

# PUBLICATION

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## New SEC Rules and Their Impact on Securities Offerings

October 28, 2016

**On October 26, 2016, the Securities & Exchange Commission ("SEC") adopted final rules that may have significant impact on local securities offerings made in one state (or, "intrastate" offerings) and offerings of securities of \$5 million or less.**

First, the final rules create a new intrastate offering exemption, Rule 147A under the Securities Act of 1933, as amended (the "Securities Act"), which rule is aimed at modernizing the pre-existing safe harbor under Rule 147 under Section 3(a)(11) of the Securities Act, largely by lifting the ban on general solicitation from such offerings.

Second, the final rules increase the maximum offering amount possible under Rule 504 of Regulation D under the Securities Act to \$5 million, add "bad actor" disqualification provisions to Rule 504 and completely repeal Rule 505 of Regulation D.

### Amendments to Rule 147 and New Rule 147A

Section 3(a)(11) states that any "security which is a part of an issue offered and sold only to persons resident in a single state or territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such state or territory." As adopted in 1974, Rule 147 clarified the requirements necessary to utilize the safe harbor under Section 3(a)(11), including the requirement of a restrictive legend on securities sold under Rule 147. The SEC did not place a limit on the amount of money that could be raised in an offering conducted under Rule 147, but required a limitation on resales to persons residing within the state or territory of the offering for a period of six months from the date of the initial sale by the issuer. The SEC chose not to alter these provisions in the rules adopted on October 26.

Indeed, the SEC's amendments to Rule 147 were minimal, made so that the requirements found in Rule 147's provisions properly correspond with new Rule 147A in form and substance. These changes, which are requirements that will now be found in both the amended Rule 147 and Rule 147A are:

- A requirement that an issuer seeking to use Rule 147 or 147A as an exemption from registration under the Securities Act have its "principal place of business" in-state and satisfy at least one of four "doing business" requirements (set forth in Rule 147 or 147A) that would demonstrate the in-state nature of the issuer's business.
- A new "reasonable belief" standard for issuers to rely on in determining the residence of the purchaser at the time of the sale of securities, supported by a requirement that issuers obtain a written representation from each purchaser as to residency.
- An integration safe harbor that would include any prior offers or sales of securities by the issuer made under another provision, as well as certain subsequent offers or sales of securities by the issuer occurring after the completion of the offering.

The key differences between Rule 147 and Rule 147A are that:

- Rule 147A is not promulgated under Section 3(a)(11) of the Securities Act. Principally, this means that Rule 147A would be substantially identical to Rule 147, except that it will allow issuers to be incorporated or organized out-of-state. This change means that a Delaware corporation that is headquartered in Tennessee can take advantage of Rule 147's exemption when raising funds from Tennessee residents.
- Rule 147A contains language prohibiting registered investment companies from using the exemption from registration under the rule.
- Rule 147A lifts the ban on general solicitation found in Rule 147, so that issuers can use means of advertising their offering such as social media and other internet-based means, even if the actual sales of the issuer's securities can only be made in-state.

By effectively leaving Rule 147 in place, the SEC allowed the 30+ states that enacted their own, intrastate crowdfunding statutes ahead of the SEC's (now-finalized) federal crowdfunding rules. However, if those states wish to allow general solicitation under new Rule 147A, those states will have to amend their laws to comply with the new rule.

The SEC's amendments to Rule 147 and creation of Rule 147A become effective 150 days after the publication of the rules in the Federal Register.

### **Amendments to Rule 504 and Repeal of Rule 505**

Rule 504 of Regulation D is an exemption from registration under the Securities Act for offers and sales of up to \$1 million of securities in a 12-month period, provided that the issuer is not reporting company under the Exchange Act of 1934, as amended, an investment company or a blank check company. The rule also imposes certain conditions on the offers and sales of securities, with limited exceptions made for offers and sales made in accordance with specified types of state registration provisions and exemptions (which, in some states means the offering can be made to unaccredited investors, unlike, for example, an offering made under Rule 506(c) of Regulation D, which must be made to only accredited investors).

The SEC's new amendments to Rule 504 would retain the foregoing, existing framework, while increasing the aggregate amount of securities that may be offered and sold under Rule 504 in any 12-month period from \$1 million to \$5 million. The amendments to Rule 504 also add the same provision found in the SEC's updates to Rule 506, which disqualify certain "bad actors" from participation in Rule 504 securities offerings.

The SEC's rule also will repeal the widely ignored (in favor of Rule 506) Rule 505 of Regulation D, which permitted offerings of up to \$5 million annually that must be sold solely to accredited investors or no more than 35 non-accredited investors.

Like the SEC's decision to leave Rule 147 largely intact, the SEC's amendments to Rule 504 should not affect the handful of states which based their intrastate crowdfunding exemption laws on Rule 504 (rather than Rule 147).

The SEC's amendments to Rule 504 and repeal of Rule 505 become effective 60 days after the publication of the rules in the Federal Register.

### **Conclusion**

By bringing intrastate securities offerings into the modern age through allowing issuers to conduct intrastate offerings over the internet, and increasing the amount that can be raised under Rule 504, the SEC's new rules appear to achieve the SEC's stated goal of allowing for more flexibility in smaller, private securities offerings.

However, issuers should be aware of the state-level implications that are inherent in a rule change such as the present ones. For example, a consequence of the SEC's rule changes may be that many states legislatures will have to revisit their intrastate crowdfunding statutes to take advantage of these changes in the law of securities offerings.

Please do not hesitate to contact your regular Baker Donelson attorney for more information on navigating the complex waters of these changes in the securities laws.