

Regulation D and Private Placement Financing

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Registered Public Offerings

- Increase in Size of Underwritten Offerings
- “You have to raise a minimum of \$100 million today.”
- Decrease in Number of Underwritten Offerings
- Most companies engaging in an offering to raise capital will rely upon Post-JOBS Act private offering exemptions

Post-JOBS Act Private Placement Financing Opportunities

- General Solicitation Now Allowed for Certain Offerings
- Section 4(a)(2) Private Placement Exemption
- Crowdfunding
- Regulation D – Rules 504, 506(b), and 506(c)
- Regulation A+
- Intrastate Offerings: Rules 147 and 147A

Prohibition Against General Solicitation

- Except for registered public offerings, general solicitation and general advertising of sales of securities have generally not been allowed.
 - Prohibits advertisements, articles, notices or other published communications
 - Prohibits use of publicly available media, such as unrestricted websites, radio, or television
 - Prohibits seminars or meetings where people have been publicly invited

Section 4(a)(2) Private Placements

- Historic statutory private placement exemption not involving a public offering
- No dollar limit
- No general solicitation or advertising
- Investors must meet sophistication requirements
- No specific disclosure requirements
- Investors must have access to information so as not to need protection
- Investors must be limited in number

Crowdfunding

- Distinguished from donation-based crowdfunding
 - \$1 million offering limit for 12 months
 - Investor limits based on income or net worth: Between \$2,000 and \$100,000
 - Registered broker-dealer or funding portal required
 - Mandated disclosure and filing obligations
 - State law compliance is problematic
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- Overall compliance is difficult and problematic
 - Very limited success due to low feasibility

Regulation D

- Rule 504
 - Offering limit \$5 million
 - No general solicitation and advertising (usually)
 - Non-accredited investors allowed
 - State law compliance required
- Rule 506(b)
 - No offering limit
 - No general solicitation and advertising
 - Accredited investors only (usually)
 - State notice filings only
- Rule 506(c)
 - No offering limit
 - General solicitation and advertising
 - Accredited investor status must be verified
 - State notice filings only
- File Form D 15 days after first sale
- Bad actor provisions apply

Accredited Investors

- Most common categories:
 - Directors, executive officers and general partners of the issuer
 - Individuals with a net worth over \$1 million excluding principal residence
 - Individuals making over \$200,000 per year (\$300,000 jointly with spouse) for past two years and reasonable expectation for same level in current year
 - Entities whose equity owners are all accredited
 - Entities with total assets in excess of \$5 million not formed for purpose of acquiring the securities offered

Rule 504

- \$5 million offering limit
- Sales to non-accredited investors allowed
- No general solicitation, unless state law registration
- No state law preemption
- No specific disclosure requirements

Rule 504 Opportunity

- Limited to Special Situations:
 - Need to raise no more than \$5 million;
 - Need to offer securities to a small number of non-accredited investors, since general solicitation is not allowed; and
 - Reasons for the offering would have to be substantial enough to make the ***disclosure cost, state law compliance, and risk of liability*** worthwhile.

Rules 506(b) and 506(c)

- 90% of all exempt offerings
- Notice filings only with SEC and states
- No required disclosure in accredited investor offerings
- No ongoing disclosure or ongoing oversight
- No suits for negligent misrepresentation
- Bad actor provisions apply

Rule 506(b)

- No general solicitation or public advertising
- Sales to accredited investors only to avoid disclosure requirements
- Self-certification of accredited investor status
- Widespread acceptance and use: During first 15 months with new Rule 506(c), Rule 506(b) had more than 24,500 filings, generating \$1.52 trillion in new capital

506(b) Opportunity

- Most popular private placement structure
- Opportunity limited by no general solicitation and sales to accredited investors only

Rule 506(c)

- General solicitation allowed
- Sale to accredited investors only to avoid disclosure requirements
- Reasonable additional steps to verify accredited investor status within last 3 months:
 - self-certification is insufficient;
 - third party assertions of accredited status (accountants, lawyers, bankers) without explanation are insufficient; and
 - current re-verification is needed.
- No widespread acceptance. Only 2.1% of the reported capital raised pursuant to Rule 506 since becoming effective in September, 2014.

Rule 506(c) Opportunity

- General solicitation affords opportunities when sales are necessary to accredited investors with whom no pre-existing relationship exists
- Limited by sales to accredited investors only and the extra step that must be taken to verify accredited status

Regulation A (Reg. A+)

- Public Offerings from \$5 million to \$50 million in a 12-month period
 - Tier 1: \$20 million
 - Tier 2: \$50 million
- Offering circular with prescribed disclosure is subject to review and comment by SEC
- Tier 1 requiring state registration/review and Tier 2 with only a state notice filing requirement
- Annual reporting requirements, including annual audited financial statements and semi-annual current reporting
- Costs as a percentage of offering amount approximate 5%

Regulation A+ Opportunity

- Limited to Special Situations:
 - Need to raise over \$5 million;
 - Need to offer securities to a wide range of buyers, including non-accredited investors; and
 - Reasons for the offering would have to be substantial enough to make the ***disclosure cost, ongoing reporting, and risk of liability*** worthwhile.

Intrastate Offerings and Rule 147A

- Limited opportunity because all sales must be made to investors in a single state where the issuer has a principal place of business
- Rule 147A allows offers to out-of-state residents (i.e., offers can be made over the Internet and through social media) and for companies to be incorporated in other states

Summary

- Registered public offerings are typically not realistic for the vast majority of private companies.
- Regulation A+ public offerings up to \$50 million are limited to specific situations.
- Crowdfunding is typically not economically feasible due to compliance costs.
- Intrastate offering exemption is usually not feasible due to one-state residency requirement.
- Section 4(a)(2) private placements are useful for small numbers of investors, e.g., friends and family.
- Rule 504 offerings with new offering limits up to \$5 million may increase, but no general solicitation (generally) and state law compliance limits feasibility.
- Rule 506(c) with general solicitations to accredited investors have a better chance of becoming a more significant opportunity, but requirement to verify accredited investor status is currently problematic.
- Rule 506(b) private placements to accredited investors without general solicitation most often represent the best opportunity for private capital offerings.