison to Rule 506(b) – even with the ability to solicit accredited investors. Rule 506(c) "permits an issuer to engage in general solicitation or general advertising in offering and selling securities pursuant to Rule 506, provided that all purchasers of the securities are

[46] Private Placements under Regulation D – Updated Investor Bulletin, SEC, Sept. 24, 2014, view at URL: https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-31

[47] Pub. L. No. 112-106, sec. 201(a), 126 Stat. 306, 313 (Apr. 5, 2012).

accredited investors and the issuer takes reasonable steps to verify that such purchasers are accredited investors."[48]

Rule 506(c) has not enjoyed extensive use and has failed to realize its intended goal of extensively expanding private capital funding. The need to be engage in a more diligent verification of "accredited investor" status undoubtedly contributed to Rule 506(c) falling short of expectations. As any practitioner handling private placements quickly learns, many investors do not want to complete a basic investor questionnaire for a Rule 506(b) offering and the step up from a "reasonable belief" that an investor is an accredited investor under a Rule 506(b) to the standard of verification of that status under Rule 506(c) has proven fatal to Rule 506(c)'s appeal to issuers.

One commentator noted: "For 506(c) offerings, however, the bar has been raised. A reasonable belief is not sufficient. For these transactions, the issuer must take "reasonable steps" to verify that the buyer meets the requirements for accredited investor status. The self-certification questionnaire is not permitted. Issuers may confirm eligibility through a variety of steps spelled out in the rule, including a review of tax documents, credit reports or written confirmations from designated professionals. The comparison to 506(b), where the potential investor may simply complete a questionnaire, is striking….Ms. Hanks [Sara Hanks, CEO and founder of CrowdCheck, Inc.,] stated that companies might be willing to put up with the more complicated requirements of Rule 506(c) if general solicitation actually opened a new pool of investors, but she observed that the accredited investor pool is already fairly well-known and well-defined. She added that smaller companies may be hesitant to go casting about across the Internet for capital, because it could make them look desperate. Ms. Hanks indicated that newer companies fear looking like failures to the market."[49]

The commentator added: "Why has the eagerly-anticipated arrival of general solicitation yielded so few results? Why do more issuers rely on good old Rule 506(b) to raise money rather than its flashier sibling?....One reason is the lure of familiarity. Issuers had years of experience with what was then the old Rule 506. As Marty Dunn, a partner at Gibson Dunn, stated on the panel, Rule 506(b) is "tried and true." Issuers and intermediaries are comfortable with the process and they know the pool of investors that they will likely approach to participate in the offering. Under 506(b), offering participants may sell to any number of accredited investors and up to 35 non-accredited investors who meet defined sophistication requirements. The issuer does not have to establish that its buyers meet the accredited investor standard. Rather, it is sufficient if the issuer

---

[48] SEC Release No. 33-9415; No. 34-69959; No. IA-3624; File No. S7-07-12, July 10, 2013, effective September 23, 2013, pg. 2, view at URL: https://www.sec.gov/rules/final/2013/33-9415.pdf

[49] "Rule 506(c)'s General Solicitation Remains Generally Disappointing," by Peter Rasmussen, Gibson Dunn & Crutcher, LLP, Bloomberglaw.com, May 26, 2017, view at URL: https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-rule-506cs-general-solicitation-remains-generally-disappointing

reasonably believes that the buyers are eligible. Self-certification accomplished through the use of an investor questionnaire is common practice to reach this result."[50]

The verification of accredited investor status for Rule 506(c) offerings entails: "Rule 506(c) sets forth a principles-based method of verification which requires an objective determination by the issuer (or those acting on its behalf) as to whether the steps taken are "reasonable" in the context of the particular facts and circumstances of each purchaser and transaction. Among the factors that an issuer should consider under this principles-based method are:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser; and
- the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

In addition to this flexible, principles-based method, Rule 506(c) includes a non-exclusive list of verification methods that issuers may use, but are not required to use, when seeking greater certainty that they satisfy the verification requirement with respect to natural person purchasers. This non-exclusive list of verification methods consists of:

- verification based on income, by reviewing copies of any Internal Revenue Service form that reports income, such as Form W-2, Form 1099, Schedule K-1 of Form 1065, and a filed Form 1040
- verification on net worth, by reviewing specific types of documentation dated within the prior three months, such as bank statements, brokerage statements, certificates of deposit, tax assessments and a credit report from at least one of the nationwide consumer reporting agencies, and obtaining a written representation from the investor;
- a written confirmation from a registered broker-dealer, an SEC-registered investment adviser, a licensed attorney or a certified public accountant stating that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the last three months and has determined that such purchaser is an accredited investor; and
- a method for verifying the accredited investor status of persons who had invested in the issuer's Rule 506(b) offering as an accredited investor before September 23, 2013 and remain investors of the issuer." [51]

(d) Rule 504 of Regulation D under Securities Act (17 C.F.R. §230.504) – Limited Offering Exemption for a Private Company. Rule 504 is based on Section 3(b) of the Securities Act and is deemed a "limited" exempt offering. Rule 504 permits the offer and sale of up to $10 million of

---

[50] *Ibid.*

[51] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings - A Small Entity Compliance Guide, SEC Division of Corporation Finance, Sept. 20, 2013, view at URL: https://www.sec.gov/info/smallbus/secg/general-solicitation-small-entity-compliance-guide

securities in a 12-month period to an unlimited number of investors and without any investor suitability requirements. A Form D must be filed with the SEC for a Rule 504 filing within 15 days after the first sale of securities. There is no pre-emption from state securities laws for Rule 504 offerings and, while not all states have a mirror exemption to Rule 504, all states have some form of limited offering exemption.

Rule 504 may only be used by private companies – "private" meaning the companies do not file with the SEC under Section 13 or Section 15(d) of the Exchange Act. The following companies are also not eligible to use Rule 504: investment companies (mutual funds; closed end funds); blank check companies (being companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company); and companies with a "bad actor" disqualification.

Securities issued in a Rule 504 offering are "restricted securities" and "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising" – **except and unless** the offering complies with one of the following conditions: "(i) 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, and are made in accordance with those state provisions; (ii) 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 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 (iii) 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 §230.501(a)." 17 C.F.R. §230.504(b)(1)(i)-(iii).

State registration of a Rule 504 offering is usually burdensome and expensive in terms of overall amount of money being raised.

RED FLAG. Rule 504 has been plagued over the years as the exemption used in many "pump and dump" schemes. This scam works as follows: "A pump-and-dump scheme requires surprisingly little time and effort. First, the "organizers" form a corporation, which generally requires nothing more than filing a few forms and cutting a modest check to the state. These organizers then sell the company's stock to themselves and a few friends, often for fractions of a penny per share. Next, the organizers drive up the price of the stock on the OTC markets by continuously trading with each other to create a false market or by spreading rumors via the Internet or "Spam" email. Finally, the organizers and their friends sell the inflated shares to unsuspecting outside investors, often for enormous profits….To operate this scam, the organizers rely on a loophole in the SEC rules that allows the shares issued in small offerings to be freely traded. The SEC places onerous resale restrictions on unregistered shares sold in larger private offerings, but shares sold in the small pump-and-dump offerings are often issued under Securities Act Rule 504, which imposes few restrictions. The ability to freely trade these shares allows the pump-and-dump market to thrive….Under Rule 504, the "seed capital" rule, a company not otherwise subject to SEC reporting requirements can issue securities to an unlimited number of

people. The aggregate offering price of the securities must remain under $1 million [increased to $5 million and then to $10 million by SEC in 2020] in any 12-month period. The SEC enacted Rule 504 to provide small businesses the opportunity to raise money while beginning operations. The Rule gives these companies a break from many federal securities laws, instead counting on state regulation to keep the companies in check." [52]

Due to its checkered past, a Rule 504 may encounter "enhanced" skepticism and scrutiny from regulators and investor representatives.

(e) REPEALED Rule 505 under Regulation D. You may see references to the Rule 505, a limited offering exemption based on Section 3(b) of the Securities Act, but Rule 505 was repealed by the SEC, effective May 22, 2017.[53] It was not extensively used by issuers because it was expensive to comply with disclosure requirements and had a relatively low maximum raise amount for a 12 month period.

(f) Rule 701 Limited Offering Exemption under Section 3(b) of Securities Act. A private company often rely on Rule 701 (17 C.F.R. §230.701) for sale or issuance of company's securities to its employees, officers, directors, members, trustees, partners or certain consultants (those who are natural persons) under a written compensation plan or a written contract. If a compensatory plan is basis for Rule 701 offering, it must be delivered to the recipient of the securities prior to issuance of securities. The compensatory plan is usually an incentive stock option or stock based plan. Under Rule 701, the aggregate sales price or amount of securities sold in any consecutive 12-month period is limited to the greatest of: (a) $1 million, (b) 15% of the total assets of the issuer and (c) 15% of the outstanding amount of the class of securities being offered. The exemption does not cover resales of securities.

If the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds $10 million (previously $5 million before July 2018), issuer must deliver to the recipients/purchasers the following **additional documents** a reasonable period of time prior to the date of issuance or sale of securities: (1) a summary of the material terms of the plan; (2) a risk factor analysis of the investment in the offered securities; and (3) financial statements of the issuer (including a balance sheet as of a date within 180 days, together with statements of income, cash flows and stockholder's equity for two complete fiscal years and for any interim period from the end of the last fiscal year to the balance sheet date).

For consultants, the issuance of securities must be to a natural person and issued for bona fide services to the issuer that do not involve promotion of capital raising activities or a market for issuer's securities.

There is no filing with the SEC for Rule 701 offering, but Rule 701 does not pre-empt state securities laws and regulations.

---

[52] "Getting Robbed at the Pump," by Editorial Staff, Trader Magazine, May 15, 2008, view at URL: https://www.tradersmagazine.com/departments/regulation/getting-robbed-at-the-pump/
[53] SEC Release Nos. 33-10238; 34-79161; File No. S7-22-15, Oct. 26, 2016, view at URL: https://www.sec.gov/rules/final/2016/33-10238.pdf

(g) Regulation A under Section 3(b) of Securities Act. Called the "quasi-public" offering, Regulation A has been around in one form or another since the 1930's. It is called a "quasi-public" offering because an issuer must file a Form 1-A with an offering circular for review by the SEC and SEC approval, called "qualification", is required before any sales can be made under the offering. Further, the securities offered under a qualified Regulation A offering are free trading and certain general solicitation and advertising is permitted. "Issuers are permitted to "test the waters" with, or solicit interest in a potential offering from, the general public either before or after the filing of the offering statement, provided that all solicitation materials include the legends required by the final rules and, after publicly filing the offering statement, are preceded or accompanied by a preliminary offering circular or contain a notice informing potential investors where and how the most current preliminary offering circular can be obtained."[54]

Prior to the overhaul of Regulation A by the JOB Act in 2012, Regulation A was a rarely used exemption because the low maximum aggregate offering amount prior to 2012 and burden of an SEC -reviewed offering circular made it unattractive to issuers. Prior to 2012, the SEC receives less than five Regulation A filings per year. With the 2012 overhaul, Regulation A filings typically exceed five filings per week. The other problem with the pre-Regulation A exemption was that the free trading stock had no immediate public market – lack of liquidity. The liquidity problem was partially remedied by The OTC Market Group ("OTC"), the primary quotation system for microcap stocks,[55] creating a market for Regulation A or "Reg A" securities. OTC has two primary trading markets: OX (operating companies that meet "high" quotation standards) and QB (for growing and venture stage companies). The OTC requirements for quoting Reg A securities are:

"Specific OTCQX Rules for Reg. A+ companies
• Current in Reg. A Tier 2 ongoing disclosure requirements [with SEC]
• Annual audit by PCAOB [Public Company Accounting Oversight Board] registered auditor
• File quarterly financials under Form 1-U [with SEC]

OTCQX Qualifications
• Meet $0.10 minimum bid & market value or net income
standards
• No Penny Stocks [as defined by OTC]
• No Shell or Blank-Check Companies
• Common sense corporate governance standards built on
established best practices:
• At least 2 Independent Directors

---

[54]Amendments to Regulation A: A Small Entity Compliance Guide, SEC Division of Corporation Finance, June 18, 2015 (revised February 4, 2019), view at URL: https://www.sec.gov/info/smallbus/secg/regulation-a-amendments-secg#4

[55] OTC QB and QX has surpassed the OTC Bulletin Board (OTCBB) as the primary microcap market for microcap stocks due to lack of FINRA enthusiasm and support for OTCBB. See following URL for a description of OTC QB/QX (OTC Link) and OTCBB: https://www.sec.gov/divisions/marketreg/mrotc

• Audit Committee with Majority Independent Directors"[56]

OTCQB Qualifications

"Current in Reg. A Tier 2 ongoing disclosure requirements
• Reg. A Tier 2 ongoing disclosure meets OTCQB continuing disclosure requirements
• OTCQB - Standards
• Must be current in reporting with US regulator (SEC, Bank) or listed on a Qualified Foreign Exchange
• Annual management certification process to verify officers, directors, controlling shareholders, and shares outstanding
• Minimum bid $0.01"[57]

Issuers eligible to use Regulation A are companies organized in and with their principal place of business in the United States or Canada – including public companies reporting under Section 13 or Section 15(d) of Exchange Act.
"Regulation A is not available to:
• "companies registered or required to be registered under the Investment Company Act of 1940 and BDCs;
• development stage companies that have no specific business plan or purpose or have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies (often referred to as, "blank check companies");
• issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights;
• issuers that are required to, but that have not, filed with the Commission the ongoing reports required by the rules under Regulation A during the two years immediately preceding the filing of a new offering statement (or for such shorter period that the issuer was required to file such reports);
• issuers that are or have been subject to an order by the Commission denying, suspending, or revoking the registration of a class of securities pursuant to Section 12(j) of the Exchange Act that was entered within five years before the filing of the offering statement; and
• issuers subject to "bad actor" disqualification under Rule 262."

Regulation A has two offering tiers: Tier 1, for offerings of up to $20 million in a 12-month period; and Tier 2, for offerings of up to $75 million in a 12-month period (including no more than $15 million on behalf of selling securityholders that are affiliates of the issuer). For offerings of up to $20 million, companies can elect to proceed under the requirements for either Tier 1 or Tier 2.

---

[56] SEC Advisory Committee on Small and Emerging Companies, OTC Markets - Dan Zinn, General Counsel, July 2016, pg. 4, view at URL: https://www.sec.gov/info/smallbus/acsec-071916-otc-zinn-reg-a.pdf
[57] SEC Advisory Committee on Small and Emerging Companies, OTC Markets - Dan Zinn, General Counsel, July 2016, pg. 6.

Under Regulation A, eligible securities are limited to ones specifically enumerated list in Section 3(b)(3) of the Securities Act, which includes warrants and convertible equity and debt securities, among other equity and debt securities. Excluded are asset-backed securities from the list of eligible securities.

"Issuers that conduct a Tier 2 offering should note that Regulation A limits the amount of securities that an investor who is not an accredited investor under Rule 501(a) of Regulation D can purchase in a Tier 2 offering to no more than: (a) 10% of the greater of annual income or net worth (for natural persons); or (b) 10% of the greater of annual revenue or net assets at fiscal year-end (for non-natural persons). This limit does not, however, apply to purchases of securities that will be listed on a national securities exchange upon qualification."[58] There is no limitation on investors in a Tier 1 offering.

As mandated by Section 508 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (Pub. L. No. 115-174, 132 Stat. 1296 (2018)), the SEC amended Rule 251 of Regulation A to allow companies subject to reporting requirements of Section 13 or 15(d) of Exchange Act to use Regulation A and amended Rule 257 of Regulation A to provide that companies that satisfied reporting requirements of Exchange Act also satisfy reporting requirements of Regulation A. SEC notes about terminating reporting obligations with the SEC: "If an issuer terminates or suspends its reporting obligations under the Exchange Act and if the issuer is eligible to suspend its Regulation A reporting obligation under Rule 257(d)(2) by filing a Form 1-Z at that time, then the ongoing reporting obligations under Rule 257 will terminate automatically.12 No Form 1-Z filing will be required to terminate the issuer's Regulation A reporting obligation. If, on the other hand, the issuer is not eligible to file a Form 1-Z at that time, it will be required to commence its Regulation A reporting with the report covering the most recent financial period after that included in any effective registration statement or a filed Exchange Act report."[59]

The SEC provides the following summary of the Form 1-A filing:

"All issuers that conduct offerings pursuant to Regulation A are required to electronically file an offering statement on Form 1-A on the Commission's Electronic Data Gathering, Analysis and Retrieval system (EDGAR). Form 1-A consists of three parts:

- Part I: an eXtensible Markup Language (XML) based fillable form;
- Part II: a text file attachment containing the body of the disclosure document and financial statements; and
- Part III: text file attachments, containing the signatures, exhibits index, and the exhibits to the offering statement.

[58] Amendments to Regulation A: A Small Entity Compliance Guide, SEC Division of Corporation Finance, June 18, 2015 (revised February 4, 2019).
[59] SEC Release No. 33-10591; File No. S7-29-18, Dec. 19, 2018, pg. 6.

a. Part I. Part I of Form 1-A serves as a notice of certain basic information about the issuer and its proposed offering, which also helps to confirm the availability of the exemption. The notification in Part I of Form 1-A requires disclosure in response to the following items:

- Item 1. (Issuer Information) requires information about the issuer's identity, industry, number of employees, financial statements and capital structure, as well as contact information.
- Item 2. (Issuer Eligibility) requires the issuer to certify that it meets various issuer eligibility criteria.
- Item 3. (Application of Rule 262 ("bad actor" disqualification and disclosure)) requires the issuer to certify that no disqualifying events have occurred and to indicate whether related disclosure will be included in the offering circular.
- Item 4. (Summary Information Regarding the Offering and other Current or Proposed Offerings) includes indicator boxes or buttons and text boxes eliciting information about the offering.
- Item 5. (Jurisdictions in Which Securities are to be Offered) requires information about the jurisdiction(s) in which the securities will be offered.
- Item 6. (Unregistered Securities Issued or Sold Within One Year) requires disclosure about unregistered issuances or sales of securities within the last year.

b. Part II. Part II of Form 1-A contains the primary disclosure document that an issuer will prepare in connection with a Regulation A offering, called an "offering circular." Issuers are required to provide financial disclosure in Part II that follows the requirements of Part F/S of Form 1-A, while they have the option to prepare narrative disclosure that follows one of two different formats.[2]

Offering Circular Format. The Offering Circular format is a simplified and scaled version of the narrative disclosure requirements otherwise required to be provided by issuers in registered offerings on Form S-1. In addition to the availability of certain scaled disclosure items, the Offering Circular format is meant to simplify the process by which an issuer prepares its narrative disclosure by limiting the need for issuers to look outside the form for disclosure guidance.

ii. Part I of Form S-1 or Part I of Form S-11 Formats. Part I of Form S-1 and Part I of Form S-11 contain the narrative disclosure requirements for registration statements filed by issuers in registered offerings. In addition to the Offering Circular format, issuers may provide narrative disclosure in Part II of Form 1-A that follows the requirements of Part I of Form S-1 or, in certain circumstances, Part I of Form S-11. While Form S-1 is generally available for all types of issuers and transactions, Form S-11 is only available for offerings of securities issued by (i) real estate investment trusts, or (ii) issuers whose business is primarily that of acquiring and holding for investment real estate or interests in real estate or interests in other issuers whose business is primarily that of acquiring and holding real estate or interest in real estate for investment. Part I of both Form S-1 and Form S-11 generally describes narrative disclosure requirements by cross-reference to the item requirements of Regulation S-K.

iii. Part F/S (Financial Statements). Part II of Form 1-A requires issuers to provide financial statements that comply with the requirements of Part F/S. Part F/S requires issuers in both Tier 1

and Tier 2 offerings to file balance sheets and related financial statements for the two previous fiscal year ends (or for such shorter time that they have been in existence). For Tier 1 offerings, issuers are not required to provide audited financial statements unless the issuer has already prepared them for other purposes. Issuers in Tier 2 offerings are required to include financial statements in their offering circulars that are audited in accordance with either the auditing standards of the American Institute of Certified Public Accountants (AICPA) (referred to as U.S. Generally Accepted Auditing Standards or GAAS) or the standards of the Public Company Accounting Oversight Board (PCAOB). Part F/S requires issuers in both Tier 1 and Tier 2 offerings to include financial statements in Form 1-A that are dated not more than nine months before the date of non-public submission, filing, or qualification, with the most recent annual or interim balance sheet not older than nine months. If interim financial statements are required, they must cover a period of at least six months.

c. Part III. Part III of Form 1-A requires issuers to file certain documents as exhibits to the offering statement. Issuers are required to file the following exhibits with the offering statement: underwriting agreement; charter and by-laws; instrument defining the rights of securityholders; subscription agreement; voting trust agreement; material contracts; plan of acquisition, reorganization, arrangement, liquidation, or succession; escrow agreements; consents; opinion regarding legality; "testing the waters" materials; appointment of agent for service of process; materials related to non-public submissions; and any additional exhibits the issuer may wish to file.

d. Non-Public Submission of Draft Offering Statements. Issuers whose securities have not been previously sold pursuant to a qualified offering statement under Regulation A or an effective registration statement under the Securities Act are allowed to submit to the Commission a draft offering statement for non-public review by the staff. Consistent with the treatment of draft registration statements in registered offerings, a non-publicly submitted offering statement must be substantially complete upon submission in order for staff of the Division of Corporation Finance to begin its review. All non-public submissions of draft offering statements must be submitted electronically via EDGAR, and the initial non-public submission, all non-public amendments thereto, and correspondence submitted by or on behalf of the issuer to the Commission staff regarding such submissions must be publicly filed and available on EDGAR not less than 21 calendar days before qualification of the offering statement.

Qualification. Issuers are only permitted to begin selling securities pursuant to Regulation A once the offering statement has been qualified by the Commission. The Division of Corporation Finance has delegated authority to declare offering statements qualified by a "notice of qualification," which is analogous to a notice of effectiveness in registered offerings."”[60]

For an example of filings by an initial Regulation A issuer (after the reform of Regulation A in 2015) with the SEC, and presented as an example of, and not as model of, Reg A filings is Elio Motors, Inc. – SEC filings at URL:
https://www.sec.gov/edgar/browse/?CIK=1531266&owner=exclude

---

[60] Amendments to Regulation A: A Small Entity Compliance Guide, SEC Division of Corporation Finance, June 18, 2015 (revised February 4, 2019).

(h) Regulation Crowdfunding under Securities Act. There are two kinds of crowdfunding: (1) one where the public agrees to purchase a product or "loan" or "advance" money for development and purchase of a product (think Kickstarter and Indiego); and (2) crowdfunding where the public can purchase the securities of start-up companies. The latter is an "equity" form of crowdfunding. All crowdfunding is conducted online through sponsoring portals.

History. "Statutory Basis. Title III of the Jumpstart Our Business Startups Act1 established equity offering crowdfunding for startup businesses to offer and sell their securities. Under the JOBS Act mandate, the SEC adopted Regulation Crowdfunding2 to implement the JOBS Act mandate. Financial Industry Regulatory Authority ("FINRA") regulates the registration of crowdfunding portals used to offer securities under Regulation Crowdfunding as well as regulate broker-dealers used to make crowdfunding offers.3 Both participating broker-dealers and online funding portals must register with the SEC and FINRA. Regulation Crowdfunding is designed to assist private start-up and very early-stage companies with funding working capital needs.
SEC Summary of Regulation Crowdfunding."[61]

Regulation Crowdfunding allows eligible companies (start-up concerns) to raise capital online, subject to:

- "require all transactions under Regulation Crowdfunding to take place online through an SEC-registered intermediary, either a broker-dealer or a funding portal
- permit a company to raise a maximum aggregate amount of $5 million through crowdfunding offerings in a 12-month period
- limit the amount individual non-accredited investors can invest across all crowdfunding offerings in a 12-month period and
- require disclosure of information in filings with the Commission and to investors and the intermediary facilitating the offering."[62]

The maximum amount allowed to be raised under a crowdfunding offering was increased from $1 million to $5 million under November 2, 2020 amendment.[63]

A Regulation Crowdfunding requires the filing of a Form C with the SEC through the EDGAR online filing system.

SEC Guidance for filing Form C follows:

"Staff Guidance on EDGAR Filing of Form C Updated

---

[61] Regulation Crowdfunding, 24A Securities Pub. & Priv. Offerings (2d. Ed.), by Wm. M. Prifti, updated by Joy Bryan and Paul Richter, §6:36, West Publishing, Egan. Minnesota.

[62] Regulation Crowdfunding, SEC Web Site, Aug. 24, 2022, view at URL: https://www.sec.gov/education/smallbusiness/exemptofferings/regcrowdfunding

[63] SEC Release Nos. 33-10884; 34-90300; IC-34082; File No. S7-05-20, Nov. 2, 2020.

In connection with the effectiveness of certain rule changes as set forth in Release No. 33-10884, the Division of Corporation Finance provides the following guidance with respect to the filing of Form C with the SEC.

The statements in this guidance represent the views of the Division of Corporation Finance. This guidance is not a rule, regulation or statement of the Securities and Exchange Commission. Further, the Commission has neither approved nor disapproved its content. This guidance, like all staff guidance, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person.

EDGAR Filing of Form C for Regulation Crowdfunding Offerings Exceeding $1,070,000

Effective March 15, 2021, a company issuing securities in reliance on Regulation Crowdfunding is permitted under Rule 100(a)(1) to raise a maximum aggregate amount of $5 million in a 12-month period. Before the amendments, the limit was $1.07 million. As of the effective date of the amendments, the changes to the "Offering Information" section of the Cover Page of Form C to permit issuers to indicate an offering amount over $1.07 million had not yet been implemented on the eXtensible Markup Language (XML)-based fillable form available on EDGAR.

Effective May 10, 2021, the changes to the XML-based fillable form have been implemented and issuers are now able to, and must, provide accurate offering amounts in the XML-based fillable form and in the offering document attached as an exhibit to the Form C. An issuer that previously completed the offering amount fields by including $1,070,000 in the XML-based fillable form in reliance on prior staff guidance must update its Cover Page to provide the actual offering amounts if it files an amendment to the Form C after May 10, 2021.

EDGAR Filing of Form C by Crowdfunding Issuers and Crowdfunding Vehicles Jointly Filing a Form C. Beginning March 15, 2021, the use of certain special purpose vehicles ("crowdfunding vehicles") is permitted in Regulation Crowdfunding. Investment Company Act Rule 3a-9 includes conditions for crowdfunding vehicles that are designed to ensure that the vehicle acts solely as a conduit for investments in a crowdfunding issuer. When a crowdfunding vehicle is used, the crowdfunding issuer and the crowdfunding vehicle are co-issuers under the Securities Act and both are required to comply with the requirements of Regulation Crowdfunding and other applicable securities laws.

For background on the use of crowdfunding vehicles, consult the adopting release at https://www.sec.gov/rules/final/2020/33-10884.pdf.

1. Is a crowdfunding vehicle required to file its own Form C, separate from the Form C filed by the crowdfunding issuer?

Response: No. Under Regulation Crowdfunding Rule 203(a)(1), the crowdfunding issuer and crowdfunding vehicle are required to jointly file one Form C, providing all of the required Form C disclosure with respect to the offer and sale of the crowdfunding issuer's securities to the crowdfunding vehicle and the offer and sale of the crowdfunding vehicle's securities to investors.

However, if the crowdfunding issuer is offering securities both through a crowdfunding vehicle and directly to investors, Rule 203(a)(1) requires the crowdfunding issuer to file two Forms C: its own Form C covering the securities offered directly to investors, and a second Form C jointly with the crowdfunding vehicle for the securities offered through such vehicle.

2. Does the crowdfunding vehicle need to have its own filer identification number (called a "Central Index Key" or "CIK" number) and EDGAR access codes?

Response: No. The jointly filed Form C will be filed under the crowdfunding issuer's CIK. However, if the crowdfunding vehicle does have a CIK based on some other filing obligation, the crowdfunding vehicle should disclose the CIK as part of its co-issuer disclosure.

3. What information about the crowdfunding vehicle is required to be provided in the XML-based portion of the Form C?

Response: The XML-based fillable portion of Form C includes the following fields to provide identifying information for the crowdfunding vehicle: name; legal status; jurisdiction of incorporation/organization; date of organization; physical address; and website. All other fields in the XML-based fillable portion of the form should be completed only with information about the crowdfunding issuer and the crowdfunding issuer's securities.

The information required by Form C with respect to the crowdfunding vehicle and its securities should be provided in an exhibit to the Form C. Consistent with the information required with respect to the crowdfunding issuer and its securities, such information may be provided in the optional Question and Answer format included in Form C or in any other format included on the intermediary's platform, including copies of screen shots of the relevant information, as appropriate and necessary. Information about both the crowdfunding issuer and the crowdfunding vehicle may be included in the same exhibit to the Form C.

4. The crowdfunding vehicle and its principal executive officer or officers, its principal financial officer, its controller or principal accounting officer and at least a majority of the board of directors or persons performing similar functions are required to sign the Form C. How should those signatures be provided?

Response: The XML-based fillable portion of Form C only includes fields to provide certain identifying information for the crowdfunding vehicle. Therefore, the crowdfunding vehicle, as co-issuer, should provide the signatures required by Form C in a document filed as an exhibit to the Form C. The signatures should be conformed to the signature requirements of Rule 302 of Regulation S-T.

Examples of conformed signatures:

HERBERT JONES / HERBERT JONES OR HERBERT JONES / HERBERT JONES / CHIEF FINANCIAL OFFICER"[64]

(h) Regulation S under the Securities Act. The SEC adopted Regulation S in 1990 [65] as a safe harbor from the registration requirements of the Securities Act for offshore offers and sales of securities to non-U.S. investors – Regulation S recognizes that foreign sales of securities, the offer and sale, occur outside the U.S. and are not directed at U.S. citizens are extraterritorial and beyond the reach of the Securities Act. The rules under Regulation S are found at 17 C.F.R. §230.901-905.

As noted by one commentator: "Regulation S is generally intended to facilitate two capital-raising scenarios: (i) a U.S. company that issues securities only to foreigners; and (ii) a U.S. investor who enters a foreign market to buy foreign securities. In essence, Regulation S permits these types of transactions, among others, to occur without SEC registration. To issuers and other distributors of securities, raising capital without registration means obtaining funding more quickly, more discreetly and less expensively than would be the case if registration were required. Any mechanism that permits such capital raising, however, is capable of being abused, and Regulation S is no exception. Abuse of Regulation S means that securities are being offered or sold without adequate disclosure to the public, the precise result that Section 5 is designed to prevent. In 1998, the SEC identified several regulatory abuses, and amended Regulation S in an attempt to strike a better balance between providing access to international markets and guarding against unwarranted evasion of Section 5 registration requirements."[66]

The amendments in 1998 provided:

•"equity securities placed offshore by domestic issuers under Regulation S will be classified as "restricted securities" within the meaning of Rule 144, so that resales without registration or an exemption from registration will be restricted; 7
• to avoid confusion between the holding period for "restricted securities"
under Rule 144 and the "restricted period" under Regulation S, the term "restricted period" will be renamed the "distribution compliance period";
• the distribution compliance period for these securities will be lengthened from 40 days to one year;
• certification, legending and other requirements, which currently are applicable only to sales of equity securities by non-reporting issuers, will be imposed on these equity securities;
• as a means to alert purchasers of these equity securities to potential restrictions on hedging their positions in these securities, purchasers will be required to agree that their hedging transactions

[64] Staff Guidance on EDGAR Filing of Form C Updated, SEC Division of Corporation Finance, Nov. 30, 2022, view at URL: https://www.sec.gov/corpfin/announcement/staff-guidance-edgar-filing-form-c
[65] Offshore Offers and Sales, SEC Release No. 33-6863 (1990).
[66] Offerings under Regulation S, by Robert B. Robbins, Pillsbury Winthrop Shaw Pittman, LLP, the American Law Institute, Continuing Legal Education, March 14-16, 2013, pg. 2.

with respect to such securities will be conducted in compliance with the Securities Act, such as Rule 144 thereunder; and
• offshore resales under Rule 901 [17 CFR 230.901] or 904 of equity securities of domestic issuers that are "restricted securities," as defined in Rule 144, will not affect the restricted status of these securities."[67]

6. Practice Points in Federal Securities Law Realm. The following are practice points and highlight of some key issues in private securities offerings under the federal securities laws

(a)(1) Educate new clients from the start of engagement about compliance with federal and state securities for any offer and sale of securities. Under federal and state securities laws and regulations, an offer and sale of securities must be either registered with federal and appropriate state securities regulators or qualify for an exemption from registration in order to be a lawful offer and sale. Use a client letter covering the general requirements of federal and state securities laws with the engagement agreement and send that letter annually to the client. *See: 6(b) below.*

Many violations of federal securities laws results from companies simply not understanding that federal and state securities laws and regulations. Many good business and even securities lawyers get into trouble by assuming what is "public", "private" and "limited" without an consideration of the applicable laws, rules, regulatory guidance, current regulatory enforcement posture, case law and common practices. Yes, of course, some securities offerings are obviously one kind or another kind – like a registered public offering to general public – but there are many instances where the determination is not simple.

Practitioners should counsel new clients at the start to seek legal counsel whenever the client is contemplating any funding offering involving investors and to do so prior to taking any steps to solicit or identify prospective investors. This precaution can prevent violations of law or rules. Remember an offer or solicitation of investors can violate a proposed safe harbor exemption from registration of an offering or constitute an outright violation of law.

Further, practitioners should counsel new clients that "regulated securities" is a broad category – it is more than stock and bonds. Options, rights, warrants, puts, convertible promissory notes, even promissory notes that are not commercial paper and investment contracts (a very broad, catch all category) can be regulated securities. General solicitation and general advertising to locate investors is also banned for many safe harbor private securities offerings exemptions. General solicitation and general advertising is a broad in scope:

"A solicitation that conditions the market for an offering of securities is generally viewed as a general solicitation that is marketing the securities. Examples include: newspaper and magazine advertisements; unrestricted public websites; TV and radio broadcasts; podcasts; and seminars" (excepting demo days under SEC Rule 148 (17 C.F.R. §230.148)).[68]

---

[67] SEC 33-7505; 34-39668; FILE NO. S7-8-97, Feb. 18, 1998, view at URL: https://www.sec.gov/rules/final/33-7505.htm
[68] General Solicitation, SEC, April 28, 2022, view at URL: https://www.sec.gov/education/capitalraising/building-blocks/general-solicitation

Also, safe harbor private offering exemptions like Rule 506 require a pre-existing relationship between issuer and investor as of the date of sale of the securities. "Preexisting relationship" is generally: "A "pre-existing" relationship is formed before the start of the offering or is established through a broker-dealer or investment adviser prior to that investment professional's participation in the offering. A "substantive" relationship is formed when the entity offering securities (i.e., the company or its broker-dealer or investment adviser) has sufficient information to evaluate and evaluates a potential investor's status as an accredited investor." [69]

A demo day under Rule 148 is an event sponsored by a qualified third party ("Sponsor") with multiple participants and complies with: "Sponsor of the event is a college, university, state or local government, nonprofit organization, angel investor group, incubator, or accelerator. Sponsor is limited in its role outside of serving as the event host. Advertising for the event does not reference any particular securities offering. Information about the offering shared during the event is limited to notification of planned or ongoing offering, type and amount of securities being offered, intended use of the proceeds, and unsubscribed amount." [70]

With respect to a private offering, a "private" securities offering is an offering not involving a "public" offering – neither "public" nor "private" is defined by a bright line definition in federal laws or rules. Neither Congress nor the Securities and Exchange Commission ("SEC" or "Commission") wanted to be trapped by static definitions. Obviously, a registered offering under Section 5 of the Securities Act being made to the general public is a "public" offering, but the clarity vanishes for many funding raising efforts.

Section 4(a)(2) of the Securities Act provides that the Securities Act does not govern "transactions by an issuer not involving any public offering" and nothing more. "Issuer" is "every person who issues or proposes to issue any security" (with "person" including any entities and "issue" referring to an initial distribution of the security – not the resale by an investor) (Section 2(a)(4) of Securities Act).

As noted by Professor Louis Loss: "These nine words [in Section 4(a)(2)] support a substantial gloss" and the legislative history for Securities Act provides little guidance on the issue other than that the private offerings are ones where there is no practical need for the protections of the Securities Act or where the benefits of the protections of the Securities Act are too remote to justify. [71] Professor Loss adds that "The administrative construction was early set in an opinion [in 1935] of the SEC General Counsel to the effect that the determination of whether a particular transaction involves a public offering depends not on any one factor but on all the surrounding circumstances. [108] Apart from the number of offerees, important factors are their relationship to each other and to the issuer, the number of units offered, and the manner offering." [72]

---

[69] General Solicitation, SEC, April 28, 2022, view at URL:
https://www.sec.gov/education/capitalraising/building-blocks/general-solicitation
[70] General Solicitation, SEC, April 28, 2022, view at URL:
https://www.sec.gov/education/capitalraising/building-blocks/general-solicitation
[71] Fundamentals of Securities Regulation, 5th Edition, by Louis Loss and Joel Seligman, Aspen Publishers, New York, new York, 2004, pg. 395.
[72] *Ibid.* Footnote in Quote: 108 Sec. Release 33-285 (1035).

(a)(2) Know Your Fish. Counsel your clients never to speak to a securities regulator, SEC or state, without consulting competent legal counsel and having that legal counsel involved in the communications with regulators.

Overkill? No. Companies' officers and directors do not know how to deal with securities regulators and when they tell you that they do know how to deal with securities regulators, especially enforcement attorneys, you know your client is delusional. Remember the old adage that a lawyer who represents himself in a legal matter "has a fool for a client." Same applies to big ego officers and directors in the context of dealing with securities regulators, especially enforcement persons.

If you do not fully understand the legal arena and rules and the mission of the securities regulator, you cannot know how to effectively deal with the securities regulator. Further, a lawyer needs to assess the nature and purpose of any regulatory inquiry and potential consequences before responding to a regulatory inquiry.

Securities regulators are either a compliance examiner of an enforcement.

Examiners or compliance staff attorneys understand the law and rules and can be reasoned with to a certain extent on issues of compliance and interpretation. Reasonable people – usually. However, all examining attorneys, especially at the SEC, are trained to refer any suspicion of securities violations to enforcement and do so without any warning to the suspected violators. Whether enforcement does anything with a referral or when enforcement will act are unknowns – sometimes the response is months later. So, be very careful in what you say to a examining or compliance staff attorney. Hence, the need for a lawyer even at this seemingly innocent interaction with examining or compliance staff attorney and regardless of how routine it seems to be.

Enforcement attorneys – SEC enforcement, state securities agency enforcement (in some states, that is the State Attorney General), DOJ enforcement staff attorneys, and US District Attorney staff attorneys are like Northern Pike or a Shark – they have the cold look and attitude of hunters eager to eat the 'guppy' victims in their sights. One compliance staff attorney at a regulator once said (off record): "Enforcement lawyers do not understand the law and that ignorance does not bother 'em at all." An exaggeration – but has a kernel of truth: enforcement is all about enforcement and the law is only at issue if it affects the odds of prevailing at trial or in a proceeding. When speaking to enforcement creatures, a lawyer is best beast for the task. Same species at least.

A client may say: "Having a lawyer present or involved only makes it look like we have something to hide." Complete Nonsense. Any experienced regulator staff attorney, compliance or enforcement, understands why the lawyer is involved and often welcomes the lawyer's presence and involvement – if only because it is a check on the client's ill-advised or often ignorant responses to inquiries. Over the years, I have seen repeated instances where a corporate officer completely mishandled a simple, very informal inquiry from a regulator and that incompetence led to informal investigation, then formal investigation and then enforcement action. One instance, and not a client: an officer of a corporation told a state compliance staff attorney that he did not have time to respond to a simple, non-threatening letter inquiry about whether the company was conducting a private placement in the state. The result was an informal investigation – you cannot blow off regulators. A

matter that a lawyer could have handled for a fee equal to a two hours of work and a call ended up costing over $150,000 in lawyer fees to handle and end the informal investigation.

An SEC or state investigation can take months or longer to complete. While pending, the existence of an investigation can constitute a breach of contracts (like covenants in loan agreements), prevent or suspend funding efforts (as an investigation is definitely a material fact requiring disclosure to investors for the offering), prevent or suspend corporate transactions (like a merger, acquisition, joint venture, going public offering, reorganization) and divert valuable corporate resources to dealing with the investigation. When it is done, if no violations of laws, then there is no "No Problem/Get out of Jail" card – just a simple "we have no further inquiries at this time."

Wells Submission. If SEC Division of Enforcement finds a basis for an enforcement action, it presents the matter and its recommendations to the SEC Commissioners for authorization of an enforcement action. Unless the circumstances dictate against doing so, SEC allows the subjects of the proposed enforcement action to make a non-public, written rebuttal of the SEC Division of Enforcement's findings of a basis for an actionable violation, which rebuttal is called a "Wells submission." A "Wells Notice" is the document sent by the SEC to the subject or subjects of an investigation stating the intent and basis for seeking an enforcement action. The Wells submission is considered prior to any authorization of an enforcement action.

The Wells Notice does not always result in the SEC Commissioners approving and launching an enforcement action (but often does result in one being commenced) and the recipients of the Wells Notice have an opportunity to submit a written response on why the SEC should not commence an enforcement action (See: Commencement of Enforcement Proceedings and Termination of Staff Investigations, SEC Securities Act Release No. 5310 Fed. Sec. L. Rep. (CCH) ¶ 79,010 (Sep. 27, 1972), codified at 17 C.F.R. §202.5(c)).

The Wells Notice and its process are described as:[73] "The Wells Process. Receipt of a Wells Notice is but one of several steps that typically occur on the path from the commencement of an investigation by the SEC Staff to the initiation of an enforcement action by the commission. Typically, the staff issues a Wells Notice and the prospective defendant prepares, in response, a Wells Submission, a progression known as the "Wells process" and codified in the SEC's procedural rules. Through a Wells Notice, the staff informs the subject of an investigation that the staff has completed its investigation and is considering recommending an enforcement action to the commission. The Wells Notice invites the subject to prepare a "Wells Submission," a statement that seeks to dissuade the staff from making such a recommendation to the commission, or seeks to convince the commission not to approve such a recommendation, by setting forth the prospective defendant's legal and factual arguments concerning a potential enforcement action. During and after the Wells process, the company may meet with members of the staff and, at the staff's discretion, hear about some of the facts and evidence obtained by the SEC... At this stage, neither the staff nor the commission has made a determination to

---

[73] "Ruling on Disclosure of Wells Notice under Federal Securities Laws," by Bradley J. Bondi, Martin L. Seidel and Nathan Bull, Cadwallader Wickersham & Taft, Published in New York Law Journal, Vol. 248, No. 24, view at URL: https://www.cadwalader.com/uploads/books/f8d2d8c729ff2fb090a3d2ab01c4a708.pdf,

recommend, much less proceed with, an enforcement action. Rather, "under [the Wells process], a prospective defendant or respondent enjoys due process" and is afforded an opportunity to be heard before the staff and the commission before any such decision is made….Failing a change of heart by the staff, the commission meets in a closed meeting to hear the recommendation by the staff, and ask questions of the staff, before taking a vote on the recommendation. Even if the commission votes to proceed with an enforcement action, it is not uncommon for a subject to nevertheless avoid litigation through a negotiated settlement."

(b) Never do securities offering work without a written engagement agreement and an accompanying memo to client about "responsibilities of company and management" in private securities offering. The liability in handling a private securities offering is too high to not use and insist on a written engagement agreement that clearly states what the lawyer will do and will not do (e.g. never sign filings or offering documents for a client; do not act as a promoter; do not be an officer or director; do not invest in offering (how can you be legal counsel and an investor at the same time?; never do financials or footnotes to financials-the numbers are strictly the duty of issuer and accountants).

The letter accompanying the engagement agreement should state: (1) what kind of offering is being made and the duties and liabilities of issuer and management in respect of the offering being contemplated; (2) summary of filing obligations for, and any ongoing filing or reporting duties stemming from making, the securities offering; (3) summary of potential liabilities under federal and state laws for misstatements or omissions of material facts in offering documents; (4) limitations on legal representation and services – especially, the only legal opinion provided is validity under state law of securities being issued and that opinion should ideally, but is often not, written by a lawyer licensed in the incorporation domicile of the issuer; and (5) list of recommendations of "do and do not" in respect of conduct of securities offering (e.g. promotional activities, record keeping, investor relations).

(c) Use a Private Placement Memorandum or "PPM" for securities offering even if not required. Not all exemptions for private offerings require a private placement memorandum or "PPM" or equivalent – under either federal or state laws. Nonetheless, a PPM is advised in all private offerings in order to avoid confusion or controversy over what was represented to investors by the issuer, management and promoters. The better rule of practice is to use a PPM and send it to all investors to ensure uniformity of representations.

When using a PPM, a practitioner must ensure that all senior officers and directors (or equivalent persons) read the PPM, edit/correct the PPM and then sign a simple acknowledgement of having received and reviewed the PPM. The PPM is the responsibility of the issuer and its management – unless a practitioner is making statements in the PPM as an expert or express legal opinion, the practitioner is not responsible for the PPM, but the practitioner must ensure that the reality and record reflect that the PPM is the result of issuer management's input, review, editing, and approval for use in raising money. A practitioner should not fall into being the "fall guy".

Further, a practitioner has to ensure that issuer management provides the disclosures required. In the PPM – and the engagement agreement should contain an acknowledgement and agreement by issuer to provide necessary disclosures and to review and approve the PPM.

Use of management and issuer questionnaires is a necessity in order to assist in drafting a PPM as well as establishing a paper trail of issuer and management verifying and providing material information for PPM.

Investor questionnaires are also necessary. A completed and signed investor questionnaire needs to be carefully examined. For a Rule 506(b) offering, supporting documentation for an investor questionnaire may be required to support the "reasonable belief" the investor is accredited or sophisticated. It is better to lose a prospective investor who refuses to provide a completed, signed investor questionnaire or provide supporting documentation than creating evidence that the client failed to comply with safe harbor rule requirements.

One area that almost always requires supporting documentation is when the prospective investor claims being "accredited" on the basis of net worth. An issuer cannot simply rely on a completed, signed investor questionnaire in such situations.

Also, under Rule 506, the issuer should have a substantive relationship with the investor prior to sale of the securities in order to ensure that the investor has the necessary sophistication and experience to understand the risks of the investment – which attributes can be attained by a assistance of a personal representative (like an investment advisor, financial planner, broker dealer). Fortunately, under a rule change, the relationship needs to exist at the time of investment and not for 90 days or some other period prior thereto.

(d) Remember – All Offers and Sales (issuances) of Regulated Securities Require Compliance Review. The offer as well as the sale of all regulated securities are regulated under federal and state securities laws. Even large companies sometimes forget this basic rule that compliance is required for all offers and sales (which includes issuance for anything of value).

Example: Google, Inc., a major corporation with top level legal counsel, was forced by SEC in 2004 to rescind the pre-IPO issuance of stock options to a large number of employees because the offer and issuance was made without any compliance with federal and state securities laws. Stock options are regulated securities. The SEC could have imposed harsher remedies on Google, Inc. than just a rescission of the issuance – which costs Google, Inc. a few million to effect. See: Google, Inc. Rule 424 Prospectus/Offering Circular, dated Nov. 23, 2004, SEC File Number: 333-117934, view at URL: https://www.sec.gov/Archives/edgar/data/1288776/000119312504204864/d424b3.htm

With respect to compliance for offers as well as sales:

(i) The U.S. Supreme Court from the landmark *SEC v. WJ Howey* case: "The Securities Act prohibits the offer as well as the sale of unregistered, non-exempt securities.[6]" S.E.C. v. W.J. Howey Co., 328 U.S. 293, 301, 66 S. Ct. 1100, 1104, 90 L. Ed. 1244 (1946). Footnote 6: The registration requirements of s[ection] 5 [of Securities Act of 1933] refer to sales of securities. Section 2(3) defines 'sale' to include every 'attempt or offer to dispose of, or solicitation of an offer to buy,' a security for value.

(ii) Section 10(b) and Rule 10b-5 under the Securities Exchange Act of 1934 ("Exchange Act") is the federal "catch all" fraud provision and provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly --
"(1) to employ any device, scheme, or artifice to defraud, or
"(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 48 Stat. 84, as amended, 15 U. S. C. §77q (a).

(e) Clients do not like to spend money on securities offering legal compliance – Cure them of their misguided "Penny Wise – Very Pound Foolish" Affliction. Clients often violate securities laws in securities offerings because they either do not want to pay the legal cost of compliance or simply do not understand the need for compliance. The need for compliance is covered by several practice points in this Section 6. Practitioners need to educate the clients on the cost of non-compliance – as follows:

Cost of Litigation. The cost of defending a securities fraud civil lawsuit by shareholders in federal court often exceeds several hundreds of thousands of dollars prior to trial. Legal fees in the millions are common in defending a federal class action lawsuit. State securities civil lawsuits by shareholders are also very expensive. Since the liability in certain securities fraud claims can be personal for defendant officers and directors (i.e. a judgment can be satisfied against insiders' personal assets) and the total cost of litigating and damages in a losing cause can bankrupt a company, paying a lawyer to do the legal compliance for securities offerings is a bargain.

Further, intentional violation of federal and state securities law can create criminal liability. Although I hear the federal prison camps (where most white collar felons go) are like community colleges with fences, no jail if fun for 2 to 5 years. Connecticut court sentenced a chief financial officer to 10 years for intentionally violating state compliance laws for private securities offerings.

Litigation is also public information – it can ruin a company's public reputation as well as ruin the public reputation and careers of defendant officers and directors – and do so even if defendants prevail at trial.

Barred from Service as an Officer or Director. In SEC enforcement actions, SEC can bar a person from affiliation with a public company for a specified number of years or impose a permanent bar for certain securities law violations as well as impose civil penalties. Prior to 1990, SEC sought officer and director bars as part of equitable relief. With passage of Securities Enforcement Remedies and Penny Stock Reform Act in 1990 (Public Law 101-429, Oct. 15, 1990), SEC had express statutory authority. Sarbanes Oxley Act of 2002 [74] lowered standard for obtaining an officer and director service bar (Section 305) and authorized SEC to issue officer and director service bar as part of cease and desist order without court order (Section 1105).

[74] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified at 15 U.S.C. §§ 7201-66).

SEC enforcement actions can take 2 forms [Emphasis added by presenter]:

[1] "Civil action: The Commission files a complaint with a U.S. District Court and asks the court for a sanction or remedy. Often the Commission asks for a court order, called an injunction, that prohibits any further acts or practices that violate the law or Commission rules. An injunction can also require audits, accounting for frauds, or special supervisory arrangements. In addition, the SEC can seek civil monetary penalties, or the return of illegal profits (called disgorgement). **The court may also bar or suspend an individual from serving as a corporate officer or director**. A person who violates the court's order may be found in contempt and be subject to additional fines or imprisonment.

[2] Administrative action: The Commission can seek a variety of sanctions through the administrative proceeding process. Administrative proceedings differ from civil court actions in that they are heard by an administrative law judge (ALJ), who is independent of the Commission. The administrative law judge presides over a hearing and considers the evidence presented by the Division staff, as well as any evidence submitted by the subject of the proceeding. Following the hearing the ALJ issues an initial decision that includes findings of fact and legal conclusions. The initial decision also contains a recommended sanction. Both the Division staff and the defendant may appeal all or any portion of the initial decision to the Commission. The Commission may affirm the decision of the ALJ, reverse the decision, or remand it for additional hearings. Administrative sanctions include cease and desist orders, suspension or revocation of broker-dealer and investment advisor registrations, censures, **bars from association with the securities industry**, civil monetary penalties, and disgorgement."[75]

A summary of officer and director bar: "Federal law permits the SEC to seek a variety of remedies in their fraud enforcement cases. Among the tools in its arsenal, the SEC may obtain a court order enjoining an individual from serving as an officer or director of a public company if the person demonstrates "unfitness" to serve as an officer or director. Such an order is called an "O&D bar." The test for unfitness turns on multiple factors: (1) the egregiousness of the violation; (2) whether the defendant profited from the alleged improper acts; (3) the defendant's history of securities law violations; (4) the defendant's degree of scienter (i.e., knowledge of wrong-doing); and (5) the likelihood that the defendant will commit future violations. See, for example, SEC v. Patel, 61 F.3d 137, 141 (2d Cir. 1995). Although this fact-specific inquiry results in a spectrum of varying degrees of unfitness, the SEC typically seeks O&D bars of only two durations—a five-year bar or a permanent bar." [76]

For instance:

- "Without admitting or denying the allegations of the complaint, Jackson and 420 Real Estate consented to the entry of final judgments permanently enjoining them from violating the registration provisions of Section 5 of the Securities Act of 1933, the

---

[75] How Investigations Work, SEC Division of Enforcement, Jan. 27, 2017, view at URL: https://www.sec.gov/enforcement/how-investigations-work

[76] Law & Liability: Officer & Director Bars in the Current Financial Crisis, by R. Daniel O'Connor and Annmarie A. Tenn, Ropes & Gray, LLP, *Directors Monthly*, Publisher: National Association of Corporate Directors, Feb. 2009.

> antifraud provisions of Section 17(a) of the Securities Act, and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Jackson also consented to the entry of an officer and director bar. The judgments order: (i) a civil penalty of $360,000 against Jackson; (ii) disgorgement including prejudgment interest of $306,913 against Jackson; and (iii) disgorgement including prejudgment interest of $477,420 against 420 Real Estate and Jackson on a joint and several basis." SEC Obtains Final Judgments Against Crowdfunding Issuer and Its CEO Litigation Release No. 25407/June 2, 2022; Securities and Exchange Commission v. Robert Samuel Shumake, Jr., et al, No. 21-cv-12193 (E.D. Mich. filed September 20, 2021).

See also: Misconduct and Fraud in Unregistered Offerings: An Empirical Analysis of Select SEC Enforcement Actions, Rachita Gullapalli, Division of Economic and Risk Analysis (DERA) U.S. Securities and Exchange Commission, August 2020, view at URL: https://www.sec.gov/files/misconduct-and-fraud-unregistered-offerings.pdf

Educate the client when explaining legal fees – of course, within the parameters of applicable state bar ethical codes and canons.

Cost of SEC or State Securities Agency investigation. Lack of legal counsel in a private securities offering can lead to non-litigation/non-enforcement woes.

The SEC and a state securities agency can commence an investigation of a company based solely on a complaint from the public, regulator review of internet postings, suspicious news reports, unusual stock trading (for public companies), or review of SEC filings results in a referral to enforcement by an examining staff attorney. Investigations can be informal inquiries. An informal investigation can lead to a formal investigation.

While the investigations are conduct privately, once an investigation becomes a formal investigation, the company, even if it did not violate any laws or rules, will be subjected to inquiries, subpoenas and depositions that are costly (in legal fees and sheer compliance costs – a company should always have legal counsel to properly handle an investigation), time consuming, a major distraction from running the business and may reveal serious violations of law in one or more areas (which violations will be referred to appropriate authority for possible prosecution or enforcement action). Keeping regulators out of the corporate closets should be a major goal of any company.

Engaging legal counsel for securities offering compliance is one way to seek to ensure that conduct of a private securities offering will, if subject of a regulatory inquiry, keep from spinning into a formal investigation.

Case Study - chief executive officer of a company called seeking legal counsel – FBI showed up at his home and offices with subpoenas and are carting away company files and computers – his neighbors have formed an audience at his residence to watch FBI agents (with the jackets with "FBI" in bright yellow letters on the back) cart off boxes and computers. Raid was result of the company not properly handling an informal investigation by SEC of an private offering of stock – an informal investigation prompted by an investor complaint. The SEC launched a formal investigation that spiraled into a joint DOJ investigation and company, without counsel, continued to have "issues"

dealing with regulators. That is how you get the FBI amusing your neighbors and stressing out your employees. It all started with not paying counsel to handle the private securities offering and the regulators.

(f) Remember - Anti-Fraud Laws apply to all offers and sales of regulated securities; Materiality. There is no exemption from federal and state anti-fraud laws and regulations. Anti-fraud laws punish mispresenting or omitting a "material" fact in the offer or sale of the securities. "Material" means (under case law – there is no statutory definition) a fact that a reasonable investor would consider important in making a decision to buy, sell or hold a regulated securities. This is a practical definition. *See: Basic, Inc. v. Levinson*, 485 U.S. 224, 240 (1988); *TSC Industries Inc. v. Northway, Inc*., 426 U.S. 438, 449 (1976). Materiality is a mixed question of law and fact.

Anti-fraud securities laws apply to offers and sales of securities that **are not** and are regulated under the federal or state securities laws.

Liability does not lie with immaterial misrepresentations unless the cumulative effect of immaterial misrepresentations constitutes the same effect as a material misrepresentation or omission.

General expressions of optimism that are clearly not a representation of "fact" often avoid being labelled as "material" if the total mix of information is not significantly altered. "A misrepresentation or omission of information is material if there is a substantial likelihood that a reasonable investor would consider the information to have significantly altered the total mix of information about investing in the company. *ABC Arbitrage Plaintiffs Group v. Tchuruk,* 291 F.3d 336, 361 (5th Cir.2002). "[G]eneralized, positive statements about the company's competitive strengths, experienced management, and future prospects are not actionable because they are immaterial." *Rosenzweig v. Azurix Corp.,* 332 F.3d 854, 869 (5th Cir.2003). "Vague, loose optimistic allegations that amount to little more than corporate cheerleading are 'puffery,' projections of future performance not worded as guarantees, and are not actionable under federal securities law because no reasonable investor would consider such vague statements material and because investors and analysts are too sophisticated to rely on vague expressions of optimism rather than specific facts." *In re Sec. Litig. BMC Software, Inc.,* 183 F.Supp.2d at 888. The Court finds Statements 11–13, *supra,* and Statements 14–15, excerpted below, to be mere vague expressions of corporate optimism, and thus dismisses with prejudice Plaintiffs' claims to the extent they are premised on these statements (*In re Blockbuster Inc. Sec. Litig.*, No. 3:03-CV-0398-M, 2004 WL 884308, at *7 (N.D. Tex. Apr. 26, 2004)).

Pharmaceutical companies are often sued over optimistic statements about clinical trial results and courts have often (not always) refused to hold those companies liable. Also, note: "Material information only needs to be disclosed if its omission would "affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists." *Brody v. Transitional Hosps. Corp*., 280 F.3d 997, 1006 (9th Cir. 2002). "But 'once defendants cho[o]se to tout' positive information to the market, 'they [are] bound to do so in a manner that wouldn't mislead investors,' including disclosing adverse information that cuts against the positive information." *Schueneman v. Arena Pharm., Inc*., 840 F.3d 698, 706 (9th Cir. 2016) (alterations in original) (quoting *Berson v. Applied Signal Tech. Inc.,* 527 F.3d 982, 987 (9th Cir. 2008))." *Pardi v. Tricida, Inc*., No. 21-CV-00076-HSG, 2022 WL 3018144, at *4 (N.D. Cal. July 29, 2022).

Those lawsuits fail over materiality issue as well as, in Section 10(b)/Rule 10b-5 under the Exchange Act claims, failure to plead with particularity the element of scienter (*Arkansas Pub. Emps. Ret. Sys. v. Bristol-Myers Squibb Co.*, No. 20-3716-CV (2d Cir. Mar. 11, 2022)) or failure to establish that statements were false (*In re FibroGen, Inc. Securities Litigation*, No. 21-cv-02623-EMC (N.D. Cal. July 15, 2022).

(g) Substance over Form. Like tax law, technical compliance with legal requirements in securities laws does not protection actions from liability if the substance or intent is to violate the law. In a securities offering exemption, technical compliance will not preserve the exemption if the intent of the transaction is to [improperly] evade the registration requirements of Securities Act.

(h) Always do the Initial Analysis - Is the investment a regulated security? There is no single bright line, universal definition of what investments or instruments are regulated securities. While federal and state statutes define a regulated "security," the statutory definition is merely a starting point – they define what are commonly understood to be regulated securities (e.g. common stock, preferred stock, convertible debentures, bonds). The universe of "regulated securities" is broad and expanding. *Wall Street* comes up with new investment schemes and financial instruments on a regular basis. A practitioner always needs to do a case by case analysis of proposed investment schemes and the SEC enforcement powers are broad. The state securities regulators have their own securities laws and rules and they are also active in enforcement, especially the Texas Securities Board and some of the other larger states' securities agencies.

Section 2(a)(1) of the Securities Act defines a "security" as any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, **investment contract**, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. [*Emphasis inserted by presenter*]

"Investment contract" in this statutory definition is the "catch all" category – what is an "investment contract" is determined by reference to court created tests – the main test being found in *SEC v. W.J. Howey* (328 U.S. 293 (1946), 66 S.Ct. 1100, 90 L.Ed. 1244, 163 A.L.R. 1043). Under *Howey*, an investment contract is:

"An "investment contract", as used in the Securities Act, means a contract, transaction, or scheme whereby [1] a person invests his money in [2] a common enterprise and is led to [3] expect profits [4] solely from efforts of promoter or a third party, it being immaterial whether shares in enterprise are evidenced by formal certificate or by nominal interests in physical assets employed in enterprise. Securities Act of 1933, §2(1), 15 U.S.C.A. §77b(1) (*SEC v. W.J. Howey Co*., 328 U.S. 293, 66 S. Ct. 1100, 90 L. Ed. 1244 (1946)). In this definition, which is still today the foundational test for determining when an instrument is a regulated security, "money" has been interpreted include

anything of ascertainable value; “solely” means “primarily” and “primarily” is broadly defined and “common enterprise” is broadly defined (as cryptocurrency promoters have discovered.

Not all securities are subject to regulation under federal and state securities laws and regulations. Section 3 of the Securities Act sets forth securities not subject to regulation under the federal and state securities laws and regulations. Again, anti-fraud securities laws apply to offers and sales of securities that are not regulated under the compliance and disclosure provisions of federal and state securities laws and regulations.

Securities that are not regulated are deemed to present such a low level of risk to investors that the regulatory regime is not needed or would be unfairly burdensome with no real benefit – for instance, securities issued by and backed by full faith and credit of U.S. Government. Some securities are regulated by other, non-securities agencies – like banks (not bank holding companies). Some securities are not regulated for public policy reasons.

(i) Determination of when a sale of security occurs. Determining when a sale of a regulated security occurs is important for timely compliance with federal and state securities laws. A sale can occur when a check is accepted (even if not deposited) or a legally binding agreement to purchase is signed. When there is a legal obligation to purchase the securities, there may exist a “sale”.

Better Rule of Practice: Regard the date of the creation of a legal obligation to purchase securities or tender of payment for securities as “date of sale.”

(j) Federal securities laws are based on adequate disclosure of “material” information about the company offering its securities and those securities to investors in order to allow the investor to make an informed decision about purchasing, selling or holding a security.

The Securities Act was the initial legislation for federal regulation of securities and its focus is the initial offer and sale of securities by the issuing company or “issuer” and its agents to investing public. There was a debate at the time of the enactment of the Securities Act about whether to base the act on a mandatory disclosure system – one that believes that requiring public disclosure of material information about the issuer and its offered securities is adequate to protect the investing public – and an opposing, New Deal inspired philosophy that the federal government should be enabled to determine the merits of an issuer and offering of securities for investors – the merit review standard employed by states securities laws of several states. The disclosure only form of regulation was adopted by the Securities Act and Securities Exchange Act of 1934 – the two foundations of federal securities regulation.

As an SEC former Commissioner noted: “The idea of "merit regulation" -- that some securities simply shouldn't be sold to anyone even if they want them -- exists in the regulatory schemes
in some states, but is not part of the plan under the federal securities laws. Nonetheless, when the Commission applies its full disclosure mandate to small issuers, it may begin to look a little bit like merit regulation, and hence the Commission in certain instances may find itself on the "fringes" of

merit regulation….”[77] “[T]he Commission does not endorse the idea of "merit regulation," but usually relies on disclosure. I see no need to depart from that principle here. In a recent review of Commission enforcement remedies, one commentator noted that Congress I affirmation of the use of a system of disclosure to bring about responsible corporate conduct.”

The lack of merit review is demonstrated by the SEC approving an initial public offering or “IPO” by a brothel in 1989 – Mustang Ranch, Inc.[78] If the business is lawful in the state in which the issuer is located – here, Nevada – then the business has met the minimum requirement of eligibility for an IPO under federal securities laws. The Mustang Ranch, Inc. offering was blocked by some states because the business was illegal in those states. The SEC has approved other IPO’s by companies with objectionable or questionable business lines.

States also require disclosures as part of its regulatory regimes, but some states adopt a merit review for certain securities offerings – mostly public securities offerings and Regulation A securities offerings. This difference between the federal regulatory regime and some state regulatory regimes is explained by one commentator on the origin of U.S. federal-state system of regulation: “Currently, a two-tier system for the regulation of securities sales exists. At the federal level, there is the Securities Act of 1933 and the Securities Exchange Commission (SEC).[2] At the state level, some thirty-six states, two territories and the District of Columbia[3] have adopted the Uniform Securities Act [4] (hereinafter USA). The two-tier system exists because the Securities Act of 1933 specifically provides that state securities laws are not preempted by that Act.[5] Because of the absence of preemption, registration compliance at the federal level is not necessarily compliance with the state "blue sky" laws.[6] However, some states have adopted a position that if the SEC approves a registration, then that registration is approved for state purposes.[7] These states have voluntarily relinquished their regulatory rights in favor of federal standards for registration. [8] Other states[9] not only require SEC approval (at least impliedly), but their regulation goes even further than the SEC disclosure standards. These stricter states review potential offerings for their quality.” [79]

Merit review under state securities laws is not covered by this presentation, but you should be aware that merit review standards are based on guidelines, some of which rely on North American Securities Administrators (“NASAA”) guidelines for merit of offerings and issuers (in whole or in part) as well as state developed guidelines. Some merit review states can be difficult to obtain approval of a securities offering subject to merit review. As a result, some “national” IPO’s do not sell in certain states.

---

[77]“ Small Issuer Disclosure Policy and the Fringes of "merit regulation" - Remarks To Nineteenth Annual Rocky Mountain State-Federal-Provincial Cooperative securities Conference,” by Christopher Cox, SEC Commissioner, Oct. 3, 1985, pg. 6, view at URL: https://www.sec.gov/news/speech/1986/100386cox.pdf

[78] “Home State Sale Approved for Mustang Ranch Stock,” AP News, April 4, 1989, view at URL: https://apnews.com/article/454648c0105e4306edc0537cd84b4450

[79] Federalism to an Advantage: The Demise of State Blue Sky Laws Under the Uniform Securities Act,” by Marianne M. Jennings, Bruce K. Childers and Ronald J. Kudla, Akron Law Review: Vol. 19: Iss. 3 , Article 3, 1986, pp. 305-396, available at: https://ideaexchange.uakron.edu/akronlawreview/vol19/iss3/3

Many financial instruments or investment opportunities are regulated securities requiring federal and state securities law compliance. Clients and sometimes their lawyers fail to recognize that an effort to raise money involves regulated securities. The universe of securities regulated under federal and state securities laws extends beyond stock and bonds. "Investment contracts" is a catch-all classification of a kind of regulated security. Under the landmark case of *SEC v. WJ Howey* (328 U.S. 293, 1946), the Supreme Court developed the well-known and still used "Howey Test" for determining if an investment contract is a "security" under securities laws. Howey involved. The sale of interests in orange groves. The Supreme Court held that these interests were investment contracts regulated under securities laws and that the characteristics of the investment that caused this holding were:

"where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of someone other than themselves" (SEC v WJ Howey, 328 U.S. 293, 298 (1946)).

Over the years, the Courts have reduced the "solely" element to a test of whether there was any substantial reliance and have interpreted "money" element to be an investment of anything of tangible value. The Courts have allowed the SEC to adopt a very "liberal" interpretation of Howey Test to assert existence of a regulated security. The following text from the *Howey* decision is worth consideration and explains in part the 'flexible' application of the Howey Test:

Thus all the elements of a profit-seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed. The investment contracts in this instance take the form of land sales contracts, warranty deeds and service contracts which respondents offer to prospective investors. And respondents' failure to abide by the statutory and administrative rules in making such offerings, even though the failure result from a bona fide mistake as to the law, cannot be sanctioned under the Act.

*This conclusion is unaffected by the fact that some purchasers choose not to accept the full offer of an investment contract by declining to enter into a service contract with *301 the respondents. The Securities Act prohibits the offer as well as the sale of unregistered, non-exempt securities.6 Hence it is enough that the respondents merely offer the essential ingredients of an investment contract.*

We reject the suggestion of the Circuit Court of Appeals, 151 F.2d at page 717, that an investment contract is necessarily missing where the enterprise is not speculative or promotional in character and where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole. The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value. See S.E.C. v. C. M. Joiner Leasing Corp., supra, 320 U.S.

352, 64 S.Ct. 124, 88 L.Ed. 88. The statutory policy of affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae." [80]

When Congress passed the Securities Act of 1933 and Securities Exchange Act of 1934 in the midst of the Great Depression, a financial crisis caused in part by Stock Market Crash of 1929, its intent was to provide broad powers to combat securities fraud in securities offerings.

The comments of SEC Chair Gary Gensler on the scope of SEC enforcement powers to combat securities fraud is also instructive:

Justice Thurgood Marshall, in describing the scope of the federal securities laws, said, "Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called."[3 - See Reves v. Ernst & Young, 494 U.S. 56, 60-61 (1990)].

Thus, to effectuate Congress's purpose, we look to underlying economic realities regardless of the "form" or "name" of the securities, funds, or investors involved. We follow Aristotle's principle: "Treat like cases alike."

Economic realities inform every sector of our enforcement program. To use "effective administration" in my speaking time, though, let me point to a few cases from this past year.

First: If you fail to register a security as required—or to register appropriately as an investment company—you violate the securities laws, regardless of the "form" or "name" of the securities involved.

That's why, when BlockFi failed to register the offers and sales of a crypto lending product, and made materially false and misleading statements about those securities, we charged them. [4 - See In re BlockFi Lending LLC, Release No. 33-11029 (Feb. 14, 2022), available at https://www.sec.gov/news/press-release/2022-26].

Second: If you improperly trade securities on inside information, you violate the securities laws, regardless of the "form" or "name" of the securities involved.

That's why, when a former Coinbase manager and others allegedly misappropriated confidential information to purchase crypto asset securities, we charged them. [5 - See SEC v. Wahi, et al., No. 22 Civ. 1009 (W.D. Wash.) (complaint filed July 21, 2022), available at https://www.sec.gov/news/press-release/2022-127]

---

80 *SEC v. WJ Howey,* 328 U.S. 293, 299-300 (1946).

Finally, fraud is fraud, regardless of the types of investors you have defrauded and the types of securities used in the fraud."[81]

A client can easily forget or assume no regulated securities are involved in a funding effort. Establishing a standing understanding that any funding effort should be discussed with legal counsel before commencement of that effort is vital to protecting the client from itself. For instance, many sponsors of cryptocurrency are finding out the hard way (by virtue of SEC and U.S. Department of Justice enforcement actions) that many "coins" and "tokens" are regulated securities and the offering of those instruments must be either registered under securities laws or qualify for a safe harbor exemption from registration. Membership Interests in a limited liability company can be regulated securities if sold to investors/members who do not actively participate in management of the limited liability company.

(k) Never be a Promoter, Officer/Director/Investor for/in a Client Private Securities Offering.

As legal counsel to a client conducting a securities offering, best rule of practice is to avoid conflicts of interest and compromising your role as legal counsel by being a promoter of an offering, an officer or director of client, or an investor in the offering. You may convince yourself that you can have multiple "hats" but in reality the need to act in different capacities only ends up with your performance of duties for one capacity falling below acceptable standards, creates a serious conflict of interest or exposes you to serious liability -both to client, investors and regulators.

This rule also covers not accepting stock for services – once you do, you are a shareholder and investor and not just legal counsel.

Of course, the rules are different if you are in house general counsel and an employee/officer prior to the offering.

(m) Form D – File It. SEC Compliance and Disclosure Interpretations provide**:**

Question 257.07. Question: Is the filing of a Form D in connection with an offer or sale a condition to the availability of a Regulation D exemption for that offer or sale? Answer: No. The filing of a Form D is a requirement of Rule 503(a), but it is not a condition to the availability of the exemption pursuant to Rule 504 or 506 of Regulation D. Rule 507 states some of the potential consequences of the failure to comply with Rule 503. [Jan. 26, 2009*][82]

DO NOT MISTAKE THIS GUIDANCE AS MEANING THAT A FORM D FILING IS NOT REQUIRED.

---

[81] - "This Law and Its Effective Administration": Remarks Before the Practicing Law Institute's 54th Annual Institute on Securities Regulation," Speech by SEC Chair Gary Gensler, November 2, 2022, view at URL: https://www.sec.gov/news/speech/gensler-remarks-practising-law-institute-110222

[82]

First, Rule 507 of Regulation D authorizes the SEC to commence enforcement actions against issuers that fail to file Form D and the result could be a bar from using Rule 504 and Rule 506 for offerings – a major disaster. Further, if the failure to file is intentional, the violation could morph into a criminal charge.

Second, even for federally covered securities under NSMIA pre-emption of state law, a state still has the right (and the states have exercised this right) to require the issuer to file with the state a copy of the Form D as filed with and accepted by the SEC and to pay a nominal state filing fee (usually $250 to $500 depending on the state).

Third, filing a Form D is evidence compliance with law. That can help in any litigation or enforcement action.

The Form D form (along with a list of exemptions requiring a Form D filing on page 2 of Form D) can be seen at URL: https://www.sec.gov/about/forms/formd.pdf

Information on filing a Form D with SEC is at URL:

https://www.sec.gov/education/smallbusiness/exemptofferings/formd

and

https://www.sec.gov/corpfin/form-d-filing

Many states require the filing of the Form D as filed with the SEC through the NASAA EDF system – see URL: https://www.efdnasaa.org/

Using NASAA edf adds an additional fee to state filing fee.

General information about the NASAA edf system is found at URL:
https://www.nasaa.org/industry-resources/securities-issuers/efd/

(n) Bad Actor Disqualification – Use questionnaires. An issuer can be prevented from making an exempt securities offering if a "bad actor" is involved. It is important to use a bad actor questionnaire to ascertain if any issuer or its participants in a private securities offering are subject to a "bad actor" disqualification.

"Bad actors" are:

"-the issuer, including its predecessors and affiliated issuers
-directors, general partners, and managing members of the issuer
-executive officers of the issuer, and other officers of the issuers that participate in the offering
-20 percent beneficial owners of the issuer, calculated on the basis of total voting power
-promoters connected to the issuer
- for pooled investment fund issuers, the fund's investment manager and its principals

-persons compensated for soliciting investors, including their directors, general partners and managing members

The discussion that follows provides background on the different categories of "covered persons" [Bad Actors]:

Issuers, predecessors and affiliated issuers: the issuer itself, any predecessor entities, and any affiliated issuers (that is, entities that are in control of, are controlled by, or are under common control with the issuer and are issuing securities in the same offering, including offerings subject to integration pursuant to Rule 502(a)).

Directors, general partners and managing members of the issuer: members of the Board of Directors (for issuers that are corporations), general partners (for issuers that are partnerships) and managing members (for issuers that are limited liability companies).

Executive officers and participating officers of the issuer.: Executive officers. The term "executive officer" means a company's president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function or any other person who performs similar policy-making functions.

Officers who participate in the offering. The term "officer" means a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, as well as any person who routinely performs corresponding functions. Participation in an offering would have to be more than transitory or incidental involvement, and could include activities such as participation or involvement in due diligence activities, involvement in the preparation of disclosure documents, and communication with the issuer, prospective investors or other offering participants.

20 percent beneficial owners of the issuer: Beneficial owners of 20% or more of the issuer's outstanding equity securities, calculated on the basis of total voting power rather than on the basis of ownership of any single class of securities.

Voting securities. Whether securities are "voting securities" depends on whether securityholders have or share the ability, either currently or on a contingent basis, to control or significantly influence the management and policies of the issuer through the exercise of a voting right. For example, the Commission would consider that securities that confer to securityholders the right to elect or remove the directors or equivalent controlling persons of the issuer, or to approve significant transactions such as acquisitions, dispositions or financings, would be considered voting securities for purposes of the rule. Conversely, securities that confer voting rights limited solely to approval or changes to the rights and preferences of the class would not be considered voting securities for purposes of the rule.

Promoters: The category of "promoter" is broad. Securities Act Rule 405 defines a promoter as any person—individual or legal entity—that either alone or with others, directly or indirectly takes initiative in founding the business or enterprise of the issuer, or, in connection with such

founding or organization, directly or indirectly receives 10% or more of any class of issuer securities or 10% or more of the proceeds from the sale of any class of issuer securities (other than securities received solely as underwriting commissions or solely in exchange for property). The test considers activities "alone or together with others, directly or indirectly"; therefore, the result does not change if there are other legal entities (which may themselves be promoters) in the chain between that person and the issuer.

Investment managers and principals of pooled investment fund issuers: For issuers that are pooled investment funds, the rule covers investment advisers and other investment managers of the fund; the directors, general partners, managing members, executive officers and other officers participating in the offering of such investment managers; and the directors, executive officers and other officers participating in the offering of the investment managers' general partners or managing members.

Compensated solicitors: Persons compensated for soliciting investors as well as their directors, general partners, managing members, executive officers and officers participating in the offering. This category covers any persons compensated for soliciting investors but will typically involve broker-dealers and other intermediaries." [83]

Note: "On July 10, 2013, the Securities and Exchange Commission (the "Commission") adopted bad actor disqualification provisions for Rule 506 of Regulation D under the Securities Act of 1933, to implement Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The disqualification and related disclosure provisions appear as paragraphs (d) and (e) of Rule 506 of Regulation D….As a result of Rule 506(d) bad actor disqualification, an offering is disqualified from relying on Rule 506(b) and 506(c) of Regulation D if the issuer or any other person covered by Rule 506(d) has a relevant criminal conviction, regulatory or court order or other disqualifying event that occurred on or after September 23, 2013, the effective date of the rule amendments. Under Rule 506(e), for disqualifying events that occurred before September 23, 2013, issuers may still rely on Rule 506, but will have to comply with the disclosure provisions of Rule 506(e) discussed in part 6 of this guide."[84]

Further: "Disqualification will not arise as a result of disqualifying events that occurred before September 23, 2013, the effective date of the rule amendments. Matters that existed before the effective date of the rule and would otherwise be disqualifying are, however, required to be disclosed in writing to investors. Issuers must furnish this written description to purchasers a reasonable time before the Rule 506 sale. Rule 506 is unavailable to an issuer that fails to provide the required disclosure, unless the issuer is able to demonstrate that it did not know and, in the exercise of reasonable care, could not have known that a disqualifying event was required to be disclosed.

---

[83] Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings and Related Disclosure Requirements- A Small Entity Compliance Guide, by SEC Division of Corporation Finance, September 19, 2013, view at URL: https://www.sec.gov/info/smallbus/secg/bad-actor-small-entity-compliance-guide

[84] *Ibid*.

Determining whether disclosure is required. The rule looks to the timing of the triggering event (*e.g.*, a criminal conviction or court or regulatory order) and not the timing of the underlying conduct. A triggering event that occurs after effectiveness of the rule amendments will result in disqualification, even if the underlying conduct occurred before effectiveness.

Form of disclosure. The Commission expects that issuers will give reasonable prominence to the disclosure to ensure that information about pre-existing bad actor events is appropriately presented in the total mix of information available to investors."[85]

The SEC does grant waivers from disqualification upon an approved written request: "Waiver for good cause shown. The final rule provides for the ability to seek waivers from disqualification by the Commission. There are a number of circumstances that could, depending upon the specific facts, be relevant to the evaluation of a waiver request. Issuers may view past applications and waivers granted under Regulation A by referring to the following page: http://www.sec.gov/divisions/corpfin/cf-noaction.shtml#3b. Staff in the Office of Small Business Policy is also available to discuss potential waiver concerns over the phone at (202) 551-3460….Waiver based on determination of issuing authority. Rule 506(d)(2) of Regulation D provides another way for issuers to request a waiver of disqualification. Disqualification will not arise if, before the relevant sale is made in reliance on Rule 506, the court or regulatory authority that entered the relevant order, judgment or decree advises in writing—whether in the relevant judgment, order or decree or separately to the Commission or its staff—that disqualification under Rule 506 should not arise as a consequence of such order, judgment or decree."[86]

See following for process of a waiver appeal:

https://www.sec.gov/divisions/corpfin/guidance/262-505-waiver.htm

***

END

[85] Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings and Related Disclosure Requirements- A Small Entity Compliance Guide, by SEC Division of Corporation Finance, September 19, 2013, view at URL: https://www.sec.gov/info/smallbus/secg/bad-actor-small-entity-compliance-guide

[86] *Ibid.*