INTRODUCTION TO BASIC CONCEPTS OF
REGULATION OF SECURITIES OFFERINGS

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THIS CLE IS DESIGNED FOR NON-SECURITIES LAW PRACTITIONERS.
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INTRODUCTION TO BASIC CONCEPTS OF REGULATION OF SECURITIES OFFERINGS

Section 1. Basic Concepts and Practice Tips.

1.1 Constitutional Basis of Regulation. Like most federal regulation, the federal securities laws constitutional and jurisdictional basis is interstate commerce – the use of the mails and other means of interstate commerce.

1.2 Necessity of Checking Federal and State Statutes and Rules for Each Securities Offering. Counsel must check compliance requirements under federal and state laws and rules prior to advising a client on securities offerings. Do not rely on what you think you know – always verify. Laws and rules as well as regulators’ policies on enforcing laws and rules change. So, the first step is to do the review, which in turn determines what kind of offering will be made and then determine the compliance requirements – before any offer is made. This step avoids inadvertent violations of law.

1.3 Secondary Sources of Reference. Your secondary sources to resolve issues and questions not resolved by checking the statutes and rules are:

A. Go to http://www.sec.gov/interps.shtml where you can check:

   (i) SEC No Action Letters: The SEC has a process where you can submit a letter setting forth a hypothetical and state your position on the issues of concern. The SEC responds with a letter in a month or more. The SEC response will either reject your position or will state that “no enforcement action would be recommended” based on the facts and position presented. SEC No Action Letter responses are not binding on the SEC but they do provide insight into current SEC policies and approach.


   (iii) SEC Compliance and Disclosure Interpretations - A FAQ on many issues, very detailed and very valuable – periodically updated. (http://www.sec.gov/divisions/corpfin/cfguidance.shtml) for additional guidance.

   (iv) SEC FINANCIAL REPORTING MANUAL (http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml);

   (v) SEC Disclosure Guidance: general guidance on common issues (http://www.sec.gov/divisions/corpfin/cfdisclosure.shtml#cfguidancetopics);

   (vi) SEC STAFF LEGAL BULLETINS: SEC stating a policy on a common issue – infrequently issued.
B. **Other Counsel.** Seek guidance from experienced SEC counsel. Also, many major law firm websites have extensive articles on securities law issues and matters.

C. **WESTLAW or LEXIS** Databases have case law and many reference sources.

D. **Publications/Sources to check:**


(iii) *Initial Public Offerings* by David Westenberg, PLIC, URL: [http://www.pli.edu/Content/Treatise/Initial_Public_Offerings_A_Practical_Guide/_/N-4iZ1z12nwi?l](http://www.pli.edu/Content/Treatise/Initial_Public_Offerings_A_Practical_Guide/_/N-4iZ1z12nwi?l); and


1.4 **Seeking Guidance from Regulators.**

If you have a filing before the SEC or a state securities agency and you have a specific question concerning the filing or its amendment or processing, then the assigned examiner is generally helpful in answering specific questions, especially ones about established process or agency policy. The regulators will not do your legal research, act as mentor or legal counsel to you, or go beyond what are known agency policy position. The SEC Staff especially is trained to be tight lipped, very focused in terms of the narrow scope of what can be discussed under agency rules, and avoid anything that may be deemed as changing or expanding the SEC’s established policies or general legal advice (other than stating established SEC policy). If you do not have a pending filing before the regulator, the state regulators are generally available by phone but again will not generally go beyond stating established policy and process – although you are more likely to get legal guidance from an state regulator than the SEC. The SEC tends to hide behind voicemail out of necessity – they are already understaff and simply can’t encourage general phone inquiries. That said, if you have dealt with specific SEC Staff attorneys in examinations or Corporate Finance Division and developed a relationship, you can speak off the record and engage in a more open conversation.
1.5 Agencies Sharing Information. Whenever you speak to a securities regulator – even if an examiner or information person - any admissions of violations or other incriminating or alarming statements, even when no violation has occurred, will likely end up in the enforcement office of that agency as well as being shared with other enforcement agencies – such as: SEC Enforcement, U.S. Department of Justice (which investigates and prosecutes criminal violations of the federal securities laws), IRS, state attorney general or state securities enforcement. Always prepare your client for any telephone conversation or face to face conversation with a regulator. Counsel should seek experienced legal counsel for any conversations with enforcement personnel.

If the answer to a regulator concerns an admission of a violation of law, then counsel needs to (1) determine what is the truth and not be seduced by any client version of the truth; (2) consult an experienced SEC/securities defense lawyer, especially one who worked at enforcement at the SEC or a state agency, to develop a plan to advise the regulators of any violation, which includes a remedial plan; (3) prepare your client for approaching the regulators; and (4) counsel should spearhead the discussions with the regulators – never let your client spearhead the discussions with the regulators – a client often sounds nervous or fails to remain focused on the narrow issues on the agenda or of concern.

For more on SEC Enforcement, see:

(i) SEC Enforcement Manual,
http://www.sec.gov/divisions/enforce/enforcementmanual.pdf;


1.6 SEC Enforcement Summary. Here is the SEC summary description of investigations: ¹

“How Investigations Work

First and foremost, the SEC is a law enforcement agency. The Enforcement Division assists the Commission in executing its law enforcement function by recommending the commencement of investigations of securities law violations, by recommending that the Commission bring civil actions in federal court or before an administrative law judge, and by prosecuting these cases on behalf of the Commission. As an adjunct to the SEC’s civil enforcement authority, the Division works closely with law enforcement agencies in the U.S. and around the world to bring criminal cases when appropriate.

The Division obtains evidence of possible violations of the securities laws from many sources, including market surveillance activities, investor tips and complaints, other Divisions and Offices of the SEC, the self-regulatory organizations and other securities industry sources, and media reports.

All SEC investigations are conducted privately. Facts are developed to the fullest extent possible through informal inquiry, interviewing witnesses, examining brokerage records, reviewing trading data, and other methods. With a formal order of investigation, the Division’s staff may compel witnesses by subpoena to testify and produce books, records, and other relevant documents. Following an investigation, SEC staff present their findings to the Commission for its review. The Commission can authorize the staff to file a case in federal court or bring an administrative action. In many cases, the Commission and the party charged decide to settle a matter without trial.

Common violations that may lead to SEC investigations include:

- Misrepresentation or omission of important information about securities
- Manipulating the market prices of securities
- Stealing customers’ funds or securities
- Violating broker-dealers’ responsibility to treat customers fairly
- Insider trading (violating a trust relationship by trading on material, non-public information about a security)
- Selling unregistered securities.

Whether the Commission decides to bring a case in federal court or within the SEC before an administrative law judge may depend upon various factors. Often, when the misconduct warrants it, the Commission will bring both proceedings.

- **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.

- **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."

**1.7 Necessity of Paper Trail.** While the client is liable for the offering documents and filings, you as counsel can get into trouble with regulators or your client if you do not: (a) understand and demand full compliance with the laws – do not let clients talk you into cutting corners; (b) document your full compliance work and document any attempt to pressure you to do less- paper trail your work; (c) make your client verify the information in the offering documents and filings – use signed questionnaires and certifications and advise the client in writing that the client is liable for misrepresentations and omissions of material fact in the offering documents and filings; (d) always do a compliance memo to the client that sets forth all of the requirements for the offering; (e) refuse to remain counsel for any client who refuses to correct misrepresentations or omissions of material fact; (e) keep the record of your compliance work in a safe place, make a back up and keep both for 10 years; (f) get proof of delivery of filings or critical documents – use delivery services that get receipt signatures, get stamped receipt copies whenever possible, and never make a filing by any means other than one that allows you to certify
delivery – don’t get cheap on delivery – use Federal Express with signature required or hand delivery with signature required – if mail is the only means of filing, use certified mail, return receipt required and postage prepaid; (g) I never toss any proof of a filing with a regulator; (h) notarize very important work product documents or memos; and (i) whenever you are uncertain about critical issues – seek counsel of more experienced lawyers if your own research does not resolve the issues.

CASE IN POINT #1: I made a filing with a state agency in 2004. Seven years later my client had to prove the filing as a part of due diligence review for a deal. The state had no record of the filing. If my client could not prove that the filing was done, the deal would fail. I found a stamp receipt copy in my archives and the State admitted, upon presentation of the stamped receipt copy, that it has accidentally deleted the filing from its database.

CASE IN POINT #2: One night I was working late at client office doing due diligence. I went to the CFO’s office and found an ex-employee rifling the CFO’s files. She was looking for dirt to use against the client in a wrongful termination lawsuit. I have heard about people paying cleaning crews to steal files or trash from companies in order to get a trading advantage, competition advantage, or find dirt for a lawsuit.

CASE IN POINT #3: My first major securities law client was one of only two legitimate companies taken public by the brokerage firm of Stratton Oakmont, the Stratton Oakmont of the movie Wolf of Wall Street. The key people of Stratton Oakmont went to jail. My client and I did not because we bent over backwards to comply with law and I applied the above rules. A Client will often pressure securities lawyers to cut corners or ignore “problems” in order to expedite an offering.

1.7.1 Sample Questionnaires. The law firm of Schulte Roth & Zabel publishes a sample questionnaire on its website – it is copyrighted but provides an understanding of the general content of a typical annual management questionnaire.

See: http://www.srz.com/SRZ_2014_Form_of_Public_Company_Director_and_Executive_Officer_Questionnaire/

You can also find questionnaires and certification samples through Westlaw or Lexis.

1.9 Emails and Texting Liability Concerns. Emails are land mines for senders and are gold mines of damaging evidence for others. One should always consider the consequences email and text contents – these are discoverable and inappropriate for sensitive corporate communications. Counsel should educate the client on appropriate means of communicating critical information or privileged information. Counsel should also assist the client in developing an appropriate email and text record retention and procedure policy.

1.10 Necessity of Background Checks. Since a violation of securities laws by an officer, director or promoter can bar a client from using certain private offering safe harbors or hinder approval of a registered. A good lawyer always checks out prospective clients and their key personnel to understand whether you are running with sheep or wolves. A quick Google search can be revealing. Also, check the SEC website’s enforcement releases for securities violations by persons and entities and check FINRA’s website for broker backgrounds. For guidance on checking the Internet for information:


CASE IN POINT: Why check backgrounds? A check revealed that one of my public company clients had an IR front man who had been convicted of a credit card fraud scheme while working as a police detective.

1.11 What are Regulated Securities? In order to determine what regulations apply, your initial step is to verify that the securities being offered are subject to regulation – usually a very simple task. Why is this a critical task – Because if your client offers securities without regulation and is found to have conducted an illegal offering, your client faces civil enforcement and possibly criminal enforcement and you, the sloppy lawyer who claimed no compliance was necessary, are facing a world of hurt.

1.11.1 Basic Criteria. Securities laws all define “securities.” Do not be fooled. Securities are more than the definitions in the statutes, which list the obvious like common stock, preferred stock, options, bond, debentures and
convertible debt instruments. The definition is not set in stone. When you realize that an interest in an orange grove can be a “security,” then you grasp the fluid nature of the term “Securities.” “Securities” subject to regulation, according to the U.S. Supreme Court in *WJ Howey*, are: (1) an investment of money; (2) in a common enterprise or business; (3) with an expectation of profit by the investor; and (4) the profit is to be derived solely from the efforts of others.² This is the *Howey Test*. That covers more than the traditional stocks and bonds. Courts have held that the sale of a life insurance settlement, where a holder of life insurance policy sells it to third party for cash is an investment security. The case law on the definition of “security” is vast.

**KEY:** The “solely” in the foregoing indicia does not mean “only” – the courts have interpreted “solely” to mean “mostly.”

**KEY:** Federal and state statues also expressly exempt certain securities from regulation – the so called “Exempt securities.” These are securities that present so little risk to investors that regulation is deemed unnecessary – like U.S. Treasury Notes or short term commercial notes by Blue Chip companies, and securities that are exempted for policy reasons – like bonds sold by churches.

1.11.2 **Membership Interests as Securities.** Some lawyers argue that Membership Interests are not investment securities. In *U.S. v. Leonard*, 2008 WL 2357233 (2nd Cir., June 11, 2008), the always influential Second Circuit held that Membership Interests are securities and are regulated under securities laws. In determining what is a security, you always focus on the economic realities – that is the Howey Test – and not what the pretend reality sought by organizational documents. What is a “security” is always a matter of the facts, never a matter of form. Apply the test, do your research – never assume.

1.11.3 **General and Limited Partnership Interests as Securities.** One must always apply the *Howey Test* to any financial instrument in order to determine whether it’s a security. It is dangerous to assume an instrument is not a security. In general, a general partnership interest is a security but not deemed requiring the protection of the securities laws because the general partners are principals – active in running the business and very knowledgeable about the business. However, when one partner becomes dependent on the skills and management of another partner, you are in quicksand. The general partnership interest may be a regulated security. Apply the test. Limited partnership interests are like limited liability company Membership Interests – probably regulated securities – but apply the test and do the research – never assume.

1.11.4 Alternative to Howey Test. Howey Test is the Gold Standard. There is another judicial test worth considering and with some influence in the U.S. – Hawaii Market Test. ³

Hawaii Market adopts a variant of the Howey Test and Hawaii Market Test has influence in other States. Hawaii Market Test argues that the application of the Howey Test has gotten caught up in semantics – such as the scope of words like “solely” – and has lost sight of the purpose of the Howey Test: to protect investors. As the Hawaii Supreme Court stated in Hawaii Market: ⁴ “The salient feature of securities sales is the public solicitation of venture capital to be used in a business enterprise. Silver Hills Country Club v. Sobieski, 55 Cal.2d 811, 815, 13 Cal.Rptr. 186, 188, 361 P.2d 906, 908(1961); Goodwin, Franchising in the Economy: The Franchise Agreement as a Security Under Securities Acts, Including 10b-5 Considerations, 24 Business Lawyer 1311, 1320-21 (1969). This subjection of the investor's money to the risks of an enterprise over which he exercises no managerial control is the basic economic reality of a security transaction. Coffey, The Economic Realities of a "Security": Is There a More Meaningful Formula?, 18 W. Res. L. Rev. 367, 412 (1967); see Silver Hills Country Club v. Sobieski, supra; see Securities & Exchange Commission v. Latta, 250 F. Supp. 170, 173 (N.D. Cal. 1965), aff'd per curiam, 356 F.2d 103 (9th Cir. 1965), cert. denied, 384 U.S. 940 (1966). Any formula which purports to guide courts in determining whether a security exists should recognize this essential reality and be broad enough to fulfill the remedial purposes of the Securities Act. Those purposes are (1) to prevent fraud, and (2) to protect the public against the imposition of unsubstantial schemes by regulating the transactions by which promoters go to the public for risk capital. HRS § 485-10(e). Therefore, we hold that for the purposes of the Hawaii Uniform Securities Act (Modified) an investment contract is created whenever:[fn5] Under the HAWAII MARKET TEST, A SECURITY IS: (1) An offeree furnishes initial value to an offeror, and (2) a portion of this initial value is subjected to the risks of the enterprise, and (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.” [Footnotes not included]

1.12 Exempt vs. Non-Exempt Securities. When we speak of securities regulation and compliance, we are speaking about “Non-Exempt” securities. “Exempt securities” are securities that are expressly excluded from regulation


by statute or rule. “Exempt securities” are defined in federal and state securities statutes and they are exempted from regulation because they are deemed to have little or no investment risk (like U.S. Treasury Notes or State Bonds), are exempted for policy reasons (like bonds issued by Churches) or are exempted because they are more pure commercial debt instruments than an investment (like mortgages, promissory notes or commercial paper with short maturities, annuities).

1.13 Public/Registered Offerings vs. Private/Unregistered Offerings. Determining whether an offering is private or public determines the regulatory requirements. The penalties for conducting a private offering that is found to be a public offering are severe. There is no intent defense. An issuer either complies or doesn’t. A public offering must have a registration statement that is reviewed and approved by regulators prior to any selling or offering.

There is no universal, statutory “bright line” definition of public vs. private offering of securities. While there are safe harbors and express exemptions from registration requirements of a public offering of securities, the U.S. regulatory scheme is built on a case-by-case analysis of the facts and circumstances to determine public vs. private offerings. It is important to classify an offering from the start as one or other because the kind and level of compliance varies greatly between the two.

1.13.1 Public Offering. Public offerings of securities are offerings made to the general public or to a number of investors that exceeds a small group (there is no magic number), involve advertisement or general solicitation of investors and are required to be registered with and approved by the SEC and to vary degrees by the states. While there is no magic number of investors to separate a public from a private securities offering, the most common state law exemptions from registration used for private securities offerings restrict the number of investors to anywhere from 10 to 35 investors. SEC’s Rule 505 and Rule 506 private offering exemptions from registration allow the sale of securities to no more than 35 investors.

There is a caveat to counting investors. Federal and most state laws make an exception for “Accredited investors” (as defined in Rule 501(a) of Regulation D under the Securities Act of 1933). Accredited investors are in general persons or firms whose wealth, investing sophistication or both remove them from the regulatory scheme – legislators and regulators deemed the accredited investors as being able to fend for themselves without Big Brother and in many exemptions from registration for private offerings, accredited investors are not counted toward any stated maximum number of investor. Under Rule 506(b) and Rule 506(c), the two heavy hitter safe harbors for private offerings, issuer can sell an unlimited number of securities to unlimited number of accredited investors – but the issuer must be able to prove that the issuer has reasonable basis for believing the investor was accredited as the
time of the sale of the securities (that means a signed investor questionnaire and supporting documents). A sample investor questionnaire is attached as a supplement to the materials. Accredited investors is covered in Concept #10 below.

1.13.2 Ralston Case. The landmark court case on what is a public offering is SEC v. Ralston Purina Co., 346 U.S. 119 (1953). The company argued that an offering to its employees did not constitute a public offering under then Section 4(1) of the Securities Act of 1933, (now designated as Section 4(a)(2)) which exempts “transactions by an issuer not involving a public offering” (without defining “public offering”). The Ralston court held that the company made an unregistered public offering by selling its stock to dozens of its employees. As the SEC stated:

"Whether a transaction is one not involving any public offering is essentially a question of fact and necessitates a consideration of all surrounding circumstances, including such factors as the relationship between the offerees and the issuer, the nature, scope, size, type and manner of the offering.

The Supreme Court in S.E.C. v. Ralston Purina Co., 346 U.S. 119, 124, 125 (1953), noted that the exemption must be interpreted in the light of the statutory purpose to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions" and held that "the applicability of section 4(1) [Now Section 4(a)(2)] should turn on whether the particular class of persons affected need the protection of the Act." The court stated that the number of offers is not conclusive as to the availability of the exemption, since the statute seems to apply to an offering "whether to few or many." FN2 See, also, Gilligan, Will & Co. v. S.E.C., 267 F. 2d 461, 467 (C.A. 2, 1959), cert. denied, 361 U.S. 896 (1960).

The Court in Ralston focused on (1) sophistication of the investors; (2) number of people receiving the offer to buy the securities; (3) size of offering and manner in which the offering is being made; and (4) relationship of issuer and investors and the relationship of the investors to one another. While there is no numerical limit on what is a private and what is a public offering, when an issuer starts to accumulate over 35 investors, the compliance paranoia alarms need to sound. Yes, an issuer can conceivably have 100, 200 or more shareholders without doing a public offering of securities, but the risk of a failed exemption for private selling stock grows with the number of investors and transactions and a failed exemption can result in an unregistered and, thus, illegal securities offering.

1.13.3 Private Offering. A private offering of securities is, of course, an offering that is not a public offering requiring registration. Section 4(a)(2) (formerly Section 4(a)) of the Securities Act is the primary statutory basis for federal private offering exemption and that section merely states that “transactions by an issuer not involving any public offering.” Section 3(b) of the Securities Act empowers the SEC to exempt from the registration requirements of a public offering any “small offerings” – being offering of such a limited nature that even if the offering might be deemed “public,” the burden of regulation is deemed unreasonable in light of the limited, remote benefits to the public of regulation.

The characteristics of a private offering are (1) the offering does not use general solicitation or advertising to locate investors; (2) the offering is made to specific investors – usually very limited in number – typically under 25 or 35 – and often the investors have a relationship to the issuer or its management; (3) the securities offered are “restricted securities” (as defined in Rule 144 under the Securities Act of 1933) – that being they cannot be freely sold, transferred, pledged or encumbered without registration or qualify for an exemption allowing resale of the securities; and (4) regulating the offering in the same manner as a public offering creates an unreasonable burden on the issuer and the public benefit of such regulation is remote.

See SEC Release #33-285 from 1935 in which SEC General Counsel refused to opine that an offering of $1.7 million in preferred stock to 25 persons was not a public offering – this reflective of the SEC’s policy that what is a public vs. private offering is based on an analysis of the facts at hand and never a bright line test.

1.13.4 Caveats in Tally of Investors in Offering. There are two important caveats: (1) “Accredited investors” and “institutional investors” are usually deemed under federal and state laws to not need the protection of regulation and are often excluded from any count of investors; and (2) there are federal and state safe harbors – if you comply with the safe harbor requirements, then you have some certainty that the offering is private.

The SEC summary of the major safe harbors is set forth below. It is straightforward and a good overview. My specific comments about the federal private offering exemptions summarized below are:

1.13.5 A private offering can qualify for more than one exemption. An important point in securities law is that if you fail to qualify under a claimed private offering exemption, then you can still safe an offering from the dreaded “illegal public offering” trap if you can show that the offering qualified for another private offering exemption – even if not expressly claimed in the offering. But

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you have to meet the qualification requirements for any other private exemption to be saved.

1.13.6 Section 4(a)(2). Section 4(a)(2) under the Securities Act of 1933: In practice, a lawyer always looks for a safe harbor under Section 4(a)(2) instead of merely relying on the general exemption of the statutory section. You are only safe in relying on Section 4(a)(2) without use of a specific safe harbor if you are an issuer selling securities to a single, institutional investor – that would be a company selling securities to Prudential Insurance Co. or AIG – a huge corporation with billions in assets that frequently purchases huge blocks of securities in private deals. These institutional investors are sophisticated – they understand the risks of the investment and they are extremely wealthy – they are able to withstand large losses in private securities investments. This is exactly the kind of investor that Congress deemed not needing the protection of regulation.

1.13.7 Rule 506(b). under Regulation D is the most commonly used safe harbor because it allows unlimited number of accredited investors purchasing an unrestricted amount of securities – you can sell up to 35 non-accredited investors (who must be sophisticated investors). While accredited investors under a Rule 506(b) offering do not have to receive any mandated information, you always use a private placement memorandum to avoid any allegations of omitted or misrepresented material facts and the 35 non-accredited investors under Rule 506(b) must receive the information mandated under Rule 505 – an annual report with financials.

1.13.8 Rule 505. Rule 505 is almost never used because its disclosure requirements and low maximum offering amount make it impractical in most circumstances.

1.13.9 Rule 504. While Rule 504 offerings can allow general solicitation or advertising for investors and can allow free trading securities – if you meet the specific requirements under the rule – Rule 504 has limited usefulness because of its low maximum offering amount of $1 million for each 12 month period. Rule 504 is typically used by start-up concerns and small companies.

1.13.10 SEC Summary of Safe Harbors for Private Offerings. SEC Summary of Private Offering Exemptions on the Federal Level:

"Non-public offering (private placement) exemption

Section 4(a)(2) of the Securities Act exempts from registration "transactions by an issuer not involving any public offering." 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 non-public offering exemption.

The precise limits of the non-public offering 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.

Rule 506(b) provides objective standards that your company can rely on to meet the requirements of the Section 4(a)(2) non-public offering exemption. Rule 506(b) is part of Regulation D, which is described more fully below.

**Regulation D — Rules 504, 505 and 506**

Regulation D contains Rules 504, 505 and 506, which establish exemptions from Securities Act registration. The only filing requirement under each of these exemptions is the requirement to file a notice on Form D with the SEC. The notice must be filed within 15 days after the first sale of securities in the offering. Many states also require the filing of a Form D notice in a Regulation D offering. The main purpose of the Form D filing is to notify federal (and state) authorities of the amount and nature of the offering being undertaken in reliance upon Regulation D.

Some rules under Regulation D specify particular disclosures that must be made to investors, while others do not. Even if your company sells securities in a manner that is not subject to specific disclosure requirements, you should take care that sufficient information is available to investors. All sales of securities are subject to the antifraud provisions of the securities laws. This means that you should consider whether the necessary information was available to investors, and that any information provided to investors must be free from false or misleading statements. Similarly, information should not be omitted if, as a result of the omission, the information that is provided to investors is false or misleading.
Felons and other "bad actors" are disqualified from involvement in Rule 505 and 506 offerings. An issuer seeking reliance on either of these rules is required to determine whether the issuer or any of its covered persons has had a disqualifying event. The list of covered persons and disqualifying events differs for Rules 505 and 506. Issuers relying on Rule 505 must refer to the disqualification provisions of Rule 262 of Regulation A. Issuers relying on Rule 506 will find the applicable disqualification provisions in Rule 506(d). An issuer that is disqualified from these rules may still qualify to apply for a waiver of disqualification. See "Process for Requesting Waivers of 'Bad Actor' Disqualification Under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D" for a description of the waiver process. We address each of the Regulation D exemptions separately below.

We address each of the Regulation D exemptions separately below.

**Rule 504.** Rule 504, sometimes referred to as the "seed capital" exemption, provides an exemption for the offer and sale of up to $1,000,000 of securities in a 12-month period. Your company may use this exemption so long as it is not a blank check company and is not subject to Exchange Act reporting requirements. In general, you may not use general solicitation or advertising to market the securities, and purchasers generally receive "restricted securities." Purchasers of restricted securities may not sell them without SEC registration or using another exemption, which is further explained below under the heading "Resales of restricted securities." Investors should be informed that they may not be able to sell securities of a non-reporting company for at least a year without the issuer registering the transaction with the SEC.

Your company may, however, use the Rule 504 exemption for a public offering of its securities with general solicitation and advertising, and investors will receive non-restricted securities, under one of the following circumstances:

- It sells in accordance with a state law that requires the public filing and delivery to investors of a substantive disclosure document; or

- It sells in accordance with a state law that requires registration and disclosure document delivery and also sells in a state without those requirements, so long as your company delivers to all purchasers the disclosure documents mandated by a state in which it registered; or

- It sells exclusively according to state law exemptions that permit general solicitation and advertising, so long as sales are made only to "accredited investors" (we describe the term "accredited investor" in more detail below in connection with our description of Rule 506 offerings).
Rule 505. Rule 505 provides an exemption for offers and sales of securities totaling up to $5 million in any 12-month period. Under this exemption, your company may sell to an unlimited number of “accredited investors” and up to 35 persons that are not accredited investors. Purchasers must buy for investment purposes only, and not for the purpose of reselling the securities. The issued securities are “restricted securities,” meaning purchasers may not resell them without registration or an applicable exemption, as explained below under the heading “Resales of restricted securities.” If your company is not an SEC reporting company, investors should be informed that they may not be able to sell securities for at least a year without the company registering the transaction with the SEC. Your company may not use general solicitation or advertising to sell the securities.

Under Rule 505, if your offering involves any purchasers that are not accredited investors, you must give these purchasers disclosure documents that generally contain the same information as those included in a registration statement for a registered offering. There are also financial statement requirements that apply to Rule 505 offerings involving purchasers that are not accredited investors. For instance, if financial statements are required, they must be audited by a certified public accountant. You must also be available to answer questions from prospective purchasers who are not accredited investors.

You may decide what information to give to accredited investors, so long as it does not violate the antifraud prohibitions of the federal securities laws. If your company provides information to accredited investors, it must make this information available to the non-accredited investors as well.

Rule 506. Rule 506 provides two different ways of conducting a securities offering that is exempt from registration: Rule 506(b) and Rule 506(c). Rule 506(b) is a long-standing rule. Rule 506(c) was added in 2013 to implement a statutory mandate under the JOBS Act.

Rule 506(b). As discussed earlier, Rule 506(b) is a "safe harbor" for the non-public offering exemption in Section 4(a)(2) of the Securities Act, which means it provides specific requirements that, if followed, establish that your transaction falls within the Section 4(a)(2) exemption. Rule 506 does not limit the amount of money your company can raise or the number of accredited investors it can sell securities to, but to qualify for the safe harbor, your company must:

- not use general solicitation or advertising to market the securities;
- not sell securities to more than 35 non-accredited investors (unlike Rule 505, 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);

- give non-accredited investors specified disclosure documents that generally contain the same information as provided in registered 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);

- be available to answer questions from prospective purchasers who are non-accredited investors; and

- provide the same financial statement information as required under Rule 505.

**Rule 506(c).** To implement Section 201(a) of the JOBS Act, the SEC promulgated Rule 506(c) to eliminate the prohibition on using general solicitation under Rule 506 where all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors.

Under Rule 506(c), issuers may offer securities through means of general solicitation, provided that:

- all purchasers in the offering are accredited investors,

- the issuer takes reasonable steps to verify their accredited investor status, and

- certain other conditions in Regulation D are satisfied.

An "accredited investor" is:

- a bank, insurance company, registered investment company, business development company, or small business investment company;

- an employee benefit plan (within the meaning of the Employee Retirement Income Security Act) if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million;

- a tax exempt charitable organization, corporation or partnership with assets in excess of $5 million;
• a director, executive officer, or general partner of the company selling the securities;

• an enterprise in which all the equity owners are accredited investors;

• an individual with a net worth of at least $1 million, not including the value of his or her primary residence;

• an individual with income exceeding $200,000 in each of the two most recent calendar years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; or

• a trust with assets of at least $5 million, not formed only to acquire the securities offered, and whose purchases are directed by a person who meets 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.

Purchasers receive “restricted securities” in a Rule 506 offering. Therefore, they may not freely trade the securities after the offering, as explained below under the heading “Resales of restricted securities.”

Section 18 of the Securities Act provides a federal preemption or exemption from state registration and review of private offerings that are exempt under Rule 506. The states still have authority, however, to investigate and bring enforcement actions for fraud, impose state notice filing requirements and collect state fees.

**Regulation A**

Regulation A is an exemption for public offerings not exceeding $5 million in any 12-month period. If you choose to rely on this exemption, your company must file an offering statement with the SEC on Form 1-A, consisting of a notification, offering circular, and exhibits. The SEC staff will review this offering statement.

Felons and other "bad actors" are disqualified from Regulation A. An issuer seeking reliance on Regulation A is required to determine whether the issuer or any of its covered persons has had a disqualifying event. The list of covered persons and disqualifying events appear in Rule 262 of Regulation A. An issuer that is disqualified from these rules may still qualify to apply for a waiver of disqualification. See "Process for Requesting Waivers of 'Bad Actor' Disqualification Under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D" for a description of the waiver process.
Regulation A offerings share many characteristics with registered offerings. For example, purchasers must be provided with an offering circular similar to a prospectus. Just as in registered offerings, the securities can be offered publicly, using general solicitation and advertising, and purchasers do not receive “restricted securities,” as explained below under the heading “Resales of restricted securities.” The principal differences between Regulation A offerings and registered public offerings are:

- financial statements for a Regulation A offering are simpler and do not need to be audited unless audited financial statements are otherwise available;
- Regulation A issuers do not incur either Exchange Act reporting obligations after the offering or Sarbanes-Oxley Act obligations applicable only to SEC reporting companies, unless the company meets the threshold triggering Exchange Act registration;
- companies may choose among three formats to prepare the Regulation A offering circular, one of which is a simplified question-and-answer document; and
- companies may "test the waters" to determine market interest in their securities before going through the expense of filing with the SEC.

SEC reporting companies are not eligible to use Regulation A. All other types of companies may use Regulation A, except development stage companies without a specified business (for example, "blank check companies") and investment companies registered or required to be registered under the Investment Company Act of 1940. In most cases, shareholders may use Regulation A to resell up to $1.5 million of securities.

The "test the waters" provisions of Regulation A allow companies to publish or deliver a written document to prospective purchasers or make scripted radio or television broadcasts to determine whether there is an interest in their contemplated securities offering before filing an offering statement with the SEC. This gives companies the opportunity of being able to determine whether enough market interest in their securities exists before they incur the full range of legal, accounting, and other costs associated with filing an offering statement with the SEC. Companies may not, however, solicit or accept money for securities offered under Regulation A until the SEC staff completes its review of the filed offering statement and the company delivers offering materials to investors.

Accredited investor exemption—Section 4(a)(5)
Section 4(a)(5) of the Securities Act exempts from registration offers and sales of securities to accredited investors when the total offering price is less than $5 million.

The definition of accredited investor is the same as that used in Regulation D, which is summarized above. Like the exemptions in Rule 505 and 506, this exemption does not permit any form of general solicitation or advertising. There are no document delivery requirements, but all transactions are subject to the antifraud provisions of the securities laws.

**Intrastate offering exemption**

Section 3(a)(11) of the Securities Act is generally known as the "intrastate offering exemption." This exemption facilitates the financing of local business operations. To qualify for the intrastate offering exemption, your company must:

- be organized in the state where it is offering the securities;
- carry out a significant amount of its business in that state; and
- make offers and sales only to residents of that state.

The intrastate offering exemption does not limit the size of the offering or the number of purchasers. Your company must determine the residence of each offeree and purchaser. If any of the securities are offered or sold to even one out-of-state person, the exemption may be lost. Without the exemption, the company could be in violation of the Securities Act.

If a purchaser resells any of the securities to a person who resides outside the state within a short period of time after the company's offering is complete (the usual test is nine months), the entire transaction, including the original sales made within the required state, might violate the Securities Act.

Your company may have difficulty relying on the intrastate exemption unless you know the persons to whom the securities are offered and the actual purchasers, and the sale is directly negotiated with them. If your company holds some of its assets outside the state, or derives a substantial portion of its revenues outside the state where it proposes to offer its securities, it may also have difficulty qualifying for the exemption.

You may follow Rule 147, a "safe harbor" rule, to ensure that you meet the requirements for the intrastate offering exemption. It is possible, however, that transactions not meeting all the requirements of Rule 147 may still qualify for the exemption.

**Coordinated limited offering exemption under California law — Rule 1001**
SEC Rule 1001 provides an exemption from the registration requirements of the Securities Act for offers and sales of securities in amounts of up to $5 million that satisfy the conditions of Section 25102(n) of the California Corporations Code. This California law exempts offerings made by California companies to "qualified purchasers" whose characteristics are similar to, but not the same as, accredited investors under Regulation D. The California provisions allow limited general solicitation before sales. Securities issued under this exemption are “restricted securities,” meaning they can only be resold by registration or an applicable exemption from SEC registration, as explained below under the heading “Resales of restricted securities.”

Exemption for sales of securities through employee benefit plans — Rule 701

SEC Rule 701 exempts certain sales of securities made to compensate employees. This exemption is available only to companies that are not subject to Exchange Act reporting requirements. You can sell at least $1,000,000 of securities under this exemption, regardless of your company’s size. You can sell even more if you satisfy certain formulas based on your company's assets or on the number of its outstanding securities. If you sell more than $5 million in securities in a 12-month period, you are required to provide disclosure to your employees that includes certain financial and other information. Employees receive "restricted securities" in these transactions, and may not freely offer or sell them to the public, unless the securities are registered or the holders can rely on an exemption.

Resales of restricted securities

"Restricted securities" are previously-issued securities held by security holders that are not freely tradable because the sale transaction from the issuer to the security holders was a private transaction. After such a private transaction, the security holders can only resell the securities into the market by using an “effective” registration statement under the Securities Act or a valid exemption from the registration requirements of the Securities Act for the resale, such as Rule 144 under the Securities Act.

If holders of restricted securities want to resell using an effective registration statement, the issuing company can provide a registration statement for them to make sales in a public offering by following the process discussed above for registering a public offering of securities.

Alternatively, a holder of restricted securities can resell using an exemption. For example, Securities Act Rule 144 provides an exemption that permits the resale of restricted securities if a number of conditions are met, including holding the securities for six months or one year, depending on whether the issuer has been filing reports under the Exchange Act. Rule 144 may limit the amount of
securities that can be sold at one time and may restrict the manner of sale, depending on whether the security holder is an affiliate. An affiliate of a company is a person that, directly, or indirectly through one or more intermediaries controls, or is controlled by, or is under common control with, the company.

What are the new exemptions mandated by the JOBS Act?

The Jumpstart Our Business Startups Act (or JOBS Act), enacted in 2012, is intended, among other things, to reduce barriers to capital formation, particularly for smaller companies. Among other things, the JOBS Act requires the SEC to adopt rules amending existing exemptions and creating new exemptions that permit companies to raise capital without SEC registration. Additional information about the JOBS Act is available here.

Eliminating the ban on general solicitation under Rule 506

The JOBS Act requires the SEC to eliminate the prohibition on the use of general solicitation and general advertising in Rule 506 of Regulation D, so long as all purchasers in the offering are accredited investors and the issuer takes reasonable steps to verify their accredited investor status. Rule 506(c) implements this statutory mandate.

Crowdfunding

The JOBS Act requires the SEC to develop new rules permitting capital raising by “crowdfunding.” Crowdfunding is a means to raise money by attracting relatively small individual contributions from a large number of people. In recent years, crowdfunding websites have proliferated to raise funds for charities, artistic endeavors and businesses. These sites did not offer securities, such as an ownership interest or share of profits in a business; rather, money was contributed in the form of donations, or in return for the product being made. The JOBS Act creates an exemption from the registration requirements of the Securities Act that provides for a form of securities crowdfunding.

Under JOBS Act crowdfunding, companies will be limited to raising $1 million in any 12-month period. Companies cannot crowdfund on their own, but will have to engage an intermediary that is registered with the SEC. These intermediaries will be subject to a number of requirements.

Individual investors will be limited in the amount they can invest by way of crowdfunding in any 12-month period to:

- if your annual income or net worth is less than $100,000—the greater of $2,000 or 5 percent of annual income or net worth, or
if your annual income or net worth is more than $100,000—10 percent of annual income or net worth up to a maximum of $100,000. (When calculating your net worth, you should not count the value of your primary residence.)

The SEC must first write rules that govern how companies can use JOBS Act crowdfunding to raise money from investors and set out the responsibilities of intermediaries. These rules will include what must be disclosed to prospective investors before they decide to participate, as well as requirements for how intermediaries will operate. Initial guidance on crowdfunding intermediaries is available here.

Companies cannot use JOBS Act crowdfunding to raise funds from investors until the SEC adopts these rules.

Expansion of Regulation A

The JOBS Act requires the SEC to develop rules for a new exemption similar to existing Regulation A, which will permit offerings of up to $50 million a year without SEC registration (Regulation A currently has a limit of $5 million).

Like current Regulation A, the new exemption will require the filing of an offering statement that will be subject to review by SEC staff. The new exemption will also permit “testing the waters” in connection with the offering. In a change from current Regulation A, issuers will be required to file audited financial statements annually with the SEC, and may be subject to additional reporting requirements, depending on the terms and conditions the SEC ultimately imposes on the exemption.

Companies cannot use this new exemption until the SEC adopts final rules.

Do state law requirements apply in addition to federal requirements?

Yes. State governments have their own securities laws and regulations. If your company is selling securities, it must comply with both federal regulations and state securities laws and regulations in the states where securities are offered and sold (typically, the states where offerees and investors are based). A particular offering exempt under the federal securities laws is not necessarily exempt from any state laws. Each state’s securities laws have their own separate registration requirements and exemptions to registration requirements. To locate a state securities regulator and learn more about a particular state’s securities laws, you may visit the website of the North American Securities Administrators Association (NASAA).

Historically, most state legislatures have followed one of two approaches in regulating public offerings of securities, or a combination of the two
approaches. Some states review the securities offerings of small businesses to determine whether companies disclose to investors all information needed to make an informed investment decision. Other states also analyze the terms of public offerings using substantive standards to determine whether the structure of the offerings are fair to investors.

To facilitate small business capital formation, NASAA, in conjunction with the American Bar Association, developed the Small Company Offering Registration or “SCOR” program. The program includes a simplified "question and answer" registration form that companies can use as the disclosure document for investors in connection with a Rule 504 offering. The SCOR program was primarily designed for state registration of small business securities offerings of up to $1 million annually conducted under the SEC’s Rule 504 of Regulation D. To assist small business securities issuers in the SCOR program, NASAA maintains a web page providing information on the program.

To assist small businesses seeking to undertake registration of a securities offering in several states, some states coordinate their reviews through a NASAA program called “coordinated review.” NASAA maintains a web page that provides information for companies seeking additional information on its coordinated review program.”

1.14 Primary vs. Secondary Offerings. A “primary” securities offering is one made by the issuer to raise money for its needs. A “secondary” offering is where an issuer is selling its securities on behalf of selling securityholders and the issuer receives nothing from the sale of the securities. An offering can be both a primary and a secondary offering. An IPO can be a secondary offering – an issuer going public because it has to registered a shareholders’ stock.

1.14.1 Public-Registered Offering. A registered offering means a public securities offering for which a registration statement has been timely filed by the issuer with the SEC and with the states, reviewed by the regulators, amended in response to regulator comments (a process that can several rounds and take months) and then approved by the SEC and state regulators. A registration statement consists of a cover page, a prospectus and a Part II section which has signatures of officers and directors, list of exhibits and some required undertakings. The prospectus is the main part and is like a super business plan with detailed information about the company, its business and products, management, management compensation, stock ownership, description of capitalization, conflicts of interest, list of experts who helped write the prospectus, description of securities being offered and how they will be sold, any dilution of current shareholders, a summary of prior private offerings, description of any significant legal proceedings and risk factors in investing in the offering.
An approved registered securities offering is declared “effective” by the SEC and the “effectiveness date” is the SEC approved first date on which public sales of the offering may occur. The regulatory approval by the SEC is evidenced by an “Effective order,” which is designated as EFFECT in the SEC website-based EDGAR system that publicly discloses all public filings by companies with the SEC.

1.14.2 Unregistered Offering. An unregistered offering is a private offering of securities that does not require registration with and review by the regulators. Unregistered offerings generally ban general solicitation or advertising to find investors (exception being a Rule 506(c) offering). The only public information about most private offerings is the notices filed with regulators. The actual offering documents do not usually see the light of day. The most common notice of a private offering notice is the SEC Form D (found on the EDGAR system), which is a check the box and fill in the blank 11-page notice form. The Form D can be found at URL:

https://www.sec.gov/about/forms/formd.pdf

1.15 Compliance required for Offer/Sale in Certain Offerings.

1.15.1 Basic Securities Compliance: In the U.S., an issuer must either register each share or unit or certificate of the securities being offering or must have an exemption from registration for each share or unit or certificate of the securities being offered. An exception is New York State’s Martin Act.

1.15.2 Importance of “Offer.” Under §2(a)(3) of the Securities Act of 1933, “offer” is defined in the same terms as a contract offer BUT ALSO includes any effort to sell a security. Offer is included in the scope of a “sale,” which triggers the dreaded Section 5 of the Securities Act of 1933 ban on public offerings made without registration, review and approval of the SEC and the use of a Section 10 prospectus. Section §2(a)(3) of that act excepts any preliminary negotiations and agreements with underwriters who have contracted with the issuer to handle the offer.

Note: for public offerings and some private offerings, the mere “offer” can trigger securities offering compliance and the fraud laws apply to any kind of offer or sale – whether public or private.

1.15.3 Business Start-Ups. Founders start a new business and issue stock left and right without even a thought of whether securities compliance is required. While there are exemptions that allow the sale of securities in the formation or a business or, alternatively, exemptions covering the sale of securities to a small number of investors in a 12 month period, and some of these exemptions require no action or filing by the issuing company or issuer, you have to verify what the compliance requirements are before offering or issuing securities. Some of these exemptions have strict requirements on number of investors, amount of securities, or filing requirements and the failure

CASE IN POINT: Google, before it became public and despite having top notch legal talent, issued stock options to dozens of employees without compliance with federal and state securities laws. After going public, the SEC decided that the stock options issuances violated securities laws and Google, Inc. had to offer to rescind the stock option issuances (See: Form S-1 by Google, Inc., #33-
As stated in the rescission offer: “Certain stock issuances pursuant to certain of our stock plans during the period from September 2001 through June 2004 were not registered under federal securities laws and we did not seek to exempt these securities from the registration requirements of these laws. In addition, certain option grants and stock issuances pursuant to certain of our stock plans during this period were not qualified under state securities laws, and we did not seek to exempt these securities from the qualification requirements of these laws.

More specifically, because of the frequency and number of sales, including the number of persons who received options and purchased shares, we do not believe that a valid exemption under the Securities Act of 1933 was available for these option grants and stock issuances. In addition, we believe that the federal exemption provided by Rule 701 of the Securities Act of 1933 may not have been available for the options and shares issued pursuant to the stock plans subject to the rescission offer because the amount of securities sold exceeded the limits set forth in Rule 701. Consequently, certain of our option grants and stock issuances pursuant to certain of our stock plans during this period may have been issued in violation of either federal or state securities laws, or both, and may be subject to rescission. In order to address this issue, we are making the rescission offer to all holders of any outstanding options and shares subject to rescission. If our rescission offer is accepted by all offerees, we will be required to make an aggregate payment to the holders of these options and shares of up to approximately $25.9 million, which includes statutory interest.”

Google, Inc. Form S-1, page 12.

1.16 Rescission Remedy for Non-Compliance. A rescission is where the issuer offers to refund the investment of a buyer of securities as a remedy for conducting a securities offering that violated securities laws or rules. Besides refunding:

A rescission for a minor violation can often prevent a state enforcement action. Rescission is not an iron clad remedy for noncompliance, but in many instances the state regulators will be content with the rescission – if timely, promptly made, in compliance with all requirements and remedying a minor noncompliance issue. Rescissions do not remedy fraud.

1.17 Handling Securities Law Violations – Prepping Client. Counsel needs to take the following steps when confronted with a securities law violation: (1) investigate and get the truth – not the CEO’s cover story or snow job; (2) bring in a private practitioner who does securities law defense work – preferably one that worked in SEC Enforcement or state enforcement – and jointly review the facts and develop a plan for contacting the regulators; (3) prep the client to narrow the issues to the violation; (4) counsel and the expert contact the regulators and offer a remedial plan. In any matter involving possible enforcement action, never let your client take the lead in this contact – the client tends to lack focus and tends to over explain matters. If issuer voluntarily report a violation, the regulators will generally, not always, give your client credit for voluntary reporting of a violation and cooperation with the ensuing investigation. Voluntary reporting and cooperation with any investigation may very
well save some officers from punishment or may lessen the penalty for violation — underline “MAY.”

1.18 SEC as an Adversary. The SEC has in the past few years gotten a black eye — well deserved. The Madow Scandal and some recent embarrassing court loses have revealed a lack of competence in understanding all aspects of how Wall Street works, a sensitivity to politics that is inappropriate for a regulatory watchdog and poor judgment in bringing as well as prosecuting cases. Do not be fooled. The SEC has some of the best lawyers in the federal government — many of them are serving at the SEC only for a limited period before returning to their Wall Street law firms. You need top notch legal talent to beat the SEC in an enforcement action. A typical securities fraud defense in federal court will cost about $1 million to $2 million in legal fees if you are using a top level law firm like Wilmer Hale or Skadden Arps or Gibson Dunn or Boies Schiller & Flexner.

1.19 Integration of Securities Offerings. Integration is an SEC policy that private and public offerings that are similar may be integrated for purposes of determining compliance with all laws and rules. Integration was developed to prevent issuers from trying to make public offerings under the guise of private offerings or trying to circumvent the requirements of particular public or private offering with a “side” offering. THIS IS A HUGE LIABILITY TRAP.

SEC Release #33-4552 and Rule 502(a) of Regulation D sets forth the five criteria of integrated offerings: (1) are the offerings part of a single plan of financing; (2) do the offerings involve issuance of the same class of security; (3) are the offerings made at or about the same time; (4) are the same type of consideration is to be received; and (5) are the offerings are for the same general purpose.

What happens when offerings are integrated by the SEC is that you may lose an exemption for one offering or the offerings together may violate a law or rule and you end up with an illegal offering.

SEC Rules have provided some safe harbors for integration:

1) Rule 502(a): excludes offerings more than six before or after an offering under Regulation D; and
2) Rule 500(g): Regulation S foreign offerings are excluded; and
3) Rule 144A(e): sales to qualified investors under Rule 144; and
4) Rule 147(b)(2): offerings six months before or after an intrastate offering under Rule 147.

One way to avoid integration is to offer different kinds of securities: for instance, one offering is common stock and one offering is for debentures.
SUPPLEMENTS

SUPPLEMENT ONE: SEC Rule on Nonpublic Offering Exemptions.

Final Rule: Nonpublic Offering Exemption

U.S. SECURITIES AND EXCHANGE COMMISSION

Release No. 33-4552
November 6, 1962

SECURITIES ACT OF 1933

Nonpublic Offering Exemption

The Commission today announced the issuance of a statement regarding the availability of the exemption from the registration requirements of section 5 of the Securities Act of 1933 afforded by the second clause of section 4(1)1 of the Act for "transactions by an issuer not involving any public offering," the so-called "private offering exemption." Traditionally, the second clause of section 4(1)1 has been regarded as providing an exemption from registration for bank loans, private placements of securities with institutions, and the promotion of a business venture by a few closely related persons. However, an increasing tendency to rely upon the exemption for offerings of speculative issues to unrelated and uninformed persons prompts this statement to point out the limitations on its availability.

Whether a transaction is one not involving any public offering is essentially a question of fact and necessitates a consideration of all surrounding circumstances, including such factors as the relationship between the offerees and the issuer, the nature, scope, size, type and manner of the offering.

The Supreme Court in S.E.C. v. Ralston Purina Co., 346 U.S. 119, 124, 125 (1953), noted that the exemption must be interpreted in the light of the statutory purpose to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions" and held that "the applicability of section 4(1) should turn on whether the particular class of persons affected need the protection of the Act." The court stated that the number of offers is not conclusive as to the availability of the exemption, since the statute seems to apply to an offering "whether to few or many."2 However, the court indicated that "noting prevents the Commission, in enforcing the statute, from using some kind of numerical test in deciding when to investigate particular exemption claims." It should be emphasized, therefore, the at the number of persons to whom the offering is extended is relevant only to the question whether they have the requisite association with and knowledge of the issuer which make the exemption available.

Consideration must be given not only to the identity of the actual purchasers but also to the offerees. Negotiations or conversations with or general solicitations of an unrestricted and unrelated group of prospective purchasers for the purpose of ascertaining who would be willing to accept an offer of securities is inconsistent with a claim that the transaction does not involve a public offering even though ultimately there may only be a few knowledgeable purchasers.3
A question frequently arises in the context of an offering to an issuer's employees. Limitation of an offering to certain employees designated as key employees may not be a sufficient showing to qualify for the exemptions. As the Supreme Court stated in *Ralston Purina* case: "The exemption as we construe it, does not deprive corporate employees, as a class, of the safeguards of the Act. We agree that some employee offerings may come within section 4(a), e.g., one made to executive personnel who because of their position have access to the same kind of information that the Act would make available in the form of a registration statement. Absent such a showing of special circumstances, employees are just as much members of the investing "public" as any of their neighbors in the community." The Court's concept is that the exemption is necessarily narrow. The exemption does not become available simply because offerees are voluntarily furnished information about the issuer. Such a construction would give each issuer the choice of registering or making its own voluntary disclosures without regard to the standards and sanctions of the Act.

The sale of stock to promoters who take the initiative in founding or organizing the business would come within the exemption. On the other hand, the transaction tends to become public when the promoters begin to bring in a diverse group of uninformed friends, neighbors and associates.

The size of the offering may also raise questions as to the probability that the offering will be completed within the strict confines of the exemption. An offering of millions of dollars to non-institutional and non-affiliated investors or one divided, or convertible, into many units would suggest that a public offering may be involved.

When the services of an investment banker, or other facility through which public distributions are normally effected, are used to place the securities, special care must be taken to avoid a public offering. If the investment banker places the securities with discretionary accounts and other customers without regard to the ability of such customers to meet the tests implicit in the *Ralston Purina* case, the exemption may be lost. Public advertising of the offerings would, of course, be incompatible with a claim of a private offering. Similarly, the use of the facilities of a securities exchange to place the securities necessarily involves an offering to the public.

An important factor to be considered is whether the securities offered have come to rest in the hands of the initial informed group or whether the purchasers are merely conduits for a wider distribution. Persons who act in this capacity, whether or not engaged in the securities business, are deemed to be "underwriters" within the meaning of section 2(11) of the Act. If the purchasers do in fact acquire the securities with a view to public distribution, the seller assumes the risk of possible violation of the registration requirements of the Act and consequent civil liabilities. This has led to the practice whereby the issuer secures from the initial purchasers representations that they have acquired the securities for investment. Sometimes a legend to this effect is placed on the stock certificates and stop-transfer instructions issued to the transfer agent. However, a statement by the initial purchaser, at the time of his acquisition that the securities are taken for investment and not for distribution is necessarily self-serving and not conclusive as to his actual intent. Mere acceptance at face value of such assurances will not provide a basis for reliance on the exemption when inquiry would suggest to a reasonable person that these assurances are formal rather than real. The additional precautions of placing a legend on the securities and issuing stop-transfer orders have proved in many cases to be an effective means of preventing illegal distributions. Nevertheless, these are only precautions and are not to be regarded as a basis for exemption from registration. The nature of the purchaser's past investment and trading practices or the character and scope of his business may be inconsistent with the purchase of large blocks of securities for investment. In particular, purchases by persons engaged in the business of buying and selling securities require careful scrutiny for the purpose of determining whether such person may be acting as an underwriter for the issuer.
The view is occasionally expressed that, solely by reason of continued holding of a security for the six month capital-gain period specified in the income-tax laws, or for a year from the date of purchase, the security may be sold without registration. There is no statutory basis for such assumption. Of course, the longer the period of retention, the more persuasive would be the argument that the resale is not at variance with an original investment intent, but the length of time between acquisition and resale is merely one evidentiary fact to be considered. The weight to be accorded this evidentiary fact must, of necessity, vary with the circumstances of each case. Further, a limitation upon resale for a stated period of time or under certain circumstances would tend to raise a question as to original intent even though such limitation might otherwise recommend itself as a policing devise. There is no legal justification for the assumption that holding a security in an "investment account" rather than a "trading account," holding for a deferred sale, for a market rise, for sale if the market does not rise, or for a statutory escrow period, without more, establishes a valid basis for an exemption from registration under the Securities Act.6

An unforeseen change of circumstances since the date of purchase may be a basis for an opinion that the proposed resale is not inconsistent with an investment representation. However, such claim must be considered in the light of all of the relevant facts. Thus, an advance or decline in market price or a change in the issuer's operating results are normal investment risks and do not usually provide an acceptable basis for such claim of changed circumstances. Possible inability of the purchaser to pay off loans incurred in connection with the purchase of the stock would ordinarily not be deemed an unforeseeable change of circumstances. Further, in the case of securities pledged for a loan, the pledgee should not assume that he is free to distribute without registration. The Congressional mandate of disclosure to investors is not to be avoided to permit a public distribution of unregistered securities because the pledgee took the securities from a purchaser, subsequently delinquent.6

The view is sometimes expressed that investment companies and other institutional investors are not subject to any restrictions regarding disposition of securities stated to be taken for investment and that any securities so acquired may be sold by them whenever the investment decision to sell is made, no matter how brief the holding period. Institutional investors are, however, subject to the same restrictions on sale of securities acquired from an issuer or a person in a control relationship with an issuer insofar as compliance with the registration requirements of the Securities Act is concerned.

Integration of Offerings

A determination whether an offering is public or private would also include a consideration of the question whether it should be regarded as a part of a larger offering made or to be made. The following factors are relevant to such question of integration: whether (1) the different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, (5) the offerings are made for the general purpose.

What may appear to be a separate offering to a properly limited group will not be so considered if it is one of a related series of offerings. A person may not separate parts of a series of related transactions, the sum total of which is really one offering, and claim that a particular part is a nonpublic transaction. Thus, in the case of offerings of fractional undivided interests in separate oil or gas properties where the promoters must constantly find new participants for each new venture, it would appear to be appropriate to consider the entire series of offerings to determine the scope of this solicitation.

As has been emphasized in other releases discussing exemptions from the registration and prospectus requirements of the Securities Act, the terms of an exemption are to be strictly construed against the claimant who also has the burden of proving its availability.7 Moreover,
persons receiving advise from the staff of the Commission that no action will be recommended if they proceed without registration in reliance upon the exemption should do so only with full realization that the tests so applied may not be proof against claims by purchasers of the security that registration should have been effected. Finally, sections 12(2) and 17 of the Act, which provide civil liabilities and criminal sanctions for fraud in the sale of a security, are applicable to the transactions notwithstanding the availability of an exemption from registration.

*Footnotes renumbered in 1986 reprint.

1 Second clause of section 4(1) is now section 4(2), as amended August 20, 1964.


3 Reference is made to the so-called "investment clubs" which have been organized under claim of an exemption from the registration provisions of the Securities Act of 1933 as well as the Investment Company Act of 1940. It should not be assumed that so long as the investment club, which is an investment company within the meaning of the later Act, does not obtain more than 100 members, a public offering of its securities, namely the memberships, will not be involved. An investment company may be exempt from the provisions of the Investment Company Act if its securities are owned by no more than 100 persons and it is not making and does not presently propose to make a public offering of its securities (section 3(c)(1)). Both elements must be considered in determining whether the exemption is available.

4 See Release No. 33-4445.


http://www.sec.gov/rules/final/33-4552.htm

**Supplement Two: JOBS ACT AND SEC GUIDANCE**

The text of the JOBS Act signed by President Obama into law is set forth below:

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**H. R. 3606**

One Hundred Twelfth Congress
of the
United States of America
AT THE SECOND SESSION

Began and held at the City of Washington on Tuesday, the third day of January, two thousand and twelve

An Act

To increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies. Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,
SECTION 1. SHORT TITLE. This Act may be cited as the “Jumpstart Our Business Startups Act”.
SEC. 2. TABLE OF CONTENTS.

The table of contents of this Act is as follows:

Sec. 1. Short title.
Sec. 2. Table of contents.
TITLE I—REOPENING AMERICAN CAPITAL MARKETS TO EMERGING GROWTH COMPANIES
Sec. 101. Definitions.
Sec. 102. Disclosure obligations.
Sec. 103. Internal controls audit.
Sec. 104. Auditing standards.
Sec. 105. Availability of information about emerging growth companies.
Sec. 106. Other matters.
Sec. 107. Opt-in right for emerging growth companies.
Sec. 108. Review of Regulation S-K.
TITLE II—ACCESS TO CAPITAL FOR JOB CREATORS
Sec. 201. Modification of exemption.
TITLE III—CROWDFUNDING
Sec. 301. Short title.
Sec. 302. Crowdfunding exemption.
Sec. 303. Exclusion of crowdfunding investors from shareholder cap.
Sec. 304. Funding portal regulation.
Sec. 305. Relationship with State law.
TITLE IV—SMALL COMPANY CAPITAL FORMATION
Sec. 401. Authority to exempt certain securities.
Sec. 402. Study on the impact of State Blue Sky laws on Regulation A offerings.
TITLE V—PRIVATE COMPANY FLEXIBILITY AND GROWTH
Sec. 501. Threshold for registration.
Sec. 502. Employees.
Sec. 503. Commission rulemaking.
Sec. 504. Commission study of enforcement authority under Rule 12g5–1.
TITLE VI—CAPITAL EXPANSION
Sec. 601. Shareholder threshold for registration.
Sec. 602. Rulemaking.
TITLE VII—OUTREACH ON CHANGES TO THE LAW
Sec. 701. Outreach by the Commission.

SEC. 101. DEFINITIONS.
(a) SECURITIES ACT OF 1933.—Section 2(a) of the Securities Act of 1933 (15 U.S.C. 77b(a)) is amended by adding at the end the following: “(19) The term ‘emerging growth company’ means an issuer that had total annual gross revenues of less than $1,000,000,000 (as such amount is indexed for inflation every 5 years by the Commission to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics, setting the threshold to the nearest 1,000,000) during its most recently completed fiscal year. An issuer that is an emerging growth company as of the first day of that fiscal year shall continue to be deemed an emerging growth company until the earliest of—(A) the last day of the fiscal year of the issuer during which it had total annual gross revenues of $1,000,000,000 (as such amount is indexed for inflation every 5 years by the Commission to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics, setting the threshold to the nearest 1,000,000) or more; “(B) the last
day of the fiscal year of the issuer following the fifth anniversary of the date if the first sale of common equity securities of the issuer pursuant to an effective registration statement under this title; “(C) the date on which such issuer has, during the previous 3-year period, issued more than $1,000,000,000 in non-convertible debt; or “(D) the date on which such issuer is deemed to be a ‘large accelerated filer’, as defined in section 240.12b–2 of title 17, Code of Federal Regulations, or any successor thereto.”.

(b) SECURITIES EXCHANGE ACT OF 1934.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended— (1) by redesignating paragraph (77), as added by section 941(a) of the Investor Protection and Securities Reform Act of 2010 (Public Law 111–203, 124 Stat. 1890), as paragraph (79); and (2) by adding at the end the following: “(80) EMERGING GROWTH COMPANY.—The term ‘emerging growth company’ means an issuer that had total annual gross revenues of less than $1,000,000,000 (as such amount is indexed for inflation every 5 years by the Commission to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics, setting the threshold to the nearest 1,000,000) during its most recently completed fiscal year. An issuer that is an emerging growth company as of the first day of that fiscal year shall continue to be deemed an emerging growth company until the earliest of— “(A) the last day of the fiscal year of the issuer during which it had total annual gross revenues of $1,000,000,000 (as such amount is indexed for inflation every 5 years by the Commission to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics, setting the threshold to the nearest 1,000,000) or more; “(B) the last day of the fiscal year of the issuer following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act of 1933; “(C) the date on which such issuer has, during the previous 3-year period, issued more than $1,000,000,000 in non-convertible debt; or “(D) the date on which such issuer is deemed to be a ‘large accelerated filer’, as defined in section 240.12b–2 of title 17, Code of Federal Regulations, or any successor thereto.”.

(c) OTHER DEFINITIONS.—As used in this title, the following definitions shall apply: (1) COMMISSION.—The term “Commission” means the Securities and Exchange Commission. (2) INITIAL PUBLIC OFFERING DATE.—The term “initial public offering date” means the date of the first sale of common equity securities of an issuer pursuant to an effective registration statement under the Securities Act of 1933. (d) EFFECTIVE DATE.—Notwithstanding section 2(a)(19) of the Securities Act of 1933 and section 3(a)(80) of the Securities Exchange Act of 1934, an issuer shall not be an emerging growth company for purposes of such Acts if the first sale of common equity securities of such issuer pursuant to an effective registration statement under the Securities Act of 1933 occurred on or before December 8, 2011.

SEC. 102. DISCLOSURE OBLIGATIONS. (a) EXECUTIVE COMPENSATION.—(1) EXEMPTION.—Section 14A(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78n–1(e)) is amended— (A) by striking “The Commission may” and inserting the following: “(1) IN GENERAL.—The Commission may”; (B) by striking “an issuer” and inserting “any other issuer”; and (C) by adding at the end the following: “(2) TREATMENT OF EMERGING GROWTH COMPANIES.—“(A) IN GENERAL.—An emerging growth company shall be exempt from the requirements of subsections (a) and (b). “(B) COMPLIANCE AFTER TERMINATION OF EMERGING GROWTH COMPANY TREATMENT.—An issuer that was an emerging growth company but is no longer an emerging growth company shall include the first separate resolution described under subsection (a)(1) not later than the end of—“(i) in the case of an issuer that was an emerging growth company for less than 2 years after the date if first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act of 1933, the 3-year period beginning on such date; and “(ii) in the case of any other issuer, the 1-year period beginning on the date the issuer is no longer an emerging growth company.”.”. (2) PROXIES.—Section 14(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(i)) is
amended by inserting “, for any issuer other than an emerging growth company,” after
“including”.
(3) COMPENSATION DISCLOSURES.—Section 953(b)(1) of the Investor Protection and
Securities Reform Act of 2010 (Public Law 111–203; 124 Stat. 1904) is amended by inserting “, other than an emerging growth company, as that term is defined in section 3(a) of the Securities Exchange Act of 1934,” after “require each issuer”.
(b) FINANCIAL DISCLOSURES AND ACCOUNTING PRONOUNCEMENTS.— (1)
SECURITIES ACT OF 1933.—Section 7(a) of the Securities Act of 1933 (15 U.S.C. 77g(a)) is amended—(A) by striking “(a) The registration” and inserting the following: “(a)
INFORMATION REQUIRED IN REGISTRATION STATEMENT.—“(1) IN GENERAL.—The registration”; and (B) by adding at the end the following:
“(2) TREATMENT OF EMERGING GROWTH COMPANIES.—An emerging growth company—“(A) need not present more than 2 years of audited financial statements in order for the registration statement of such emerging growth company with respect to an initial public offering of its common equity securities to be effective, and in any other registration statement to be filed with the Commission, an emerging growth company need not present selected financial data in accordance with section 229.301 of title 17, Code of Federal Regulations, for any period prior to the earliest audited period presented in connection with its initial public offering; and “(B) may not be required to comply with any new or revised financial accounting standard until such date that a company that is not an issuer (as defined under section 2(a) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201(a))) is required to comply with such new or revised accounting standard, if such standard applies to companies that are not issuers.”.

(2) SECURITIES EXCHANGE ACT OF 1934.—Section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a)) is amended by adding at the end the following: “In any registration statement, periodic report, or other reports to be filed with the Commission, an emerging growth company need not present selected financial data in accordance with section 229.301 of title 17, Code of Federal Regulations, for any period prior to the earliest audited period presented in connection with its first registration statement that became effective under this Act or the Securities Act of 1933 and, with respect to any such statement or reports, an emerging growth company may not be required to comply with any new or revised financial accounting standard until such date that a company that is not an issuer (as defined under section 2(a) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201(a))) is required to comply with such new or revised accounting standard, if such standard applies to companies that are not issuers.”.
(c) OTHER DISCLOSURES.—An emerging growth company may comply with section 229.303(a) of title 17, Code of Federal Regulations, or any successor thereto, by providing information required by such section with respect to the financial statements of the emerging growth company for each period presented pursuant to section 7(a) of the Securities Act of 1933 (15 U.S.C. 77g(a)). An emerging growth company may comply with section 229.402 of title 17, Code of Federal Regulations, or any successor thereto, by disclosing the same information as any issuer with a market value of outstanding voting and nonvoting common equity held by non-affiliates of less than $75,000,000.
SEC. 103. INTERNAL CONTROLS AUDIT. Section 404(b) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7262(b)) is amended by inserting “, other than an issuer that is an emerging growth company (as defined in section 3 of the Securities Exchange Act of 1934),” before “shall attest to”.
SEC. 104. AUDITING STANDARDS. Section 103(a)(3) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7213(a)(3)) is amended by adding at the end the following:
“(C) TRANSITION PERIOD FOR EMERGING GROWTH COMPANIES.—Any rules of the Board requiring mandatory audit firm rotation or a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an emerging growth company, as defined in section 3 of the Securities Exchange Act of 1934. Any additional rules adopted by the Board after the date of enactment of this subparagraph shall not apply to an audit of any emerging growth company, unless the Commission determines that the application of such additional requirements is necessary or appropriate in the public interest,
after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.”

SEC. 105. AVAILABILITY OF INFORMATION ABOUT EMERGING GROWTH COMPANIES.
(a) PROVISION OF RESEARCH.—Section 2(a)(3) of the Securities Act of 1933 (15 U.S.C. 77b(a)(3)) is amended by adding at the end the following: “The publication or distribution by a broker or dealer of a research report about an emerging growth company that is the subject of a proposed public offering of the common equity securities of such emerging growth company pursuant to a registration statement that the issuer proposes to file, or has filed, or that is effective shall be deemed for purposes of paragraph (10) of this subsection and section 5(c) not to constitute an offer for sale or offer to sell a security, even if the broker or dealer is participating or will participate in the registered offering of the securities of the issuer. As used in this paragraph, the term ‘research report’ means a written, electronic, or oral communication that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision.”

(b) SECURITIES ANALYST COMMUNICATIONS.—Section 15D of the Securities Exchange Act of 1934 (15 U.S.C. 78o–6) is amended—(1) by redesignating subsection (c) as subsection (d); and (2) by inserting after subsection (b) the following: “(c) LIMITATION.—Notwithstanding subsection (a) or any other provision of law, neither the Commission nor any national securities association registered under section 15A may adopt or maintain any rule or regulation in connection with an initial public offering of the common equity of an emerging growth company—“(1) restricting, based on functional role, which associated persons of a broker, dealer, or member of a national securities association, may arrange for communications between a securities analyst and a potential investor; or “(2) restricting a securities analyst from participating in any communications with the management of an emerging growth company that is also attended by any other associated person of a broker, dealer, or member of a national securities association whose functional role is other than as a securities analyst.”

(c) EXPANDING PERMISSIBLE COMMUNICATIONS.—Section 5 of the Securities Act of 1933 (15 U.S.C. 77e) is amended—(1) by redesignating subsection (d) as subsection (e); and (2) by inserting after subsection (c) the following: “(d) LIMITATION.—Notwithstanding any other provision of this section, an emerging growth company or any person authorized to act on behalf of an emerging growth company may engage in oral or written communications with potential investors that are qualified institutional buyers or institutions that are accredited investors, as such terms are respectively defined in section 230.144A and section 230.501(a) of title 17, Code of Federal Regulations, or any successor thereto, to determine whether such investors might have an interest in a contemplated securities offering, either prior to or following the date of filing of a registration statement with respect to such securities with the Commission, subject to the requirement of subsection (b)(2).”

(d) POST OFFERING COMMUNICATIONS.—Neither the Commission nor any national securities association registered under section 15A of the Securities Exchange Act of 1934 may adopt or maintain any rule or regulation prohibiting any broker, dealer, or member of a national securities association from publishing or distributing any research report or making a public appearance, with respect to the securities of an emerging growth company, either—(1) within any prescribed period of time following the initial public offering date of the emerging growth company; or (2) within any prescribed period of time prior to the expiration date of any agreement between the broker, dealer, or member of a national securities association and the emerging growth company or its shareholders that restricts or prohibits the sale of securities held by the emerging growth company or its shareholders after the initial public offering date.

SEC. 106. OTHER MATTERS. (a) DRAFT REGISTRATION STATEMENTS.—Section 6 of the Securities Act of 1933 (15 U.S.C. 77f) is amended by adding at the end the following: “(e) EMERGING GROWTH COMPANIES.—“(1) IN GENERAL.—Any emerging growth company, prior to its initial public offering date, may confidentially submit to the Commission a draft registration statement, for confidential nonpublic review by the staff of the Commission prior to public filing, provided that the initial confidential submission and all amendments
thereto shall be publicly filed with the Commission not later than 21 days before the date on
which the issuer conducts a road show, as such term is defined in section 230.433(h)(4) of title
17, Code of Federal Regulations, or any successor thereto. “

(2) CONFIDENTIALITY.—Notwithstanding any other provision of this title, the Commission
shall not be compelled to disclose any information provided to or obtained by the Commission
pursuant to this subsection. For purposes of section 552 of title 5, United States Code, this
subsection shall be considered a statute described in subsection (b)(3)(B) of such section 552.
Information described in or obtained pursuant to this subsection shall be deemed to constitute
confidential information for purposes of section 24(b)(2) of the Securities Exchange Act of
1934.”.

(b) TICK SIZE.—Section 11A(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78k–1(c))
is amended by adding at the end the following new paragraph: “(6) TICK SIZE.—“(A) STUDY
AND REPORT.—The Commission shall conduct a study examining the transition to trading
and quoting securities in one penny increments, also known as decimalization. The study shall
examine the impact that decimalization has had on the number of initial public offerings since
its implementation relative to the period before its implementation. The study shall also examine
the impact that this change has had on liquidity for small and middle capitalization company
securities and whether there is sufficient economic incentive to support trading operations in
these securities in penny increments. Not later than 90 days after the date of enactment of this
paragraph, the Commission shall submit to Congress a report on the findings of the study. “(B)
DESIGNATION.—If the Commission determines that the securities of emerging growth
companies should be quoted and traded using a minimum increment of greater than $0.01, the
Commission may, by rule not later than 180 days after the date of enactment of this paragraph,
designate a minimum increment for the securities of emerging growth companies that is greater
than $0.01 but less than $0.10 for use in all quoting and trading of securities in any exchange
or other execution venue.”.

SEC. 107. OPT-IN RIGHT FOR EMERGING GROWTH COMPANIES. (a) IN GENERAL.—
With respect to an exemption provided to emerging growth companies under this title, or an
amendment made by this title, an emerging growth company may choose to forgo such
exemption and instead comply with the requirements that apply to an issuer that is not an
emerging growth company.

(b) SPECIAL RULE.—Notwithstanding subsection (a), with respect to the extension of time to
comply with new or revised financial accounting standards provided under section 7(a)(2)(B) of
the Securities Act of 1933 and section 13(a) of the Securities Exchange Act of 1934, as added
by section 102(b), if an emerging growth company chooses to comply with such standards to
the same extent that a non-emerging growth company is required to comply with such
standards, the emerging growth company— (1) must make such choice at the time the
company is first required to file a registration statement, periodic report, or other report with the
Commission under section 13 of the Securities Exchange Act of 1934 and notify the Securities
and Exchange Commission of such choice; (2) may not select some standards to comply with
in such manner and not others, but must comply with all such standards to the same extent that
a non-emerging growth company is required to comply with such standards; and (3) must
continue to comply with such standards to the same extent that a non-emerging growth
company is required to comply with such standards for as long as the company remains an
emerging growth company.

SEC. 108. REVIEW OF REGULATION S-K. (a) REVIEW.—The Securities and Exchange
Commission shall conduct a review of its Regulation S-K (17 CFR 229.10 et seq.) to— (1)
comprehensively analyze the current registration requirements of such regulation; and (2)
determine how such requirements can be updated to modernize and simplify the registration
process and reduce the costs and other burdens associated with these requirements for
issuers who are emerging growth companies.

(b) REPORT.—Not later than 180 days after the date of enactment of this title, the Commission
shall transmit to Congress a report of the review conducted under subsection (a). The report
shall include the specific recommendations of the Commission on how to streamline the
registration process in order to make it more efficient and less burdensome for the Commission
and for prospective issuers who are emerging growth companies.
SEC. 201. MODIFICATION OF EXEMPTION. (a) MODIFICATION OF RULES.—(1) Not later than 90 days after the date of the enactment of this Act, the Securities and Exchange Commission shall revise its rules issued in section 230.506 of title 17, Code of Federal Regulations, to provide that the prohibition against general solicitation or general advertising contained in section 230.502(c) of such title shall not apply to offers and sales of securities made pursuant to section 230.506, provided that all purchasers of the securities are accredited investors. Such rules shall require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission. Section 230.506 of title 17, Code of Federal Regulations, as revised pursuant to this section, shall continue to be treated as a regulation issued under section 4(2) of the Securities Act of 1933 (15 U.S.C. 77d(2)). (2) Not later than 90 days after the date of enactment of this Act, the Securities and Exchange Commission shall revise subsection (d)(1) of section 230.144A of title 17, Code of Federal Regulations, to provide that securities sold under such revised exemption may be offered to persons other than qualified institutional buyers, including by means of general solicitation or general advertising, provided that securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe is a qualified institutional buyer.

(b) CONSISTENCY IN INTERPRETATION.—Section 4 of the Securities Act of 1933 (15 U.S.C. 77d) is amended—(1) by striking “The provisions of section 5” and inserting “(a) The provisions of section 5”; and (2) by adding at the end the following: “(b) Offers and sales exempt under section 230.506 of title 17, Code of Federal Regulations (as revised pursuant to section 201 of the Jumpstart Our Business Startups Act) shall not be deemed public offerings under the Federal securities laws as a result of general advertising or general solicitation.”.

(c) EXPLANATION OF EXEMPTION.—Section 4 of the Securities Act of 1933 (15 U.S.C. 77d) is amended—(1) by striking “The provisions of section 5” and inserting “(a) The provisions of section 5”; and (2) by adding at the end the following: “(b)(1) With respect to securities offered and sold in compliance with Rule 506 of Regulation D under this Act, no person who meets the conditions set forth in paragraph (2) shall be subject to registration as a broker or dealer pursuant to section 15(a)(1) of this title, solely because—(A) that person maintains a platform or mechanism that permits the offer, sale, purchase, or negotiation of or with respect to securities, or permits general solicitations, general advertisements, or similar or related activities by issuers of such securities, whether online, in person, or through any other means; (B) that person or any person associated with that person co-invests in such securities; or (C) that person or any person associated with that person provides ancillary services with respect to such securities. (2) The exemption provided in paragraph (1) shall apply to any person described in such paragraph if—(A) such person and each person associated with that person receives no compensation in connection with the purchase or sale of such security; (B) such person and each person associated with that person does not have possession of customer funds or securities in connection with the purchase or sale of such security; and (C) such person is not subject to a statutory disqualification as defined in section 3(a)(39) of this title and does not have any person associated with that person subject to such a statutory disqualification. (3) For the purposes of this subsection, the term ‘ancillary services’ means—(A) the provision of due diligence services, in connection with the offer, sale, purchase, or negotiation of such security, so long as such services do not include, for separate compensation, investment advice or recommendations to issuers or investors; and (B) the provision of standardized documents to the issuers and investors, so long as such person or entity does not negotiate the terms of the issuance for and on behalf of third parties and issuers are not required to use the standardized documents as a condition of using the service.”.

TITLE III—CROWDFUNDING

SEC. 301. SHORT TITLE.
This title may be cited as the “Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012” or the “CROWDFUND Act”.

SEC. 302. CROWDFUNDING EXEMPTION. (a) SECURITIES ACT OF 1933.—Section 4 of the Securities Act of 1933 (15 U.S.C. 77d) is amended by adding at the end the following: “(6) transactions involving the offer or sale of securities by an issuer (including all entities controlled by or under common control with the issuer), provided that—“(A) the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, is not more than $1,000,000; “(B) the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, does not exceed— “(i) the greater of $2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; and “(ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000; “(C) the transaction is conducted through a broker or funding portal that complies with the requirements of section 4A(a); and “(D) the issuer complies with the requirements of section 4A(b).”.

(b) REQUIREMENTS TO QUALIFY FOR CROWDFUNDING EXEMPTION.—The Securities Act of 1933 (15 U.S.C. 77a et seq.) is amended by inserting after section 4 the following:

SEC. 4A. REQUIREMENTS WITH RESPECT TO CERTAIN SMALL TRANSACTIONS. “(a) REQUIREMENTS ON INTERMEDIARIES.—A person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others pursuant to section 4(6) shall— “(1) register with the Commission as— “(A) a broker; or “(B) a funding portal (as defined in section 3(a)(80) of the Securities Exchange Act of 1934); “(2) register with any applicable self-regulatory organization (as defined in section 3(a)(26) of the Securities Exchange Act of 1934); “(3) provide such disclosures, including disclosures related to risks and other investor education materials, as the Commission shall, by rule, determine appropriate; “(4) ensure that each investor— “(A) reviews investor-education information, in accordance with standards established by the Commission, by rule; “(B) positively affirms that the investor understands that the investor is risking the loss of the entire investment, and that the investor could bear such a loss; and “(C) answers questions demonstrating— “(i) an understanding of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers; “(ii) an understanding of the risk of illiquidity; and “(iii) an understanding of such other matters as the Commission determines appropriate, by rule; “(5) take such measures to reduce the risk of fraud with respect to such transactions, as established by the Commission, by rule, including obtaining a background and securities enforcement regulatory history check on each officer, director, and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person; “(6) not later than 21 days prior to the first day on which securities are sold to any investor (or such other period as the Commission may establish), make available to the Commission and to potential investors any information provided by the issuer pursuant to subsection (b); “(7) ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, and allow all investors to cancel their commitments to invest, as the Commission shall, by rule, determine appropriate; “(8) make such efforts as the Commission determines appropriate, by rule, to ensure that no investor in a 12-month period has purchased securities offered pursuant to section 4(6) that, in the aggregate, from all issuers, exceed the investment limits set forth in section 4(6)(B); “(9) take such steps to protect the privacy of information collected from investors as the Commission shall, by rule, determine appropriate; “(10) not compensate promoters, finders, or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor; “(11) prohibit its directors, officers, or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services; and “(12) meet such other requirements as the Commission may, by rule, prescribe, for the protection of investors and in the public interest.
“(b) REQUIREMENTS FOR ISSUERS.—For purposes of section 4(6), an issuer who offers or sells securities shall—“(1) file with the Commission and provide to investors and the relevant broker or funding portal, and make available to potential investors—“(A) the name, legal status, physical address, and website address of the issuer;“(B) the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer;“(C) a description of the business of the issuer and the anticipated business plan of the issuer;“(D) a description of the financial condition of the issuer, including, for offerings that, together with all other offerings of the issuer under section 4(6) within the preceding 12-month period, have, in the aggregate, target offering amounts of—“(i) $100,000 or less—“(I) the income tax returns filed by the issuer for the most recently completed year (if any); and“(II) financial statements of the issuer, which shall be certified by the principal executive officer of the issuer to be true and complete in all material respects;“(ii) more than $100,000, but not more than $500,000, financial statements reviewed by a public accountant who is independent of the issuer, using professional standards and procedures for such review or standards and procedures established by the Commission, by rule, for such purpose; and“(iii) more than $500,000 (or such other amount as the Commission may establish, by rule), audited financial statements;“(E) a description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;“(F) the target offering amount, the deadline to reach the target offering amount, and regular updates regarding the progress of the issuer in meeting the target offering amount;“(G) the price to the public of the securities or the method for determining the price, provided that, prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities;“(H) a description of the ownership and capital structure of the issuer, including—“(i) terms of the securities of the issuer being offered and each other class of security of the issuer, including how such terms may be modified, and a summary of the differences between such securities, including how the rights of the securities being offered may be materially limited, diluted, or qualified by the rights of any other class of security of the issuer;“(ii) a description of how the exercise of the rights held by the principal shareholders of the issuer could negatively impact the purchasers of the securities being offered;“(iii) the name and ownership level of each existing shareholder who owns more than 20 percent of any class of the securities of the issuer;“(iv) how the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions; and“(v) the risks to purchasers of the securities relating to minority ownership in the issuer, the risks associated with corporate actions, including additional issuances of shares, a sale of the issuer or of assets of the issuer, or transactions with related parties; and“(I) such other information as the Commission may, by rule, prescribe, for the protection of investors and in the public interest;“(2) not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker;“(3) not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal, without taking such steps as the Commission shall, by rule, require to ensure that such person clearly discloses the receipt, past or prospective, of such compensation, upon each instance of such promotional communication;“(4) not less than annually, file with the Commission and provide to investors reports of the results of operations and financial statements of the issuer, as the Commission shall, by rule, determine appropriate, subject to such exceptions and termination dates as the Commission may establish, by rule; and“(5) comply with such other requirements as the Commission may, by rule, prescribe, for the protection of investors and in the public interest.”

(c) LIABILITY FOR MATERIAL MISSTATEMENTS AND OMISSIONS.—“(1) ACTIONS AUTHORIZED.—“(A) IN GENERAL.—Subject to paragraph (2), a person who purchases a security in a transaction exempted by the provisions of section 4(6) may bring an action against an issuer described in paragraph (2), either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if
such person no longer owns the security.”

(1) IN GENERAL .—An action brought under this paragraph shall be subject to the provisions of section 12(b) and section 13, as if the liability were created under section 12(a)(2). ”

(2) APPLICABILITY .—An issuer shall be liable in an action under paragraph (1), if the issuer—

(A) by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by any means of any written or oral communication, in the offering or sale of a security in a transaction exempted by the provisions of section 4(6), makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading, provided that the purchaser did not know of such untruth or omission; and

(B) does not sustain the burden of proof that such issuer did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.”

(3) DEFINITION .—As used in this subsection, the term ‘issuer’ includes any person who is a director or partner of the issuer, and the principal executive officer or officers, principal financial officer, and controller or principal accounting officer of the issuer (and any person occupying a similar status or performing a similar function) that offers or sells a security in a transaction exempted by the provisions of section 4(6), and any person who offers or sells the security in such offering.”

(d) INFORMATION AVAILABLE TO STATES .—The Commission shall make, or shall cause to be made by the relevant broker or funding portal, the information described in subsection (b) and such other information as the Commission, by rule, determines appropriate, available to the securities commission (or any agency or office performing like functions) of each State and territory of the United States and the District of Columbia.”

(e) RESTRICTIONS ON SALES .—Securities issued pursuant to a transaction described in section 4(6)—

(1) may not be transferred by the purchaser of such securities during the 1-year period beginning on the date of purchase, unless such securities are transferred—

(A) to the issuer of the securities;

(B) to an accredited investor;

(C) as part of an offering registered with the Commission; or

(D) to a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance, in the discretion of the Commission; and

(2) shall be subject to such other limitations as the Commission shall, by rule, establish.”

(f) APPLICABILITY .—Section 4(6) shall not apply to transactions involving the offer or sale of securities by any issuer that—

(1) is not organized under and subject to the laws of a State or territory of the United States or the District of Columbia;

(2) is subject to the requirement to file reports pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934;”

(3) is an investment company, as defined in section 3 of the Investment Company Act of 1940, or is excluded from the definition of investment company by section 3(b) or section 3(c) of that Act; or

(4) the Commission, by rule or regulation, determines appropriate.”

(g) RULE OF CONSTRUCTION .—Nothing in this section or section 4(6) shall be construed as preventing an issuer from raising capital through methods not described under section 4(6).”

(h) CERTAIN CALCULATIONS .—

(1) DOLLAR AMOUNTS .—Dollar amounts in section 4(6) and subsection (b) of this section shall be adjusted by the Commission not less frequently than once every 5 years, by notice published in the Federal Register to reflect any change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics.”

(2) INCOME AND NET WORTH .—The income and net worth of a natural person under section 4(6)(B) shall be calculated in accordance with any rules of the Commission under this title regarding the calculation of the income and net worth, respectively, of an accredited investor.”

(c) RULEMAKING .—Not later than 270 days after the date of enactment of this Act, the Securities and Exchange Commission (in this title referred to as the “Commission”) shall issue such rules as the Commission determines may be necessary or appropriate for the protection of investors to carry out sections 4(6) and section 4A of the Securities Act of 1933, as added by this title. In carrying out this section, the Commission shall consult with any securities commission (or any agency or office performing like functions) of the States, any territory of the United States, and the District of Columbia, which seeks to consult with the Commission, and with any applicable national securities association. ”

(d) DISQUALIFICATION .—

(1) IN GENERAL .—Not later than 270 days after the date of enactment of this Act, the Commission shall, by rule, establish disqualification provisions under
which—(A) an issuer shall not be eligible to offer securities pursuant to section 4(6) of the
Securities Act of 1933, as added by this title; and (B) a broker or funding portal shall not be
eligible to effect or participate in transactions pursuant to that section 4(6).

(2) INCLUSIONS.—Disqualification provisions required by this subsection shall— (A) be
substantially similar to the provisions of section 230.262 of title 17, Code of Federal
Regulations (or any successor thereto); and (B) disqualify any offering or sale of securities by a
person that— (i) is subject to a final order of a State securities commission (or an agency or
officer of a State performing like functions), a State authority that supervises or examines
banks, savings associations, or credit unions, a State insurance commission (or an agency or
officer of a State performing like functions), an appropriate Federal banking agency, or the
National Credit Union Administration, that— (I) bars the person from— (aa) association with an
entity regulated by such commission, authority, agency, or officer; (bb) engaging in the
business of securities, insurance, or banking; or (cc) engaging in savings association or credit
union activities; or (II) constitutes a final order based on a violation of any law or regulation that
prohibits fraudulent, manipulative, or deceptive conduct within the 10-year period ending on the
date of the filing of the offer or sale; or (ii) has been convicted of any felony or misdemeanor in
connection with the purchase or sale of any security or involving the making of any false filing
with the Commission.

SEC. 303. EXCLUSION OF CROWDFUNDING INVESTORS FROM SHAREHOLDER CAP.

(a) EXEMPTION.—Section 12(g) of the Securities Exchange Act of 1934 (15 U.S.C.
78l(g)) is amended by adding at the end the following: “(6) EXCLUSION FOR PERSONS
HOLDING CERTAIN SECURITIES.—The Commission shall, by rule, exempt, conditionally or
unconditionally, securities acquired pursuant to an offering made under section 4(6) of the
Securities Act of 1933 from the provisions of this subsection.”.

(b) RULEMAKING.—The Commission shall issue a rule to carry out section 12(g)(6) of
the Securities Exchange Act of 1934 (15 U.S.C. 78c), as added by this section, not later than
270 days after the date of enactment of this Act.

SEC. 304. FUNDING PORTAL REGULATION.

(a) EXEMPTION.—(1) IN GENERAL.—Section 3 of the Securities Exchange Act of 1934 (15
U.S.C. 78c) is amended by adding at the end the following: “(h) LIMITED EXEMPTION FOR
FUNDING PORTALS.—The Commission shall, by rule, exempt, conditionally or
unconditionally, a registered funding portal from the requirement to register as a
broker or dealer under section 15(a)(1), provided that such funding portal— (A) remains
subject to the examination, enforcement, and other rulemaking authority of the Commission;
(B) is a member of a national securities association registered under section 15A; and (C) is
subject to such other requirements under this
title as the Commission determines appropriate under such rule. “(2) NATIONAL SECURITIES
ASSOCIATION MEMBERSHIP.—For purposes of sections 15(b)(8) and 15A, the term ‘broker
or dealer’ includes a funding portal and the term ‘registered broker or dealer’ includes a
registered funding portal, except to the extent that the Commission, by rule, determines
otherwise, provided that a national securities association shall only examine for and enforce
against a registered funding portal rules of such national securities association written
specifically for registered funding portals.”. (2) RULEMAKING.—The Commission shall issue a
rule to carry out section 3(h) of the Securities Exchange Act of 1934 (15 U.S.C. 78c), as added
by this subsection, not later than 270 days after the date of enactment of this Act.

(b) DEFINITION.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is
amended by adding at the end the following: “(80) FUNDING PORTAL.—The term ‘funding
portal’ means any person acting as an intermediary in a transaction involving the offer or sale of
securities for the account of others, solely pursuant to section 4(6) of the Securities Act of 1933
(15 U.S.C. 77d(6)), that does not— (A) offer investment advice or recommendations; “(B)
solicit purchases, sales, or offers to buy the securities offered or displayed on its website or
portal; “(C) compensate employees, agents, or other persons for such solicitation or based on
the sale of securities displayed or referenced on its website or portal; “(D) hold, manage,
possess, or otherwise handle investor funds or securities; or “(E) engage in such other
activities as the Commission, by rule, determines appropriate.”.

SEC. 305. RELATIONSHIP WITH STATE LAW. (a) IN GENERAL.—Section 18(b)(4) of the

Securities Act of 1933 (15 U.S.C. 77r(b)(4)) is amended—(1) by redesignating subparagraphs (C) and (D) as subparagraphs (D) and (E), respectively; and (2) by inserting after subparagraph (B) the following:

"(C) section 4(6);", (b) CLARIFICATION OF THE PRESERVATION OF STATE ENFORCEMENT AUTHORITY.—(1) IN GENERAL.—The amendments made by subsection (a) relate solely to State registration, documentation, and offering requirements, as described under section 18(a) of Securities Act of 1933 (15 U.S.C. 77r(a)), and shall have no impact or limitation on other State authority to take enforcement action with regard to an issuer, funding portal, or any other person or entity using the exemption from registration provided by section 4(6) of that Act. (2) CLARIFICATION OF STATE JURISDICTION OVER UNLAWFUL CONDUCT OF FUNDING PORTALS AND ISSUERS.—Section 18(c)(1) of the Securities Act of 1933 (15 U.S.C. 77r(c)(1)) is amended by striking “with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.” and inserting the following: “, in connection with securities or securities transactions “(A) with respect to—“(i) fraud or deceit; or “(ii) unlawful conduct by a broker or dealer; and ’(B) in connection to a transaction described under section 4(6), with respect to— “(i) fraud or deceit; or “(ii) unlawful conduct by a broker, dealer, funding portal, or issuer.”.

(c) NOTICE FILINGS PERMITTED.—Section 18(c)(2) of the Securities Act of 1933 (15 U.S.C. 77r(c)(2)) is amended by adding at the end the following: “(F) FEES NOT PERMITTED ON CROWDFUNDED SECURITIES.—Notwithstanding subparagraphs (A), (B), and (C), no filing or fee may be required with respect to any security that is a covered security pursuant to subsection (b)(4)(B), or will be such a covered security upon completion of the transaction, except for the securities commission (or any agency or office performing like functions) of the State of the principal place of business of the issuer, or any State in which purchasers of 50 percent or greater of the aggregate amount of the issue are residents, provided that for purposes of this subparagraph, the term ‘State’ includes the District of Columbia and the territories of the United States.”.

(d) FUNDING PORTALS.—(1) STATE EXEMPTIONS AND OVERSIGHT.—Section 15(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(i)) is amended—(A) by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively; and (B) by inserting after paragraph (1) the following:

“(2) FUNDING PORTALS.— “(A) LIMITATION ON STATE LAWS.—Except as provided in subparagraph (B), no State or political subdivision thereof may enforce any law, rule, regulation, or other administrative action against a registered funding portal with respect to its business as such.

“(B) EXAMINATION AND ENFORCEMENT AUTHORITY.— Subparagraph (A) does not apply with respect to the examination and enforcement of any law, rule, regulation, or administrative action of a State or political subdivision thereof in which the principal place of business of a registered funding portal is located, provided that such law, rule, regulation, or administrative action is not in addition to or different from the requirements for registered funding portals established by the Commission.

“(C) DEFINITION.—For purposes of this paragraph, the term ‘State’ includes the District of Columbia and the territories of the United States.”. (2) STATE FRAUD AUTHORITY.—Section 18(c)(1) of the Securities Act of 1933 (15 U.S.C. 77r(c)(1)) is amended by striking “or dealer” and inserting “, dealer, or funding portal”.

TITLE IV—SMALL COMPANY CAPITAL FORMATION

SEC. 401. AUTHORITY TO EXEMPT CERTAIN SECURITIES. (a) IN GENERAL.—Section 3(b) of the Securities Act of 1933 (15 U.S.C. 77c(b)) is amended—(1) by striking “(b) The Commission” and inserting the following: “(b) ADDITIONAL EXEMPTIONS.— “(1) SMALL ISSUES EXEMPTIVE AUTHORITY.—The Commission”; and (2) by adding at the end the following: “(2) ADDITIONAL ISSUES.—The Commission shall by rule or regulation add a class of securities to the securities exempted pursuant to this section in accordance with the following terms and conditions:
“(A) The aggregate offering amount of all securities offered and sold within the prior 12-month period in reliance on the exemption added in accordance with this paragraph shall not exceed $50,000,000. “
(B) The securities may be offered and sold publicly. “
(C) The securities shall not be restricted securities within the meaning of the Federal securities laws and the regulations promulgated thereunder.
(D) The civil liability provision in section 12(a)(2) shall apply to any person offering or selling such securities.
(E) The issuer may solicit interest in the offering prior to filing any offering statement, on such terms and conditions as the Commission may prescribe in the public interest or for the protection of investors. “
(F) The Commission shall require the issuer to file audited financial statements with the Commission annually.
(G) Such other terms, conditions, or requirements as the Commission may determine necessary in the public interest and for the protection of investors, which may include—“(i) a requirement that the issuer prepare and electronically file with the Commission and distribute to prospective investors an offering statement, and any related documents, in such form and with such content as prescribed by the Commission, including audited financial statements, a description of the issuer’s business operations, its financial condition, its corporate governance principles, its use of investor funds, and other appropriate matters; and“(ii) disqualification provisions under which the exemption shall not be available to the issuer or its predecessors, affiliates, officers, directors, underwriters, or other related persons, which shall be substantially similar to the disqualification provisions contained in the regulations adopted in accordance with section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (15 U.S.C. 77d note).
(3) LIMITATION.—Only the following types of securities may be exempted under a rule or regulation adopted pursuant to paragraph (2): equity securities, debt securities, and debt securities convertible or exchangeable to equity interests, including any guarantees of such securities.
(4) PERIODIC DISCLOSURES.—Upon such terms and conditions as the Commission determines necessary in the public interest and for the protection of investors, the Commission by rule or regulation may require an issuer of a class of securities exempted under paragraph (2) to make available to investors and file with the Commission periodic disclosures regarding the issuer, its business operations, its financial condition, its H. R. 3606—20 corporate governance principles, its use of investor funds, and other appropriate matters, and also may provide for the suspension and termination of such a requirement with respect to that issuer.
(5) ADJUSTMENT.—Not later than 2 years after the date of enactment of the Small Company Capital Formation Act of 2011 and every 2 years thereafter, the Commission shall review the offering amount limitation described in paragraph (2)(A) and shall increase such amount as the Commission determines appropriate. If the Commission determines not to increase such amount, it shall report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate on its reasons for not increasing the amount.”.
(b) TREATMENT AS COVERED SECURITIES FOR PURPOSES OF NSMIA.—Section 18(b)(4) of the Securities Act of 1933 (as amended by section 303) (15 U.S.C. 77r(b)(4)) is further amended by inserting after subparagraph (C) (as added by such section) the following:“(D) a rule or regulation adopted pursuant to section 3(b)(2) and such security is—“(i) offered or sold on a national securities exchange; or“(ii) offered or sold to a qualified purchaser, as defined by the Commission pursuant to paragraph (3) with respect to that purchase or sale;”.
(c) CONFORMING AMENDMENT.—Section 4(5) of the Securities Act of 1933 is amended by striking “section 3(b)” and inserting “section 3(b)(1)”.
SEC. 402. STUDY ON THE IMPACT OF STATE BLUE SKY LAWS ON REGULATION A OFFERINGS. The Comptroller General shall conduct a study on the impact of State laws regulating securities offerings, or “Blue Sky laws”, on offerings made under Regulation A (17 CFR 230.251 et seq.). The Comptroller General shall transmit a report on the findings of the
study to the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate not later than 3 months after the date of enactment of this Act.

TITLE V—PRIVATE COMPANY FLEXIBILITY AND GROWTH

SEC. 501. THRESHOLD FOR REGISTRATION.
Section 12(g)(1)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g)(1)(A)) is amended to read as follows: “(A) within 120 days after the last day of its first fiscal year ended on which the issuer has total assets exceeding $10,000,000 and a class of equity security (other than an exempted security) held of record by either— “(i) 2,000 persons, or “(ii) 500 persons who are not accredited investors (as such term is defined by the Commission), and”.

SEC. 502. EMPLOYEES. Section 12(g)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g)(5)), as amended by section 302, is amended in subparagraph (A) by adding at the end the following: “For purposes of determining whether an issuer is required to register a security with the Commission pursuant to paragraph (1), the definition of ‘held of record’ shall not include securities held by persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of section 5 of the Securities Act of 1933.”.

SEC. 503. COMMISSION RULEMAKING. The Securities and Exchange Commission shall revise the definition of “held of record” pursuant to section 12(g)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g)(5)) to implement the amendment made by section 502. The Commission shall also adopt safe harbor provisions that issuers can follow when determining whether holders of their securities received the securities pursuant to an employee compensation plan in transactions that were exempt from the registration requirements of section 5 of the Securities Act of 1933.

SEC. 504. COMMISSION STUDY OF ENFORCEMENT AUTHORITY UNDER RULE 12G5–1. The Securities and Exchange Commission shall examine its authority to enforce Rule 12g5–1 to determine if new enforcement tools are needed to enforce the anti-evasion provision contained in subsection (b)(3) of the rule, and shall, not later than 120 days after the date of enactment of this Act transmit its recommendations to Congress.

TITLE VI—CAPITAL EXPANSION

SEC. 601. SHAREHOLDER THRESHOLD FOR REGISTRATION. (a) AMENDMENTS TO SECTION 12 OF THE SECURITIES EXCHANGE ACT OF 1934.—Section 12(g) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g)) is further amended— (1) in paragraph (1), by amending subparagraph (B) to read as follows: “(B) in the case of an issuer that is a bank or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841), not later than 120 days after the last day of its first fiscal year ended after the effective date of this subsection, on which the issuer has total assets exceeding $10,000,000 and a class of equity security (other than an exempted security) held of record by 2,000 or more persons,”; and (2) in paragraph (4), by striking “three hundred” and inserting “300 persons, or, in the case of a bank or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841), 1,200 persons”.

(b) AMENDMENTS TO SECTION 15 OF THE SECURITIES EXCHANGE ACT OF 1934.—Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)) is amended, in the third sentence, by striking “three hundred” and inserting “300 persons, or, in the case of a bank or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841), 1,200 persons”.

SEC. 602. RULEMAKING. Not later than 1 year after the date of enactment of this Act, the Securities and Exchange Commission shall issue final regulations to implement this title and the amendments made by this title.

TITLE VII—OUTREACH ON CHANGES TO
SEC. 701. OUTREACH BY THE COMMISSION.
The Securities and Exchange Commission shall provide online information and conduct outreach to inform small and medium sized businesses, women owned businesses, veteran owned businesses, and minority owned businesses of the changes made by this Act.

Speaker of the House of Representatives.
Vice President of the United States and
President of the Senate."

S. 2190 amended the JOBS Act to:  

“Allow entrepreneurs to raise up to $1 million per year through an SEC-registered crowdfunding portal.

Free people to invest a percentage of their income. For investors with an income of less than $100,000, investments will be capped at the greater of $2,000 or 5% of income. For investors within an income of more than $100,000, investments will be capped at 10% up to $100,000.

Require crowdfunding portals to provide investor protection, including investor education materials on the risks associated with small issuers and illiquidity.”

The JOBS Act and Senate amendment can be found, along with the legislative history, at the Congressional website: JOBS ACT at http://thomas.loc.gov/cgi-bin/query/z?c112:H.R.+3606, and Senate Amendment at: http://thomas.loc.gov/cgi-bin/query/z?c112:S.2190:.

SEC Guidance on the JOBS Act provisions affecting the Exchange Act is as follows:  

“Changes to the Requirements for Exchange Act Registration and Deregistration

April 11, 2012

The Jumpstart Our Business Startups Act (the “JOBS Act”) was enacted on April 5, 2012. In these Frequently Asked Questions, the Division of Corporation Finance is providing guidance on the implementation and application of the JOBS Act, based on our current understanding of the JOBS Act and in light of our existing rules, regulations and procedures. These FAQs are not rules, regulations or statements of the Commission. Further, the Commission has neither approved nor disapproved these FAQs.

Title V and Title VI of the JOBS Act amend Section 12(g) and Section 15(d) of the Exchange Act as follows:

- The holders of record threshold for triggering Section 12(g) registration for issuers (other than banks and bank holding companies) has been raised from 500 or more persons to either (1) 2,000 or more persons or (2) 500 or more persons who are not accredited investors.

- Banks and bank holding companies, as such term is defined in the Bank Holding Company Act of 1956, will have a Section 12(g) registration obligation as of any fiscal year-end after April 5, 2012 with respect to a class of equity security held of record by 2,000 or more persons. Under Exchange Act Section 12(i), banks do not register their securities or file reports with the Commission. Accordingly, these FAQs relate only to bank holding companies.

- The holders of record threshold for Section 12(g) deregistration for banks and bank holding companies has been increased from 300 to 1,200 persons.

- The holders of record threshold for the suspension of reporting under Section 15(d) for banks and bank holding companies has been increased from 300 to 1,200 persons.

- In calculating the number of holders of record for purposes of determining whether Section 12(g) registration is required with respect to a class of equity security, issuers (including banks and bank holding companies) may exclude persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act.

These FAQs address questions relating to how these changes affect the requirement of issuers (including bank holding companies) to register a class of equity security under Section 12(g) and the ability of bank holding companies to deregister a class of equity security under Section 12(g) or to suspend a reporting obligation under Section 15(d).

(1) Question:

How do the amendments to Section 12(g)(1)(A) affect the obligations of issuers (other than bank holding companies) to register a class of equity security under Section 12(g) where such obligations were triggered as of a fiscal year-end before April 5, 2012?

Answer:

If an issuer that is not a bank holding company triggered a Section 12(g) registration obligation with respect to a class of equity security as of a fiscal year-end before April 5, 2012 but would not trigger such obligation under the amended holders of record threshold contained in the JOBS Act, and the issuer has not yet registered that class of equity security under Section 12(g), then the issuer is no longer subject to a Section 12(g) registration obligation with respect to that class. Therefore, if the issuer has not filed an Exchange Act registration statement, it is no longer required to do so. If the issuer has filed an Exchange Act registration statement and the registration statement is not yet effective, then the issuer may withdraw the registration statement. If the issuer has registered a class of equity security under Section 12(g), it would need to continue that registration unless it is eligible to deregister under Section 12(g) or current rules.

(2) Question:
How do the amendments to Section 12(g)(1)(B) affect the obligations of bank holding companies to register a class of equity security under Section 12(g) where such obligations were triggered as of a fiscal year-end on or before April 5, 2012?

Answer:

Under Section 12(g)(1)(B), a bank holding company will have a Section 12(g) registration obligation if, as of any fiscal year-end after April 5, 2012, it has total assets of more than $10 million and a class of equity security held of record by 2,000 or more persons. We consider that the effect of this provision is to eliminate, for bank holding companies, any Section 12(g) registration obligation with respect to a class of equity security as of a fiscal year-end on or before April 5, 2012. Therefore, if a bank holding company has filed an Exchange Act registration statement and the registration statement is not yet effective, then it may withdraw the registration statement. If a bank holding company has registered a class of equity security under Section 12(g), it would need to continue that registration unless it is eligible to deregister under Section 12(g) or current rules.

(3) Question:

On or after April 5, 2012, how can a bank holding company terminate the registration of a class of equity security under Section 12(g)?

Answer:

If the class of equity security is held of record by less than 1,200 persons, the bank holding company may file a Form 15 to terminate the Section 12(g) registration of that class. Form 15 has not yet been amended to reflect the change to Exchange Act Section 12(g)(4). Therefore, a bank holding company should include an explanatory note in its Form 15 indicating that it is relying on Exchange Act Section 12(g)(4) to terminate its duty to file reports with respect to that class of equity security.

Pursuant to Section 12(g)(4), the Section 12(g) registration will be terminated 90 days after the bank holding company files the Form 15. Until that date of termination, the bank holding company is required to file all reports required by Exchange Act Sections 13(a), 14 and 16.

Alternatively, a bank holding company could rely on Exchange Act Rule 12g-4, which permits the immediate suspension of Section 13(a) reporting obligations upon filing a Form 15, if it meets the requirements of that rule. Note that Rule 12g-4 has not yet been amended to incorporate the new 1,200 holder deregistration threshold.

(4) Question:

On or after April 5, 2012, how can a bank holding company suspend its reporting obligations under Section 15(d)?

Answer:

In general, the Section 15(d) reporting obligation is suspended if, and for so long as, the issuer has a class of security registered under Section 12. When an issuer terminates Section 12 registration, it must address any Section 15(d) obligation that would apply once the Section 15(d) suspension is lifted.
For the current fiscal year, a bank holding company can suspend its obligation to file reports under Section 15(d) with respect to a class of security that was sold pursuant to a Securities Act registration statement and that was held of record by less than 1,200 persons as of the first day of the current fiscal year. Such suspension would be deemed to have occurred as of the beginning of the fiscal year in accordance with Section 15(d) (as amended by the JOBS Act). If, during the current fiscal year, a bank holding company has a registration statement that becomes effective or is updated pursuant to Securities Act Section 10(a)(3), then it will have a Section 15(d) reporting obligation for the current fiscal year.

If a bank holding company with a class of security held of record by less than 1,200 persons as of the first day of the current fiscal year has a registration statement that is updated during the current fiscal year pursuant to Securities Act Section 10(a)(3), but under which no sales have been made during the current fiscal year, the bank holding company may be eligible to seek no-action relief to suspend its Section 15(d) reporting obligation. Such issuers should contact the Division’s Office of Chief Counsel for further information.

(5) Question:

Section 503 of the JOBS Act requires the Commission to revise the definition of “held of record” to exclude, from the Section 12(g)(1) holder of record calculation, persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act. May an issuer (including a bank holding company) exclude such persons before the effective date of the revised definition? If so, would an issuer also be able to exclude former employees?

Answer:

Yes. As of April 5, 2012, an issuer (including a bank holding company) may exclude persons who received securities pursuant to an employee compensation plan in Securities Act-exempt transactions whether or not the person is a current employee of the issuer. Although Section 503 of the JOBS Act directs the Commission to adopt “safe harbor provisions that issuers can follow when determining whether holders of their securities received the securities pursuant to an employee compensation plan in transactions that were exempt from the registration requirements of section 5 of the Securities Act of 1933,” the lack of a safe harbor does not affect the application of Exchange Act Section 12(g)(5).

http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-12g.htm

Further SEC Guidance on the JOBS Act, emerging growth company provisions, is set forth below: 9

“Jumpstart Our Business Startups Act
Frequently Asked Questions

Generally Applicable Questions on Title I of the JOBS Act

April 16, 2012

The Jumpstart Our Business Startups Act (the “JOBS Act”) was enacted on April 5, 2012. In these Frequently Asked Questions, the Division of Corporation Finance is providing guidance on the implementation and application of the JOBS Act, based on our current understanding of the JOBS Act and in light of our existing rules, regulations and procedures. These FAQs are not rules, regulations or statements of the Commission. Further, the Commission has neither approved nor disapproved these FAQs.

These FAQs address questions of general applicability under Title I of the JOBS Act. Title I provides scaled disclosure provisions for emerging growth companies, including, among other things, two years of audited financial statements in the Securities Act registration statement for an initial public offering of common equity securities, the smaller reporting company version of Item 402 of Regulation S-K, and no requirement for Sarbanes-Oxley Act Section 404(b) auditor attestations of internal control over financial reporting. Title I also enables emerging growth companies to use test-the-waters communications with QIBs and institutional accredited investors and liberalizes the use of research reports on emerging growth companies.

For information about the confidential submission of emerging growth company draft registration statements, please refer to the Division announcement regarding confidential submission of draft registration statements under the JOBS Act.

(1) Question:

How can an issuer determine whether or not it meets the revenue test for “emerging growth company”?

Answer:

An “emerging growth company” is defined in the Securities Act and the Exchange Act as an issuer with “total annual gross revenues” of less than $1 billion during its most recently completed fiscal year. The phrase “total annual gross revenues” means total revenues as presented on the income statement presentation under U.S. GAAP (or IFRS as issued by the IASB, if used as the basis of reporting by a foreign private issuer). If the financial statements of a foreign private issuer are presented in a currency other than U.S. dollars, total annual gross revenues for purposes of this test should be calculated in U.S. dollars using the exchange rate as of the last day of the most recently completed fiscal year. In addition, if the financial statements for the most recent year included in the registration statement are those of the predecessor of the issuer, the predecessor’s revenues should be used when determining if the issuer meets the definition of an emerging growth company.

(2) Question:

How can an issuer determine whether it qualifies as an “emerging growth company” as of the effective date for the definition of that term?

Answer:

Section 101(d) of the JOBS Act provides an “effective date” for the definition of emerging growth company: an “issuer shall not be an emerging growth company for purposes of [the Securities Act and the Exchange Act]...if the first sale of common equity securities of such issuer pursuant to an effective registration statement under the Securities Act of 1933 occurred on or before December 8, 2011.” The phrase “first sale of common equity securities” in the JOBS Act is not limited to a company’s initial primary offering of common equity securities for cash. It could also include offering common equity pursuant to an employee benefit plan on a
Form S-8 as well as a selling shareholder’s secondary offering on a resale registration statement.

Even if the issuer had a registration statement declared effective on or before December 8, 2011, so long as the first sale of common equity securities occurs after December 8, 2011, an issuer may qualify as an emerging growth company, assuming the other requirements of the definition are satisfied.

(3) Question:

When would a company determine whether it is an emerging growth company for purposes of the various provisions in Title I?

Answer:

Current Commission rules do not address when emerging growth company status should be determined or provide for any transition into or out of emerging growth company status. Absent rule changes, we will apply the following general principles, based on current rules and on the language of Title I:

A company must qualify as an emerging growth company at the time of submission in order to submit a confidential draft registration statement, or any amendment thereto, under Securities Act Section 6(e). If a company ceases to qualify as an emerging growth company while undergoing the confidential review of its draft registration statement – for example, since the initial submission date, a fiscal year has been completed with revenues over $1 billion – it would need to file a registration statement to continue the review process and comply with current rules and regulations applicable to companies that are not emerging growth companies. At that time, the prior confidential draft submissions would be filed as exhibits to the registration statement (see Question 10, Confidential Submission Process for Emerging Growth Companies).

Securities Act Rule 401(a) provides that “the form and contents of a registration statement and prospectus shall conform to the applicable rules and forms as in effect on the initial filing date of such registration statement and prospectus.” The date of the initial confidential draft submission is not the “initial filing date” for these purposes since it is not the filing of a registration statement. Under Rule 401(a), a company’s status at the time of the initial filing date of its registration statement will determine the requirements for the contents of that registration statement. If a company files its registration statement at a time when it qualifies as an emerging growth company, in accordance with Rule 401(a), the disclosure provisions for emerging growth companies would continue to apply through effectiveness of the registration statement even if the company loses its emerging growth company status during registration. Conversely, if a company submits a draft registration statement for confidential review at a time when it qualifies as an emerging growth company, but files its initial registration statement at a time when it does not qualify as an emerging growth company, then the initial registration statement would need to comply with the requirements applicable to registration statements filed by companies that are not emerging growth companies.

For purposes of Securities Act Section 5(d) test-the-waters communications, a company would need to determine whether it qualifies as an emerging growth company at the time it engages in communications in reliance on Section 5(d). For example, if a company made test-the-waters communications in reliance on Section 5(d) before filing a registration statement at a time when it qualifies as an emerging growth company, but is no longer an emerging growth company at the time it files a registration statement, we would not view the earlier communications as a violation of Section 5. Further test-the-waters communications in reliance on Section 5(d),
however, would not be permitted if the company no longer qualifies as an emerging growth company. The same approach would apply to the research reports described in amended Securities Act Section 2(a)(3).

(4) Question:

How should an emerging growth company identify itself as an emerging growth company in a draft registration statement submitted to the staff on a confidential basis under Securities Act Section 6(e) and in the subsequent electronic filing of the registration statement on EDGAR?

Answer:

The issuer should disclose that it is an emerging growth company on the cover page of its prospectus.

(5) Question:

May an issuer that qualifies as an emerging growth company amend its registration statement to provide the scaled disclosure available to emerging growth companies if the registration statement was initially filed prior to April 5, 2012?

Answer:

Yes. The emerging growth company may provide the scaled disclosure available to emerging growth companies in a pre-effective amendment to a pending registration statement or in a post-effective amendment.

(6) Question:

An emerging growth company completed its initial public offering after December 8, 2011 and prior to April 5, 2012. May this company file its next periodic report using the scaled disclosure provisions in Title I?

Answer:

Yes.

(7) Question:

Is an emerging growth company required to follow all of the scaled disclosure provisions for emerging growth companies set out in Title I, or may it comply with some of the scaled disclosure provisions and some of the regular disclosure requirements?

Answer:

Other than the accounting standards referenced in Section 7(a)(2)(B) of the Securities Act and Section 107(b) of the JOBS Act (addressed in Question 13 below), an emerging growth company may decide to follow only some of the scaled disclosure provisions for emerging growth companies.

(8) Question:
May a foreign private issuer that qualifies as an emerging growth company comply with the scaled disclosure provisions available to emerging growth companies to the extent relevant, even though the JOBS Act refers only to Regulation S-K and does not refer to the corresponding items in Form 20-F?

Answer:

Yes, the staff will not object if a foreign private issuer that qualifies as an emerging growth company complies with the scaled disclosure provisions available to emerging growth companies to the extent relevant to the form requirements for foreign private issuers.

(9) Question:

A foreign private issuer qualifies as an emerging growth company and is also entitled to submit its draft registration statement on a non-public basis pursuant to the Division’s policy on Non-Public Submissions from Foreign Private Issuers. In this situation, will the foreign private issuer be required to publicly file its confidential submissions at least 21 days before the road show?

Answer:

If the foreign private issuer chooses to take advantage of any benefit available to emerging growth companies, then it will be treated as an emerging growth company and will be required to publicly file its confidential submissions at least 21 days before the road show. If the foreign private issuer chooses not to take advantage of any emerging growth company benefit, then it may follow the Division’s policy on Non-Public Submissions from Foreign Private Issuers.

(10) Question:

May a Canadian issuer filing under the Multi-Jurisdictional Disclosure System (“MJDS”) qualify as an emerging growth company if it satisfies the requirements of the definition of emerging growth company?

Answer:

Yes. While the disclosure requirements for this Canadian issuer would continue to be established under its home country standards in accordance with the MJDS, other provisions of Title I, such as the test-the-waters provision in Section 5(d) of the Securities Act and the deferral of compliance with Section 404(b) of the Sarbanes-Oxley Act, would be available to an MJDS filer that qualifies as an emerging growth company.

(11) Question:

How many years of financial data need to be included under Item 301 of Regulation S-K in the initial public offering registration statement of an emerging growth company?

Answer:

Securities Act Section 7(a)(2)(A) provides that an emerging growth company need not present more than two years of audited financial statements in a registration statement for an initial public offering of its common equity securities. This section also provides that, “in any other registration statement to be filed with the Commission, an emerging growth company need not present selected financial data in accordance with section 229.301 of title 17… for any period prior to the earliest audited period presented in connection with its initial public offering.”
Although Section 7(a)(2)(A) refers to “any other” registration statement, we will not object if an emerging growth company presenting two years of audited financial statements in its initial public offering registration statement in accordance with Section 7(a)(2)(A) limits the number of years of selected financial data under Item 301 of Regulation S-K to two years as well.

(12) Question:

How many years of audited financial statements are required to be included in an emerging growth company’s registration statement other than the registration statement for its initial public offering of common equity securities?

Answer:

The provision in Securities Act Section 7(a)(2)(A) permitting the filing of only two years of audited financial statements is limited to the registration statement for the emerging growth company’s initial public offering of common equity securities. Although the provision is limited to the initial public offering registration statement, we will not object if, in other registration statements, an emerging growth company does not present audited financial statements for any period prior to the earliest audited period presented in connection with its initial public offering of common equity securities.

(13) Question:

If an emerging growth company chooses not to take advantage of the extended transition period provided in Securities Act Section 7(a)(2)(B) for complying with new or revised accounting standards, when is the emerging growth company required to make that decision, and how should that be communicated to the Commission?

Answer:

Section 107(b)(1) of the JOBS Act provides that an emerging growth company “must make such choice at the time the company is first required to file a registration statement, periodic report, or other report with the Commission” and to notify the Commission of such choice. Although emerging growth companies that are submitting their draft registration statements on a confidential basis will not be required to file a registration statement until at least 21 days before the road show, they should notify the review staff of their choice in their initial confidential submission, as that choice will inform the staff’s review of the financial statements in the draft registration statement. Emerging growth companies that currently are in registration or are subject to Exchange Act reporting should make and disclose their choice in their next amendment to the registration statement or in their next periodic report, respectively.

Note that Section 107(b)(2) provides that any decision to opt out of the extended transition period provided in Securities Act Section 7(a)(2)(B) for complying with new or revised accounting standards is irrevocable.

(14) Question:

If an emerging growth company chooses to take advantage of the extended transition period provided in Securities Act Section 7(a)(2)(B) for complying with new or revised accounting standards, what type of disclosure should be included in its registration statement or periodic report prior to the adoption of such standards?

Answer:
SAB Topic 11M provides disclosure guidance with respect to recently issued accounting standards that will be adopted by the registrant in a future period. SAB Topic 11M specifies that one of the disclosures that should generally be considered by a registrant is the effective date of such standards. For each recently issued accounting standard that will apply to its financial statements, an emerging growth company that chooses to take advantage of the extended transition periods should disclose the date on which adoption is required for non-emerging growth companies and the date on which the emerging growth company will adopt the recently issued accounting standard, assuming it remains an emerging growth company as of such date.

(15) Question:

Until the Commission amends the form requirements, Regulation S-X and Regulation S-K to be consistent with the disclosure provisions for emerging growth companies as set forth in Title I of the JOBS Act, how should emerging growth companies handle any conflict between the disclosure provisions in Title I and existing rules and regulations?

Answer:

An emerging growth company may comply with Title I’s disclosure provisions in its registration statements, periodic reports and proxy statements, even if doing so would be inconsistent with existing rules and regulations. The disclosure provisions in Title I supersede, in relevant part, existing rules and regulations.

For example, we note that Section 102(c) of the JOBS Act, which was not enacted as part of the Exchange Act, provides that an emerging growth company may comply with Item 402 of Regulation S-K by providing only the information required of a smaller reporting company, even if it does not qualify as a smaller reporting company. In addition, Section 103 of the JOBS Act, which also was not enacted as part of the Exchange Act, provides that an emerging growth company is not required to comply with the requirements of Sarbanes-Oxley Section 404(b).

An emerging growth company’s CEO and CFO are required to certify in their Sarbanes-Oxley Act Section 906 certifications that the company’s periodic report fully complies with the requirements of Sections 13(a) or 15(d) of the Exchange Act. We view compliance with Sections 102(c) and 103 of the JOBS Act as being consistent with full compliance with the requirements of Sections 13(a) or 15(d) of the Exchange Act.

(16) Question:

In addition to presenting its own financial statements, an issuer may be required to present up to three years of financial statements of other entities in its registration statement, based on the significance of those entities (e.g., financial statements of acquired businesses and equity method investees under Rules 3-05 and 3-09 of Regulation S-X, respectively). How many years of financial statements must be presented for these entities if an emerging growth company presents only two years of financial statements pursuant to Section 7(a)(2)(A) of the Securities Act?

Answer:

If the significance test results in a requirement to present three years of financial statements for these other entities, we would not object if the emerging growth company presents only two years of financial statements for these other entities in its registration statement. This approach is similar to how smaller reporting companies report the financial statements of businesses acquired or to be acquired pursuant to Rule 8-04(c) of Regulation S-X.
(17) Question:

Securities Act Section 2(a)(19)(C) provides that an issuer may lose its emerging growth company status on the “date on which such issuer has during the previous 3-year period, issued more than $1,000,000,000 in non-convertible debt,” provided that none of the other disqualifying conditions in Section 2(a)(19) have been triggered. How is the 3-year period measured, and what constitutes “non-convertible debt”?

Answer:

The 3-year period covers any rolling 3-year period. It is not limited to completed calendar or fiscal years. As of any date on which an issuer has issued more than $1 billion in non-convertible debt over the three years prior to such date, the issuer will lose its status as an emerging growth company, provided that none of the other disqualifying conditions have been triggered.

“Non-convertible debt” means any non-convertible security that constitutes indebtedness, whether issued in a registered offering or not. 

The SEC has also established a confidential process for emerging growth Securities Act registration statements, as set forth below: 10

“Division announcement regarding confidential submission of draft registration statements under the Jumpstart Our Business Startups Act

Pursuant to the Jumpstart Our Business Startups Act, an Emerging Growth Company (as defined in the Act) whose common equity securities have not been previously sold pursuant to an effective registration statement under the Securities Act of 1933 may confidentially submit to the Commission a draft registration statement for confidential nonpublic review. Until we fully implement a system that provides for electronic transmission and receipt of confidential submissions, we ask that you submit draft registration statements in a text searchable PDF file on a CD/DVD. Alternatively, you may submit them in paper, and if you do, we ask that you not staple or bind them. Please include a transmittal letter in which the company confirms its Emerging Growth Company status.

Please send one copy of your confidential draft registration statement to:

Draft Registration Statement
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Foreign private issuers eligible to submit draft registration statements as Emerging Growth Companies or eligible to follow the Division of Corporation Finance policy must submit their

draft registration statements in the same format and to the same address provided above as the e-mail address previously available for these submissions is no longer active.

If you submit a draft registration statement, we will contact you to confirm receipt and advise you of the office to which we have assigned your submission for review. A registration fee is not required with a confidential draft registration statement. Please note that this submission is not a public filing and that a registration statement submitted through this process is not filed for purposes of Section 5 of the Securities Act of 1933.

Please direct questions about the draft registration statement submission and review process to (202) 551-5867. http://www.sec.gov/divisions/corpfin/cfannouncements/draftregstatements.htm”

The individual bills within the JOBS Act are:

“Jumpstart Our Business Startups (JOBS) Act

Bills included in the JOBS Act:


H.R. 3606, introduced by Rep. Stephen Fincher of the Financial Services Committee, establishes a new category of issuers, identified as “Emerging Growth Companies” (EGCs), which will be exempt from certain regulatory requirements until the earliest of three conditions: (1) five years from the date of the initial public offering; (2) the date an EGC has $1 billion in annual gross revenue; or (3) the date an EGC becomes what is defined by the Securities and Exchange Commission (SEC) as a “large accelerated filer,” which is a company with a worldwide market value of outstanding voting and non-voting common equity held by non-affiliates (also known as “public float”) of $700 million or more. The regulatory relief provided by H.R. 3606 is designed to be temporary and transitional, encouraging small companies to go public but ensuring they transition to full conformity with regulations over time or as they grow large enough to have the resources to sustain the type of compliance infrastructure associated with more mature enterprises. The Committee favorably reported H.R. 3606 to the House by a vote of 54 to 1 on February 16, 2012.

H.R. 2940, the Access To Capital For Job Creators Act. Approved by the Financial Services Committee on October 26, 2011 and by the House 413-11 on November 3, 2011.

H.R. 2940, introduced by Rep. Kevin McCarthy of the Financial Services Committee, makes the exemption under the SEC’s Regulation D Rule 506 available to issuers even if the securities are marketed through a general solicitation or advertising so long as the purchasers are “accredited investors.” The legislation would allow companies greater access to accredited investors and to new sources of capital to grow and create jobs, without putting less sophisticated investors at risk. The Committee favorably reported H.R. 2940 to the House by a voice vote on October 26, 2011, and the House passed H.R. 2940 by a vote of 413 to 11 on November 3, 2011.

H.R. 2930, the Entrepreneur Access To Capital Act. Approved by the Financial Services Committee on October 26, 2011 and by the House 407-17 on November 3, 2011.
H.R. 2930, introduced by Rep. Patrick McHenry of the Financial Services Committee, creates a new registration exemption from the Securities Act of 1933 for securities issued through internet platforms also known as “crowdfunding.” To use this new exemption, the issuer’s offering cannot exceed $1 million, unless the issuer provides investors with audited financial statements, in which case the offering amount may not exceed $2 million. An individual’s investment must be equal to or less than the lesser of $10,000 or 10 percent of the investor’s annual income. By exempting such offerings from registration with the SEC and preempting state registration laws, H.R. 2930 will enable entrepreneurs to more easily access capital from potential investors across the United States to grow their business and create jobs. The Committee favorably reported H.R. 2930 to the House by a voice vote on October 26, 2011, and the House passed H.R. 2930 by a vote of 407 to 17 on November 3, 2011.

H.R. 1070, the Small Company Capital Formation Act. Approved by the Financial Services Committee on June 22, 2011 and by the House 421-1 on November 2, 2011.

H.R. 1070, introduced by Rep. David Schweikert of the Financial Services Committee, raises the offering threshold for companies exempted from registration with the SEC under Regulation A from $5 million — the threshold set in the early 1990s — to $50 million. Raising the offering threshold helps small companies gain access to capital markets without the costs and delays associated with the full-scale securities registration process. H.R. 1070 provides the SEC with the authority to increase the threshold and requires the SEC to re-examine the threshold every two years and report to Congress on its decisions regarding adjustment of the threshold. The Committee favorably reported H.R. 1070 to the House by a voice vote on June 22, 2011, and the House passed H.R. 1070 by a vote of 421 to 1 on November 2, 2011.

H.R. 2167, the Private Company Flexibility and Growth Act. Approved by Financial Services Committee on October 26, 2011.

H.R. 2167, introduced by Rep. David Schweikert of the Financial Services Committee, raises the threshold for mandatory registration under the Securities Exchange Act of 1934 from 500 shareholders to 1,000 shareholders for all companies and excludes securities held by shareholders who received such securities under employee compensation plans from the calculation. Raising the shareholder threshold would eliminate one impediment to capital formation for small companies. The Committee favorably reported H.R. 2167 to the House by a voice vote on October 26, 2011.

H.R. 4088, the Capital Expansion Act, a modified version of H.R. 1965, which passed the Financial Services Committee on October 26, 2011 and by the House 420-2 on November 2, 2011.

H.R. 4088, introduced by Rep. Ben Quayle, raises the threshold for mandatory registration under the Securities Exchange Act of 1934 from 500 shareholders to 2,000 shareholders for all banks and bank holding companies and raises the shareholder deregistration threshold from 300 shareholders to 1,200 shareholders. Raising the shareholder threshold for these small financial institutions will reduce their regulatory burdens and eliminate an impediment of raising equity capital from new shareholders without triggering SEC oversight in addition to prudential regulation.

A Few Important Facts

Emerging Growth Companies Drive U.S. Job Creation

- From 1980 to 2005, firms less than five years old accounted for all net U.S. job growth
On average, 92% of a company’s job growth occurs after an IPO. Since 2006, companies have reported an average of 86 percent job growth since IPO. Venture-capital backed revenue (former start-ups) accounted for 21 percent of U.S. GDP in 2010. Challenges for Emerging Growth Company IPOs: Increased regulation makes IPOs more costly: the average cost to go public is $2.5 million, and annual cost to stay public is $1.5 million (includes Sarbanes-Oxley compliance, legal, and accounting costs). Fewer post-1999 IPOs involve emerging growth companies and focus instead on deal sizes exceeding $50 million. The economic infrastructure that enables small IPOs has been damaged by regulations. The IPO Market Has Stalled: The U.S. IPO market has experienced a sharp decline over the last 15 years. The pre-1999 average for IPOs was 547 per year. After 1999 the U.S. averaged merely 192 IPOs per year, with the lowest being 45 IPOs in 2008. The time to IPO has doubled: the average age since company inception at IPO has gone from 4.8 years in the 1980s to 9.4 years since 2007.

Small IPOs – the best for job creation – have been hit hardest. From 1991-1997, nearly 80% of U.S. IPOs were smaller than $50 million. By 2000, only 20% of IPOs were smaller than $50 million.

The following statement was released by the SEC on the JOBS Act:

“Public Statement by Commissioner: Investor Protection is Needed for True Capital Formation

by Commissioner Luis A. Aguilar, U.S. Securities and Exchange Commission

March 16, 2012

Last week, the House of Representatives passed H.R. 3606, the “Jumpstart Our Business Startups Act.” It is clear to me that H.R. 3606 in its current form weakens or eliminates many regulations designed to safeguard investors. I must voice my concerns because as an SEC Commissioner, I cannot sit idly by when I see potential legislation that could harm investors. This bill seems to impose tremendous costs and potential harm on investors with little to no corresponding benefit.

H.R. 3606 concerns me for two important reasons. First, the bill would seriously hurt investors by reducing transparency and investor protection and, in turn, make securities law enforcement more difficult. That is bad for ordinary Americans and bad for the American economy. Investors are the source of capital needed to create jobs and expand businesses. True capital formation and economic growth require investors to have both confidence in the capital markets and access to the information needed to make good investment decisions.

Second, I share the concerns expressed by many others that the bill rests on faulty premises. Supporters claim that the bill would improve capital formation in the United States by reducing the regulatory burden on capital raising. However, there is significant research to support the

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conclusion that disclosure requirements and other capital markets regulations enhance, rather than impede, capital formation, and that regulatory compliance costs are not a principal cause of the decline in IPO activity over the past decade. Moreover, nothing in the bill requires or even incentivizes issuers to use any capital that may be raised to expand their businesses or create jobs in the U.S.

Professor John Coates of Harvard Law School has testified that proposals of the type incorporated into H.R. 3606 could actually hurt job growth:

While [the proposals] have been characterized as promoting jobs and economic growth by reducing regulatory burdens and costs, it is better to understand them as changing … the balance that existing securities laws and regulations have struck between the transaction costs of raising capital, on the one hand, and the combined costs of fraud risk and asymmetric and unverifiable information, on the other hand. Importantly, fraud and asymmetric information not only have effects on fraud victims, but also on the cost of capital itself. Investors rationally increase the price they charge for capital if they anticipate fraud risk or do not have or cannot verify relevant information. Anti-fraud laws and disclosure and compliance obligations coupled with enforcement mechanisms reduce the cost of capital.

… Whether the proposals will in fact increase job growth depends on how intensively they will lower offer costs, how extensively new offerings will take advantage of the new means of raising capital, how much more often fraud can be expected to occur as a result of the changes, how serious the fraud will be, and how much the reduction in information verifiability will be as a result of the changes.

Thus, the proposals could not only generate front-page scandals, but reduce the very thing they are being promoted to increase: job growth.

Similarly, Professor Jay Ritter of the University of Florida has testified before the Senate banking committee that such proposals could in fact reduce capital formation:

In thinking about the bills, one should keep in mind that the law of unintended consequences will never be repealed. It is possible that, by making it easier to raise money privately, creating some liquidity without being public, restricting the information that stockholders have access to, restricting the ability of public market shareholders to constrain managers after investors contribute capital, and driving out independent research, the net effects of these bills might be to reduce capital formation and/or the number of small [emerging growth company] IPOs.

As drafted, H.R. 3606 would have significant detrimental impacts on the U.S. securities regulatory regime, including the following:

First, the bill will reduce publicly available information by exempting “emerging growth companies” from certain disclosure and other requirements currently required under the Federal securities laws. The bill’s definition of “emerging growth company” would include every issuer with less than $1 billion in annual revenues (other than large accelerated filers and companies that have issued over $1 billion in debt over a three year period) for five years after the company’s first registered public offering. It is estimated that this threshold would pick up 98% of IPOs and a large majority of U.S. public companies for that five year period.

An emerging growth company would only have to provide two years (rather than three years) of audited financial statements, and would not have to provide selected financial data for any period prior to the earliest audited period presented in connection with its initial public offering. It would also be exempt from the requirements for “Say-on-Pay” voting and certain compensation-related disclosure. Such reduced financial disclosure may make it harder for
investors to evaluate companies in this category by obscuring the issuer’s track record and material trends.

“Emerging growth companies” would also be exempt from complying with any new or revised financial accounting standards (other than accounting standards that apply equally to private companies), and from some new standards that may be adopted by the PCAOB. Such wholesale exemptions may result in inconsistent accounting rules that could damage financial transparency, making it difficult for investors to compare emerging companies with other companies in their industry. This could harm investors and, arguably, impede access to capital for emerging companies, as capital providers may not be confident that they have access to all the information they need to make good investment decisions about such companies.

Second, the bill would greatly increase the number of record holders a company may have, before it is required to publish annual and quarterly reports. Currently, companies with more than 500 shareholders of record are required to register with the SEC pursuant to Section 12(g) of the Securities Exchange Act and provide investors with regular financial reports. H.R. 3606 would expand that threshold to 2000 record holders (provided that, in the case of any issuer other than a community bank, the threshold would also be triggered by 500 non-accredited investors). Moreover, the bill would exclude from such counts any shareholders that acquire securities through crowdfunding initiatives and those that acquire securities as eligible employee compensation. Thus, a company could have a virtually unlimited number of record stockholders, without being subject to the disclosure rules applicable to public companies. This effect is magnified by the fact that the reporting threshold only counts records holders, excluding the potentially unlimited number of beneficial owners who hold their shares in “street name” with banks and brokerage companies, and thus are not considered record holders. This provision of the bill raises concerns because it could significantly reduce the number of companies required to file financial and other information. Such information is critical to investors in determining how to value securities in our markets. Regular financial reporting enhances the allocation of capital to productive companies in our economy.

Third, the bill would exempt “emerging growth companies” from Section 404(b) of the Sarbanes-Oxley Act, which requires the independent audit of a company’s internal financial controls. Section 404(b) currently applies only to companies with a market capitalization above $75 million; companies below that threshold have never been subject to the internal controls audit requirement and were exempted from such requirement in the Dodd-Frank Act. The internal controls audit was established following the accounting scandals at Enron, WorldCom and other companies, and is intended to make financial reporting more reliable. Indeed, a report last year by Audit Analytics noted that the larger public companies, known as accelerated filers, that are subject to Section 404(b), experienced a 5.1% decline in financial statement restatements from 2009 to 2010; while non-accelerated filers, that are not subject to Section 404(b), experienced a 13.8% increase in such restatements. A study by the SEC’s Office of the Chief Accountant recommended that existing investor protections within Section 404(b) be retained for issuers with a market capitalization above $75 million. With the passage of H.R. 3606, an important mechanism for enhancing the reliability of financial statements would be lost for most public companies, during the first five years of public trading.

Fourth, the bill would benefit Wall Street, at the expense of Main Street, by overriding protections that currently require a separation between research analysts and investment bankers who work in the same firm and impose a quiet period on analyst reports by the underwriters of an IPO. These rules are designed to protect investors from potential conflicts of interests. The research scandals of the dot-com era and the collapse of the dot-com bubble buried the IPO market for years. Investors won’t return to the IPO market, if they don’t believe they can trust it.
Fifth, H.R. 3606 would fundamentally change U.S. securities law, by permitting unlimited offers and sales of securities under Rule 506 of Regulation D (which exempts certain non-public offerings from registration under the Securities Act), provided only that all purchasers are “accredited investors”. The bill would specifically permit general solicitation and general advertising in connection with such offerings, obliterating the distinction between public and private offerings.

This provision may be unnecessary. A recent report by the SEC’s Division of Risk, Strategy and Financial Innovation confirms that Regulation D has been effective in meeting the capital formation needs of small businesses, with a median offering size of $1,000,000 and at least 37,000 unique offerings since 2009. Regulation D offerings surpassed $900 billion in 2010. The data does not indicate that users of Regulation D have been seriously hampered by the prohibition on general solicitation and advertising.

I share the concerns expressed by many that this provision of H.R. 3606 would be a boon to boiler room operators, Ponzi schemers, bucket shops, and garden variety fraudsters, by enabling them to cast a wider net, and making securities law enforcement much more difficult. Currently, the SEC and other regulators may be put on notice of potential frauds by advertisements and Internet sites promoting “investment opportunities.” H.R. 3606 would put an end to that tool. Moreover, since it is easier to establish a violation of the registration and prospectus requirements of the Securities Act than it is to prove fraud, such scams can often be shut down relatively quickly. H.R. 3606 would make it almost impossible to do so before the damage has been done and the money lost.

In addition others have noted that the current definition of “accredited investor” may not be adequate and that the requirement that purchasers be accredited investors would provide limited protection. For example, an “accredited investor” retiree with $1 million in savings, who depends on that money for income in retirement, may easily fall prey for a “hot” offering that is continually hyped via the internet or late night commercials.

These are just a few observations regarding H.R. 3606. It also includes other provisions that require substantial further analysis and review, including among other things the so-called crowdfunding provisions.

The removal of investor protections in this bill are among the factors that have prompted serious concerns from the Council of Institutional Investors, AARP, the North American Securities Administrators Association, the Consumer Federation of America, and Americans for Financial Reform, among others.

Questions Re: H.R. 3606

As H.R. 3606 is considered, the following is a non-exhaustive list of questions that should be addressed:

1. The bill would define “emerging growth company” as any company, within 5 years of its IPO, with less than $1 billion in annual revenue, other than a large accelerated filer or a company that has issued $1 billion in debt over a three-year period.

   • What is the basis for the $1 billion revenue trigger?

   • Why is revenue the right test? Why is $1 billion the right level?
• It has been estimated that this definition would include 98% of all IPOs, and a large majority of all public companies within the 5-year window. Was such a broad scope intended?

2. As provided in the bill, financial accounting standards, auditing and reporting standards, disclosure requirements, and the period for which historical financial statements is required, could all differ as between “emerging growth companies” and all other public companies – including all companies that went public before December 8, 2011.

• How will these differences affect the comparability of financial reporting for these two classes of issuers?

• Will reduced transparency, or lack of comparability, affect the liquidity of emerging growth companies?

• Will reduced transparency or reduced liquidity affect the cost of capital for emerging growth companies? Will investors demand a “discounted price” to offset any perceived higher risk resulting from reduced disclosures and protections?

• Will emerging growth companies be required to include risk factors or other disclosure in their registration statements and other filings, regarding transparency, comparability and any potential effects thereof?

3. The bill would expand the threshold for the number of shareholders an issuer may have, before it is required to file annual and other reports under Section 12(g) of the Exchange Act, from 500 to 2000 (of which no more than 500 may be non-accredited investors, for issuers other than community banks), and would exclude from such counts shareholders that acquire securities through crowdfunding initiatives and those that acquire securities as eligible employee compensation.

• How was the new threshold of 2000 holders determined?

• Is that the right threshold for determining whether the public interest in such securities justifies regulatory oversight?

• How many companies would be exempted from registration and reporting by the bill?

• When shares are held in “street name” the number of beneficial owners may greatly exceed the number of record holders. How will the new threshold of 2000 record holders be applied in such cases?17

• How would the exclusion of employees and crowdfunding purchasers be applied, if such holders transfer their shares to other investors? How would this be tracked?

4. To the extent the bill results in reduced transparency and/or reduced liquidity for emerging growth companies, or for companies exempted from Exchange Act reporting by the new thresholds under Section 12(g), such results may impact investment decisions by institutional investors.

• How would mutual fund managers, pension fund administrators, and other investors with fiduciary duties address such reduced transparency or lack of liquidity in making investment decisions?
• Could reduced transparency or reduced liquidity impact the ability of fund managers to meet applicable diversification requirements?

• Could such effects cause managers to increase concentration into fewer US reporting companies? How would such concentration affect market risk? Would the bill result in investor funds being redirected to companies overseas?

5. The bill is being promoted as a jobs measure, on the grounds that reducing regulation will improve access to capital for small and emerging businesses, allowing them to grow and add employees.

• What is the evidence that regulatory oversight unduly impedes access to capital?

• What is the evidence that companies that are otherwise prepared to grow (that is, they have the appropriate business model, management team, and aspirations) are prevented from growing by an inherent lack of access to potential sources of capital?

• I understand that the costs of complying with regulatory requirements are a factor underpinning H.R. 3606. How do such costs compare to other costs of raising capital, such as investment banking fees? How do such costs compare to other administrative costs? If reduced transparency, lack of comparability, and other consequences of the bill result in a higher cost of capital for emerging growth companies, will the money saved on compliance be worth it?

6. Evidence shows that the public companies that are currently exempt from internal controls audit requirements have a higher incidence of financial reporting restatements, and that companies that have restated their financial results produce substantially lower returns for investors.

• How do any perceived benefits from H.R. 3606’s exemption of emerging growth companies from the audit of internal controls compare to the likelihood of increased restatements? Would an increase in restatements hamper capital formation?

• Will the lack of an internal controls audit result in greater financial and accounting fraud?

7. The bill requires the Commission to revise its rules to provide that the prohibition against general solicitation or general advertising contained in Regulation D shall not apply to offers and sales of securities pursuant to Rule 506, provided that all purchasers are accredited investors.

• Given the success of Regulation D as a capital raising mechanism, including its successful use by small and emerging companies, is there any evidence that general solicitation and general advertising are necessary for capital formation?

• Given the current definition of “accredited investor”, is that the right test for determining who issuers may target, in offers made by general solicitation or advertising?

Conclusion

H.R. 3606 would have a significant impact on the capital markets and raises many questions that have yet to be satisfactorily resolved. I have yet to see credible evidence that justifies the extensive costs and potential harm to investors this bill may impose.
I urge Congress to undertake the review necessary to resolve these questions, and to ensure that investors, as the providers of the capital that companies need to grow and create jobs, have the protections they need and deserve.

FOOTNOTES:


2 See, e.g., Frank B. Cross and Robert A. Prentice, The Economic Value of Securities Regulation, 28 Cardozo L. Rev. 333 (2006). See also, Luis A. Aguilar, Comm’r, U.S. Securities and Exchange Commission, Speech at the Council of Institutional Investors Spring Meeting: Facilitating Real Capital Formation (April 4, 2011), www.sec.gov/news/speech/2011/spch040411laa.htm#P64_30599, notes 24-26; but cf id., note 20. For the effects of information asymmetry on capital formation, see, George A. Akerlof, The Market for ‘Lemons’: Quality Uncertainty and the Market Mechanism, The Quarterly Journal of Economics (August 1970) (demonstrating that a lack of adequate information about the quality of an item being purchased can drive a market out of existence: “There may be potential buyers of good quality products and there may be potential sellers of such products in the appropriate price range; however, the presence of people who wish to pawn bad wares as good wares tends to drive out the legitimate business. The cost of dishonesty, therefore, lies not only in the amount by which the purchaser is cheated; the cost also must include the loss incurred from driving legitimate business out of existence.”). Numerous studies speak to the benefits that investor protection brings to capital formation. For example, a 2003 study showed that enhanced financial disclosures and analysis in filings under the Securities Exchange Act resulted in more accurate and informed share prices, which contributes to a better functioning real economy. Merritt B. Fox, Randall Morck, Bernard Yeung, and Artyom Durnev, Law, Share Price Accuracy, and Economic Performance: The Empirical Evidence, 102 Mich. L. Rev. 331 (2003). The conclusion that more accurate and informed share prices contribute to the real economy references Jeffrey Wurgler, Financial Markets and the Allocation of Capital, 58 J. Fin. Econ. 187 (2000) and Artyom Durnev et al., Value Enhancing Capital Budgeting and Firm-specific Stock Return Variation, 58 J. Fin. 64 (2004). Id. notes 86 and 87. A 2006 study found that the Exchange Act amendments of 1964, which extended disclosure requirements to over-the-counter companies, created substantial value for the shareholders of such companies. Michael Greenstone, Paul Oyer, and Annette Vissing-Jorgensen, Mandated Disclosure, Stock Returns and the 1964 Securities Acts Amendments, Quarterly Journal of Economics, May 2006 (stating that the “results imply that the 1964 Amendments created … $3.2 to $6.2 billion [, measured in 2005 dollars] , of value for stockholders”). A summary version of the paper is available at http://www.stanford.edu/group/siepr/cgi-bin/siepr/?q=system/files/shared/pubs/papers/briefs/policybrief_jan06.pdf. See also, Allen Ferrell, Mandated Disclosure and Stock Returns: Evidence from the Over-the-counter Market,

3 See, e.g., statement of Professor Ritter, infra note 5, at pp 3-5, and statement of Professor Coffee, infra note 15, at pp 1-3.

4 Testimony of Professor John C. Coates IV, John F. Cogan, Jr. Professor of Law and Economics, Harvard Law School, before the Subcommittee on Securities, Insurance, and Investment of the Committee on Banking, Housing, and Urban Affairs, United States Senate, on Examining Investor Risks in Capital Raising (December 14, 2011), at 2.


6 As drafted, an issuer that goes public “through the back door”, without ever selling common equity securities pursuant to an offering registered under the Securities Act, could conceivably remain an “emerging growth company” forever.


8 Exchange Act reporting is also required for companies listed on a national securities exchange, as well as companies that have filed an effective registration statement under the Securities Act (provided that, after the fiscal year in which such registration statement becomes effective, the company has at least 300 shareholders of record). Significantly, the bill would raise the 300 shareholder threshold for “going dark” to 1200 shareholders, for bank holding companies.


10 Id.


12 Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 For Issuers With Public Float Between $75 and $250 Million (April 2011). http://www.sec.gov/news/studies/2011/404bfloat-study.pdf. This study was required pursuant to section 989G(b) of the Dodd-Frank Act. The GAO is required to conduct a study of the impact of the exemption provided by Section 989G(a), which is due three years after enactment of the Dodd-Frank Act.
13 Vlad Ivanov and Scott Baugess, Capital raising in the U.S.: The significance of unregistered offerings using
the Regulation D exemption (December 5, 2011).


17 See, Coffee testimony, note 10, supra, at 1, “Of even greater concern to me is the overbreadth inherent in S.1824 [the Senate version of H.R. 2167, which became Title V of H.R. 3606], which pushes up the threshold at which an issuer must become a "reporting company" and make periodic disclosures to the market to 2,000 shareholders of record. I can understand the case for increasing the threshold under Section 12(g), but the problem with the approach taken is that record ownership is easily manipulated and companies could come to have 5,000 or more beneficial shareholders (and billions in stock market capitalization) without becoming subject to the increased transparency of the Securities and Exchange Act of 1934. There is no need for such an open-ended exemption (largely benefitting larger firms) or for such a dramatic retreat from the principle of transparency that has long governed our securities markets in order to spur job creation at smaller firms.”

18 See, e.g., Whitehouse article, note 11, supra, and Turner testimony, note 7, supra, at pp 16-19.

19 See, note 13, supra, and accompanying text.
INVESTOR QUESTIONNAIRE/INVESTOR: __________________________________________
Date: ____________________
Securities Offering of: __________________________________________

I, __________________________________________________________ ("Investor" or "I") (print full legal
name), hereby state under oath and hereby represent to ____________, Inc., a Virginia
corporation, (Company or Issuer) that I meet the requirements of an “accredited investor” under
Rule 501 of Regulation D of the Securities Act of 1933, as amended, under and because I meet
the requirements of the following subsection or subsections that have been checked and
initialized by me:

ACCREDITED INVESTOR DEFINITION

An “accredited investor” is one who meets one of the following criteria:

1. Check ___/initial ; ______. An individual whose net worth or joint net worth with a spouse
at the time of the purchase or acquisition of the securities exceeds $1,000,000
(excluding the value of the primary residence).
2. Check ___/initial ; ______. An individual who had income in excess of $200,000 during
each of the past two years and reasonably expects to reach the same income level in the
current year.
3. Check ___/initial ; ______. An individual whose joint income with a spouse exceeded
$300,000 in each of the past two years and reasonably expects to reach the same
income level in the current year.
4. Check ___/initial ; ______. A corporation, partnership, business trust or limited liability
company, which has total assets in excess of $5,000,000 and which has not been
formed for the specific purpose of acquiring the or receiving the securities offered or to
be distributed hereby.
5. Check ___/initial ; ______. Any employee benefit plan within the meaning of ERISA, if
the investment decision is made by a plan fiduciary, as defined in ERISA § 3(21), which
is either a bank, savings and loan association, insurance company or registered
investment adviser, or if the 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.
6. Check ___/initial ; ______. Any trust with total assets in excess of $5,000,000, not
formed for the specific purpose of acquiring or holding the securities distributed or
offered hereby, whose purchase is directed by a “sophisticated person” as described in
Rule 506(b)(2)(ii) under the Securities Act.
7. Check ___/initial ; ______. A director or executive officer of the Company.
8. Check ___/initial ; _____. Any entity (but, with respect to a non-business trust, only a revocable trust) that does not qualify as an “accredited investor” under Rule 501(a)(1) of the Securities Act but all of whose equity owners are accredited investors.

The following statements and responses are true and complete as of the date first written above:

My primary residence is located at or my domicile is (if I am a corporation or entity) located at:
_____________________________________________________________________________
_____________________________________________________________________________

If I am a natural person, I am over 18 years of age and I am a U.S. Citizen or Permanent Resident of the U.S.

I have invested in private securities offerings in the past? ___TRUE or ___ FALSE

I have a brokerage or stock trading account? ___ TRUE or ____ FALSE

I have never filed for bankruptcy protection due to losses in investments in securities? ___ TRUE or _______ FALSE

I have never been a member of a class action plaintiff’s law suit against a company alleging securities fraud or securities law violations? ____ TRUE or _____ FALSE

I estimate that approximately ____________________ percent (____%) of my Net Worth consists of investment securities.

I have prior experience in or I have expertise in financial analysis? _____ TRUE or _______ FALSE

I have expertise or prior experience in investment securities trading? _____ TRUE or ____ FALSE

My highest level of education (in terms of a degree awarded) is (check one):

___ High School or less; _____ Technical School; _____ 2 year junior college or 2 year certification program; _____ 4 year college; _____ Masters Degree; _____ J.D.; _________ L.L.M.; ________; PhD

My contemplated investment in the securities offered in above captioned offering is less than _____10% of my estimated net worth. _____ TRUE or _______FALSE

The Investor agrees and understands that the Company will be relying on the accuracy and completeness of the Investor’s responses to the foregoing questions and the investor represents and warrants to the Company as follows:

(i) The answers to the above questions are complete and correct and may be relied upon by the Company whether or not the offering in which the investor proposes to participate is exempt from registration under the Securities Act and the securities laws of certain states;

(ii) The Investor will notify the Company immediately in writing of any material change in any statement made herein occurring prior to the closing of any purchase by the investor of the Company’s securities
(Contact for Notice: ______________); and

(iii) The Investor or its management, in case of an entity, has sufficient knowledge and experience in financial, investment and business matters to evaluate the merits and risks of the prospective investment, and the Investor is able to bear the economic risk of the investment in the securities to be distributed and currently could afford a complete loss of such investment.

IN WITNESS WHEREOF, the undersigned has executed this Investor Questionnaire as of ______________, 201__, and declares under oath that it is truthful and correct to the best of the undersigned’s knowledge and belief.

________________________________________
(Signature)

________________________________________
(Printed or typed name)
(Title if signing on behalf of an entity)

________________________________________
(Second signature—required if securities will be held in more than one name)

________________________________________
(Printed or typed name)
(Title if signing on behalf of an entity)

RECOMMENDED READING

Corporate Law, Robert Clark, AA Balkema, 1986. Dated but provides a solid understanding of corporate law.
