The Securities and Exchange Commission Proposes Amendments of Limited Offering Exemptions in Regulation D

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On August 3, 2007, the Securities and Exchange Commission (the "SEC") published proposed amendments to Regulation D. The proposed amendments would create a new exemption for offers and sales to "large accredited investors," revise the definition of the term "accredited investor," shorten the time period for the avoidance of integration required by the integration safe harbor for Regulation D offerings and establish provisions that would disqualify certain persons from using any of the exemptions contained in Regulation D. The proposing release also contains a free-standing interpretation of the SEC's integration doctrine as it applies to combinations of public and private offerings. The goal of the proposed amendments is to "clarify and modernize" the existing rules to facilitate capital formation for issuers while maintaining investor protection.

Proposed Rule 507 – Exemption for Limited Offers and Sales to Large Accredited Investors

The SEC proposes to create a new exemption to the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"), for "large accredited investors." Under the proposed rule, legal entities otherwise eligible for treatment as "accredited investors" would be required to have $10 million in investments to qualify as large accredited investors. Individuals would need $2.5 million in investments or an annual income of $400,000 ($600,000 with a spouse). Legal entities not required to satisfy dollar-amount thresholds to qualify as accredited investors would not have to satisfy dollar-amount thresholds to qualify as large accredited investors.

A principal purpose behind creating a new category of "large accredited investors" is to allow limited advertising of offerings to such investors. Publication of an announcement would be limited to "written form," in any written medium, including newspapers and the Internet. Radio and television advertisements would not be permitted, the latter presumably even if there were no sound track. An announcement would be permitted to contain only certain information, including:

- the name and address of the issuer,
- a brief description of the business of the issuer in 25 or fewer words,
- the name, type, number, price and aggregate amount of securities being offered and a brief description of the securities,
- a description of what large accredited investor means,
- any suitability standards and minimum investment requirements for prospective purchasers of the offering and
- the name, postal or e-mail address and telephone number of a person to contact for additional information.

No such advertising is currently permitted under Regulation D. To accommodate the proposed permissibility of limited general advertising with the prohibition of such advertising in Rule 144A, the SEC is proposing to add a Preliminary Note 8 to Rule 144A to the effect that an announcement in accordance with proposed Rule 507 would not preclude resales under Rule 144A. This proposal leaves unclear whether providing, as permitted by proposed Rule 507, certain information in addition to the general announcement would make Rule 144A unavailable for resales. Given the nature of permitted buyers under Rule 144A, there would appear to be no need to restrict the provision of such additional information. It is also unclear why general announcements of the type proposed to be permitted by

Rule 507 should not be generally permissible for any resales under Rule 144A.

Issuers relying on Rule 507 would be permitted to sell securities *only* to investors who qualify as large accredited investors. This is a departure from the approach in Rule 506, which permits purchases by up to 35 non-accredited investors as well as by an unlimited number of accredited investors. As a result of the differing treatment of advertising and sale limitations in Rules 506 and 507, neither exemption would be available if an offering under Rule 506 were integrated with one under Rule 507.

Large accredited investors that participate in a Rule 507 offering will be defined in Rule 146 as "qualified purchasers." Thus, securities sold in a Rule 507-exempt offering would be "covered securities," primarily subject to regulation on the federal, rather than the state, level. However, the basis of the Rule 507 exemption is not the private placement exemption but rather the more general exemption provision found in Section 28 of the Securities Act. For purposes of resale under Rule 144, securities issued pursuant to Rule 507 would be restricted securities.

Proposed Amendments to the Term "Accredited Investor"

The SEC also proposes to amend the definition of "accredited investor." The proposed changes in asset requirements would affect Rules 504 through 506, whereas the proposed changes regarding the eligible legal entities would affect Rule 507 as well as Rules 504 through 506. An alternative "investments-owned" standard would be added for entities and individuals to meet accredited investor status. The SEC believes it may be easier for investors to calculate the value of their investments than the value of their assets. For this purpose, a definition of "investment" is being proposed. Legal entities currently required to have more than $5 million in assets would qualify if they owned more than $5 million in investments. Individuals and spouses would qualify if they either owned more than $750,000 in investments or had a net worth of more than $1 million or an annual income greater than $200,000 ($300,000 with a spouse). Real estate used for personal purposes (*e.g.*, as a personal residence) would not be counted toward satisfaction of the investments-owned standard.

To account for inflation, the SEC also proposes to adjust all dollar-amount thresholds set forth in Rule 501 of Regulation D on a going forward basis starting on July 1, 2012, and every five years thereafter.

A simplified definition of "joint investments" would permit individuals seeking to make an investment in a Regulation D-exempt offering without the signature and commitment of their spouses to include only 50 percent of any investments held jointly with their spouses or in which they have a community property or similar shared ownership interest with their spouses. In instances where both spouses sign and are bound, the full amount of their joint and individual investments would be counted in determining accredited investor or large accredited investor status. For clarification and the avoidance of confusion in other parts of Rule 501, the term "joint net worth" would be changed to "aggregate net worth" and the term "joint income" would be changed to "aggregate income."

The proposed amendments would expand the list of entities in Rule 501(a)(3) that may qualify as accredited investors and large accredited investors by adding limited liability companies, Indian tribes, labor unions and governmental bodies to a list that already includes banks, savings and loan associations, registered broker-dealers, insurance companies, registered

investment companies, Small Business Investment Companies, certain employee benefit plans, private business development companies, certain organizations described in Section 501(c)(3) of the Internal Revenue Code, corporations and Massachusetts or similar business trusts and partnerships.

Proposed Amendments of General Conditions to Regulation D

Integration. To provide increased flexibility to issuers, the integration safe harbor for Regulation D would be shortened from six months to 90 days.

In addition, the proposing release provides interpretive guidance that clarifies the SEC's position on the integration doctrine. The SEC takes the position that a company's filing of a registration statement either before or after it has commenced a private offering would not be treated as a general solicitation or general advertising that *per se* precludes the company from relying on Section 4(2) as an exemption for that private offering. In the SEC's view, companies and their counsel should consider whether or not the investors in the private offering were solicited by the registration statement. For example, the Section 4(2) exemption would be available for a private offering that is concurrent with a public offering if the company were able to solicit interest for the private offering from investors who:

- were not identified or contacted through the marketing of the public offering and
- did not independently contact the issuer as a result of a general solicitation by means of a registration statement.

This guidance by the SEC does not apply to abandoned private placements that are continued as public offerings or to abandoned public offerings that are continued as private placements. It also does not apply to offerings that might be made under proposed Rule 507, which does not derive from Section 4(2) and has special advertising provisions of its own. In a footnote, the SEC says it may provide additional integration guidance if it adopts Rule 507.

Bad Actor Disqualification. Bad actor disqualification provisions would preclude an issuer from relying on Regulation D if:

- the issuer, any predecessor of the issuer and any affiliated issuer;
- any director, executive officer, general partner or managing member of the issuer;
- any beneficial owner of 20 percent or more of any class of the issuer's equity securities or
- any promoter connected with the issuer
    - has filed a registration statement within the last five years that is the subject of a currently effective permanent or temporary injunction or any administrative stop order;
    - was convicted of a criminal offense in the last 10 years that was in connection with the offer, purchase or sale of a security or involved the making of a false filing with the SEC;
    - has been subject to an adjudication or determination within the last five years by a federal or state regulator that the person violated federal or state securities or commodities laws or a law under which a business involving investments, insurance, banking or finance is regulated;
    - is subject to an order, judgment or decree by a court entered within the

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your LeBoeuf Lamb relationship partner.

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last five years that restrains or enjoins the issuer or person from engaging in any conduct or practice involving securities and other similar businesses, including an order for failure to comply with Rule 503 (the filing of Form D);

- is subject to a cease and desist order entered within the last five years issued under federal or state securities or similar laws; or
- is subject to a suspension or expulsion from membership in or association with a member of a national securities exchange or national securities association for an act or omission constituting conduct inconsistent with just and equitable principles of trade.

The general length of the disqualification would be five years. More egregious conduct in connection with a criminal conviction would result in disqualification for 10 years. Relief would be available in certain cases upon application to the SEC.

Other Proposed Changes. In addition to the above proposals, the SEC seeks comment on whether Rule 504, the ''seed capital'' exemption, should be amended so that securities sold pursuant to a state law exemption permitting sales only to accredited investors would be deemed ''restricted securities'' for purposes of Rule 144.

There will be a 60-day comment period after publication in the Federal Register.

If you have any questions, please contact Elizabeth W. Powers at +1 212 424 8662 or epowers@llgm.com, George M. Williams, jr at +1 212 424 8064 or gwilliam@llgm.com or your LeBoeuf Lamb relationship partner.

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