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Securities Law

Regulation D
Limited Offering Exemptions

A. **Preliminary Notes**:

1. Regulation D is not exclusive (See Sections 3(a)(11), 4(2) and 4(6) discussed above); it is a safe harbor. In other words, if an issuer follows the requirements set forth in Regulation D, the issuer will be deemed to be in compliance with the 33 Act. Regulation D removes the uncertainty of compliance with Section 4(2) above.
2. Applies only to issuers. (Regulation D exemption is not available to any affiliate of the issuer or to any other person for resales of the issuer's securities.)
3. Exemption applies only to the transaction in which the securities are offered or sold by the issuer, not the securities themselves.
4. Exemption relates only to the requirement to register under the 33 Act. Such transactions are not exempt from the anti-fraud, civil liability or other provisions of the federal securities laws.
5. Issuers are required to provide such further material information, if any, as may be necessary to make the information required, under this regulation, in light of the circumstances under which it is furnished, not misleading.
6. Regulation D does not obviate the need to comply with applicable state laws.

B. **Rule 501 of Regulation D** - Definitions and terms used in Regulation D

1. Among other terms, the following are defined: Accredited Investor, Affiliate, Aggregate Offering Price, Calculation of Number of Purchasers, Executive Officer, Issuer, and Purchaser Representative.

C. **Rule 502 of Regulation D** - General Conditions for a Regulation D offering

1. Integration.

a. All sales that are part of the same Regulation D offering must meet all of the terms and conditions of Regulation D.

b. Offers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering, *so long as during those six-month periods there are no offers or sales of securities by or for the issuer that are of the same or similar class as those offered or sold under Regulation D.*

c. The following factors should be considered in determining whether offers and sales should be integrated for purposes of exemptions under Regulation D:

   i. Whether the sales are part of a single plan of financing;

   ii. Whether the sales involve issuance of the same class of securities;

   iii. Whether the sales have been made at or about the same time;

   iv. Whether the same type of consideration is being received; and

   v. Whether the sales are made for the same general purpose.

See Release No. 33-4552 (November 6, 1962).

2. Information requirements.

   a. If the issuer sells securities under Rule 505 or Rule 506 to any purchaser that is not an accredited investor, the issuer shall furnish the information specified in paragraph (b)(2) (*see below)* of Rule 502 to such purchaser ***a reasonable time prior to sale***.

   b. **The issuer is not required to furnish the specified information to purchasers when it sells securities under Rule 504 of Regulation D, or to any accredited investor.** However, a note to Rule 502(b)(1) cautions issuers that, if it is providing investors with the information called for by the Rule, it should also consider providing the information to accredited investors as well in view of the anti-fraud provisions of the federal securities laws.

   c. Non-financial information required by an issuer that is not a reporting company under the 34 Act

      i. If the issuer is eligible to use Regulation A (Rules 251-263 of the 33 Act), it may provide non-accredited investors with the same kind of information as is required under any of the three alternative disclosure formats set forth in Regulation A of the 33 Act.

      ii. If the issuer is not eligible to use Regulation A, it is required to provide the same information to non-accredited investors as required under Part I of a registration statement filed under the 33 Act on the form that the issuer would be entitled to use.

d. Financial information required by an issuer that is not a reporting company under the 34 Act

   i. For offerings up to $2,000,000, the issuer must furnish two years of financial statements, except that only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited;

   ii. For offerings up to $7.5 million, the issuer must furnish an audited balance sheet as of the end of the most recent fiscal year, or as of a date within 135 days if the issuer existed for a period less than one fiscal year, and audited statements of income, cash flows and changes in stockholders' equity for each of the two fiscal years preceding the date of such audited balance sheet (or such shorter period as the registrant has been in business).

   iii. For offerings over $7.5 million, the issuer must furnish three years of audited financial statements.

   iv. If the issuer can not obtain the financial information required by ii) and iii) above *without unreasonable effort or expense*, certain leniency provisions permit modified financial information to be provided.

e. Information required if issuer is a reporting company under the 34 Act

   i. Annual report to shareholders for the most recent fiscal year and, if requested in writing, the issuer's most recent Form 10-K or Form 10-KSB under the 34 Act; ***or***

   ii. The information contained in an annual report on Form 10-K or Form 10-KSB under the 34 Act or in a registration statement on Forms S-1, SB-1, SB-2 or S-11 under the 33 Act or on Form 10 or Form 10-SB under the 34 Act, whichever filing is the most recent required to be filed; ***and***

   iii. Any recent development filings filed since the filing of the above reports and a brief description of the securities being offered, the use of the proceeds from the offering, and any material changes in the issuers affairs that are not disclosed in the documents furnished.

f. Exhibits that would normally be required to be filed by an issuer registering securities with the SEC in a public offering need not be furnished to each purchaser that is not an accredited investor if the contents of the material exhibits are identified and the exhibits are made available to the purchaser, upon his written request, a reasonable time prior to the purchase.

g. The issuer shall provided to any purchaser that is not an accredited investor a brief description in writing of any material written information

concerning the offering that has been provided by the issuer to any accredited investor but not previously delivered to such unaccredited purchaser.

h. The issuer shall make available to each purchaser the opportunity to ask questions and receive answers concerning the terms and conditions of the offering and to obtain any additional information which the issuer possesses or can acquire without unreasonable effort or expense that is necessary to verify the accuracy of information furnished as required under paragraphs (b)(2)(i) or (ii) of Rule 502 (described in this section in paragraphs (c)-(e) immediately above).

i. The issuer shall advise the purchaser of the limitations on resale in the manner contained in paragraph (d)(2) of Rule 502 (described in this section in paragraph (4) immediately below). This disclosure may be contained in other materials required to be provided by this paragraph.

3. Limitation on the Manner of Offering.

a. Except as provided in Rule504(b)(1), neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to the following:

i. Any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio, and

ii. Any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.

4. Limitations on Resale.

a. Except as provided in Rule 504(b)(1), securities acquired in a Regulation D offering have the status of securities acquired in a Section 4(2) transaction (discussed in this outline at I.G.3. above) and, therefore, cannot be resold by the holder of the securities without registration under the 33 Act (discussed in this outline at I.F.1 above) or an exemption therefrom. (See below Part IV, Sale of Restricted Securities by Non-Affiliates.)

b. The issuer is required to exercise *reasonable care* to assure that the purchaser of the securities are not underwriters within the meaning of Section 2(11) of the 33 Act. Reasonable care can be demonstrated by:

i. Reasonable inquiry to determine if the purchaser is acquiring the securities for himself or for other persons;

ii. Written disclosure to each purchaser, prior to sale, that the securities have not been registered under the 33 Act and, therefore, cannot be resold unless they are registered under the 33 Act or an exemption from registration is available; and

iii. A legend is placed on the securities certificate stating that the securities have not been registered under the 33 Act and setting forth or referring to the restrictions on transferability and sale of the securities.

The foregoing actions are not the exclusive method by which an issuer may demonstrate reasonable care. Other actions may satisfy this requirement. (Also above regarding Rule 502 at c.(2)(i).)

D. **Rule 503 of Regulation D** - Notices of sales to be filed with the SEC

a. An issuer is required to file five copies of Form D with the SEC within 15 days after the first sale of securities made in reliance on Rule 504, 505 or 506 of Regulation D.

b. If sales are made under Rule 505, the issuer must also file an undertaking to furnish the SEC, upon written request, the information furnished by the issuer under Rule 502(b)(2) to any purchaser not an accredited investor. (See above regarding Rule 502 at c.(2).)

E. **Rule 504 of Regulation D** - promulgated under Section 3(b) of the 33 Act

0. Rule 504 is the limited offering exemption designed to aid small businesses raise "seed capital". The general philosophy behind Rule 504 is to remove the federal government from involvement in small offerings of $1,000,000 or less by small businesses, leaving the regulation of this area exclusively to the states. Significant coordination between the states has been achieved through the North American Securities Administrators Association (NASAA). See joint report of SEC and NASAA issued April 26, 1984, 16 Sec. Reg. & L. Rep. (BNA) (April 27, 1984). Unfortunately, Florida has been slow to join this band wagon and has only recently enacted legislation, effective October 1997, permitting small offerings under Regulation A and Rule 504, with a number of strings attached. (See below, Part III, Florida Securities Laws.)

1. To be eligible to use Rule 504, an issuer must **not** be:

a. a reporting company under the 34 Act;

b. an investment company; or

c. a development stage company that either has **no specific business plan** or has indicated that its plan is to engage in a merger or acquisition of an unidentified company or companies.

2. Conditions to be met:

a. Offers and sales must satisfy the terms of Rules 501, 502(a), *Integration* discussed above. Moreover, as in the case of other Regulation D offerings, the resale of securities offered under Rule 504 are restricted and there is a prohibition on the general solicitation and general advertising of securities sold in a Rule 504 offering (see *"Limitations on Manner of Offering"* and

"*Limitations on Resales*" above) unless the specific conditions permitting a public offering are met. These conditions are:

i. The transactions are registered under a state law requiring public filing and delivery of a disclosure document before sale. For sales to occur in a state without this type of provision, the transaction must be registered in another state with such a provision and the disclosure document filed in that state must be delivered to all purchasers before sale in both states; or

ii. The securities are issued under a state law exemption that permits general solicitation and general advertising so long as sales are made only to "accredited investors" as that term is defined in Regulation D.

b. The *aggregate offering price*, as defined in Rule 501(c), does not exceed $1,000,000, **less** the aggregate offering price for **all** securities sold within the 12 months before the start of and during the offering of securities under this Rule 504 (either in reliance of an exemption under Section 3(b) or in violation of Section 5(a) of the 33 Act).

3. No limitation on number of offerees.

4. No limitations on nature of offerees.

5. No specific disclosure required; however, the anti-fraud requirements of the 33 Act and the 34 Act still apply.

6. **State law requirements (referred to as "Blue Sky" laws) are applicable and must be complied with**. (See Part III, Florida Securities Laws.)

7. Issuer must still file Form D, but this is not a condition to the offering (See Rule 503 above.)

F. **Rule 505 of Regulation D** - Offerings of up to $5,000,000 - promulgated under Section 3(b) of the 33 Act

0. Issuer may not be an investment company

1. The terms and conditions of Rules 501 and 502 must be met.

a. Integration of other securities sales;

b. Limitations on manner of sales including prohibition against general advertisements and solicitations;

c. Limitations on resales; and,

d. Information requirements with respect to non-accredited purchasers.

(See above discussion of Rule 502 regarding the terms and conditions of this rule.)

2. The aggregate offering price, as defined in Rule 501(c), for an offering under Rule 505 may not exceed $5,000,000, less the aggregate offering price fro all

securities sold with the 12 months before the start of and during the offering of securities under this rule in reliance on any exemption under Section 3(b) of the 33 Act or in violation of Section 5(a) of the 33 Act.

3. There are no more than, or the issuer reasonably believes, that there are no more than 35 purchasers of the securities from the issuer in any offering under this rule.
    a. Rule 501(e) sets forth certain provisions regarding the calculation of purchasers.
        i. The following purchasers are to be excluded in calculating the number of purchasers: 1) any relative, spouse or relative of the spouse of a purchaser who has the same principal residence as the purchaser; 2) any accredited investor; and 3) certain trusts and corporations controlled by a purchaser or other person related to the purchaser as specified in the rule.
        ii. A corporation, partnership or other entity is counted as one purchaser (unless formed for the sole purpose of evading the limitation on purchasers).
4. The exemption provided by Rule 505 is not available if the issuer, its promoters, officers, directors or 10 percent security holders or certain other persons associated with the offering have been the subject of certain administrative orders or actions unless the SEC waives this prohibition. This provision is called the *Bad Boy Disqualification*. This disqualification provision is only found in Rule 505 and is not present in Rules 504 or 506.

G. **Rule 506 of Regulation D** - No limitation on dollar amount - promulgated under Section 4(2) of the Act
    0. Available to all companies
    1. The terms and conditions of Rules 501 and 502 must be met
        a. Integration of other securities sales;
        b. Limitations on manner of sales including prohibition against general advertisements and solicitations;
        c. Limitations on resales; and,
        d. Information requirements with respect to non-accredited purchasers.

    (See above discussion on Rule 502 regarding the terms and conditions of this rule.)

    2. There are no more than, or the issuer reasonably believes that there are no more than, 35 purchasers of the securities from the issuer in any offering under this rule.
        a. Rule 501(e) sets forth certain provisions regarding the calculation of purchasers. (See discussion above with regard to Rule 505.)

3. Rule 506 has additional requirement that any non-accredited must be *sophisticated*. Specifically, "Each purchaser who is not an accredited investor either alone or with his purchaser representative(s) [as defined in Rule 501] has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description."
    a. Note that furnishing a purchaser representative to each non-accredited investor at the issuer's expense generally satisfies issuer's obligation. (See SEC no-action letter re *Ticket Master Company*, available April 2, 1984.)

H. **Rule 507 of Regulation D** - Disqualifying Provision

0. Disqualifying provision whereby an issuer will be barred from making an exempt offering under Regulation D if a court enters an order enjoining the issuer for failing to file the required forms under Rule 503 discussed above.

1. The SEC can waive this disqualification

I. **Rule 508 of Regulation D** - Insignificant Deviations

0. Rule 508 provides that the failure to comply with all the terms, conditions and requirements of Regulation D will not necessarily cause a loss of exemption for an offer or sale to a particular individual if the issuer shows:
    a. The condition violated was not intended to protect the complaining individual or entity;
    b. The failure to comply was insignificant in relationship to the offering as a whole (note: general solicitation, dollar ceilings and numerical purchaser limits are always significant to an offering as a whole);
    c. A good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirements of Rule 504, 505 or 506.

1. Rule 508 preserves the SEC's right to take enforcement action regardless of the significance of a violation.

J. **Federal preemption of state laws regarding Rule 506**

0. On October 11, 1996, the "National Securities Markets Improvement Act of 1996" ("NSMIA") became law. NSMIA provides for federal preemption of state laws with respect to a "covered security".

1. NSMIA defines a "covered security" to include a security that is exempt from registration under the 33 Act pursuant to SEC rules and regulations issued under Section 4(2) of the 33 Act.

2. NSMIA does not prohibit a state from imposing a notice filing requirement that are substantially similar to those required by rule or regulation under section 4(2) in effect on September 1, 1996.

3. NSMIA preserves for the securities commission of any state jurisdiction to investigate and bring enforcement actions with respect to fraud, deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.
4. NSMIA preserves for the states the authority to collect filing or registration fees with respect to securities or securities transactions as in effect on the day before enactment of NSMIA (October 11, 1996).
5. As a result of NSMIA, all authority of the states regarding private placements under Section 4(2) of the 33 Act or under Rule 506 of Regulation D are now preempted by federal law