



Stock Offerings and Securities Laws – Regulation D

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Federal law generally prohibits companies from *offering* to sell securities unless a federal registration statement has been filed with the SEC, and from *selling* securities unless the registration statement has been declared effective. Federal registration is an expensive and time-consuming process, but fortunately federal law provides various exemptions from the registration requirements. Several of the most common exemptions are those contained in Regulation D.

Regulation D Generally

Regulation D currently is a series of nine rules (Rules 500 through 508) establishing three different exemptions from the federal registration requirements (two new rules under Regulation D have been proposed but not yet adopted). Rules 500, 501, 502, and 503 contain preliminary notes, definitions, and general conditions applicable to Regulation D. Rules 504, 505, and 506 contain the substantive exemptions. Rules 507 and 508 address the consequences of the failure to comply with certain requirements of Regulation D.

Information Requirements

Rule 502(b) describes the type of information that a company offering and selling securities (an “issuer”) must provide to prospective investors. If sales are made under Rule 504 or are made only to accredited investors, no information need be furnished. However, the antifraud and civil liability provisions of federal and state securities laws are applicable and because of this it may be prudent for the issuer to provide written disclosures even where such disclosures are not expressly required. If sales are made to nonaccredited investors under Rule 505 or Rule 506, specified information must be provided to the purchasers prior to sale. (For information on accredited investor status, see our November 21, 2013 Quick Study “Stock Offerings and Securities Laws: What is an Accredited Investor?”)

General Solicitation/Advertising

Rule 502(c) prohibits the use of any general solicitation or general advertising in connection with the offer or sale of securities. This restriction applies to all offerings under Rule 505 and to certain offerings under Rule 504 and Rule 506. Included within this restriction, with limited exceptions, are advertisements, articles, notices, and other communications published in a newspaper or magazine, or broadcast over television or radio, as well as seminars and meetings to which the attendees have been invited by general solicitation or general advertising.

Resale Restrictions

Securities acquired in offerings under Rules 505 and 506, and in certain offerings under Rule 504, are “restricted securities” and, as a result, can be resold only in limited circumstances. Rule 502(d) (which applies to all offerings under Rules 505 and 506 and to certain offerings under Rule 504) requires that the issuer use reasonable care to assure that purchasers are purchasing for investment and not with a view to distribution.

Disqualification Provisions

An issuer will be disqualified from using the Rule 505 and Rule 506 exemptions if the issuer or certain persons affiliated with the issuer (for example, directors, executive officers and significant stockholders of the issuer) had a disqualifying event, including but not limited to a criminal conviction in connection with the purchase or sale of a security or involving a false filing with the SEC.

Filing Requirements

Rule 503 requires an issuer offering or selling securities in reliance on Regulation D to file with the SEC a notice of sales on Form D, generally not later than 15 calendar days after the first sale of securities in the offering.

Rule 504 Exemption

To be eligible to use the Rule 504 exemption, an issuer cannot be subject to the reporting requirements under the Securities Exchange Act of 1934, an investment company, or a development stage company that either has



no specific business plan or purpose or has a plan to engage in a merger or acquisition with an unidentified company or companies.

The aggregate offering price for an offering of securities under Rule 504 cannot exceed \$1 million (less the aggregate offering price of all securities sold within the preceding 12 months in reliance on certain exemptions including Rule 504 and Rule 505 or in violation of federal registration requirements).

Rule 504 does not impose any specific information delivery requirements. With certain limited exceptions, the prohibition on general solicitation and general advertising, and the resale restrictions (discussed above) apply to offers and sales under Rule 504.

Rule 505 Exemption

To be eligible to use the Rule 505 exemption, an issuer cannot be an investment company or subject to any of the disqualification provisions applicable to Rule 505 offerings (discussed above).

The aggregate offering price for an offering of securities under Rule 505 cannot exceed \$5 million (less the aggregate offering price of all securities sold within the preceding 12 months in reliance on certain exemptions including Rule 504 and Rule 505 or in violation of federal registration requirements). Rule 505 also limits the number of purchasers to 35 nonaccredited investors. There is no limit on the number of accredited investors.

The information disclosure obligations, the prohibition on general solicitation and general advertising, and the resale restrictions are all applicable to offers and sales under Rule 505.

Rule 506 Exemption

Unlike Rules 504 and 505, Rule 506 imposes no general issuer eligibility requirements and no limitations on the aggregate offering price of securities sold. However, to be eligible to use the Rule 506 exemption an issuer cannot be subject to any of the disqualification provisions applicable to Rule 506 offerings.

Like Rule 505, Rule 506 limits the number of purchasers to 35 nonaccredited investors and does not limit the number of accredited investors. The information disclosure obligations and the resale restrictions are applicable to offers and sales under Rule 506. The prohibition on general solicitation and general advertising is applicable to some but not all offerings under Rule 506 (see the discussion of the Rule 506(c) Exemption, below)

Rule 506 also imposes an additional sophistication standard for nonaccredited investors.

Rule 506(c) Exemption

Recently, the SEC adopted Rule 506(c), which permits the use of general solicitation and general advertising to offer and sell securities under Rule 506, provided that the following conditions are met:

- The issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors;
- All purchasers of the securities must be accredited investors (either because they come within one of the enumerated categories of persons that qualify as accredited investors or the issuer, after having taken reasonable steps to verify, reasonably believes that they do) at the time of the sale of the securities; and
- The issuer must comply with all other requirements of Regulation D applicable to Rule 506 offerings (other than, of course, the prohibition against general solicitation and general advertising).

Although new Rule 506(c) allows Rule 506 offerings that use general solicitation and general advertising, it does not affect the ability of issuers to conduct Rule 506 offerings without the use of general solicitation and general advertising, thus avoiding the need to comply with Rule 506(c).

We will be covering Rule 506(c) in more detail in an upcoming Quick Study.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the author:

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