AN INTRODUCTION TO THE OFFERING OF SECURITIES

In General

The offer and sale of securities is subject to the jurisdiction of federal and state securities laws. Federal securities laws are primarily enforced by the Securities and Exchange Commission (SEC) which maintains a principal office in Washington, D.C., and nine regional offices located throughout the United States. The SEC processes filings under federal securities laws and conducts investigations to determine the need for criminal prosecutions, injunctive relief, or other remedial actions for violations of the provisions of federal securities laws.

The SEC administers the Securities Act of 1933, see 15 U.S.C. §77a, et seq., which governs registration of securities and certain companies issuing securities. It also administers the following securities laws:

(1) The Securities Exchange Act of 1934, see 15 U.S.C. §78a et seq.;

(2) The Investment Company Act of 1940, see 15 U.S.C. §§80a-1 through 80a-64;

(3) The Investment Advisors Act, see 15 U.S.C. §§80b-1 through 80b-21; and

(4) The Trust Indenture Act of 1939, see 15 U.S.C. §§77aaa-77bbb.

This paper will focus upon the requirements of the Securities Act of 1933 regarding offering of securities and implementing rules issued by the SEC with particular emphasis upon securities and transactions which are exempt from the registration process.

Registration and Disclosure Requirements

The basic objective of the Securities Act of 1933 (hereafter the Act) is one of disclosure. Accordingly, the Act requires the filing of a registration statement with the SEC before a nonexempt security can be offered for sale in the United States. See 15 U.S.C. §77e; *Milnarik v. M-S Commodities, Inc*., 320 F. Supp. 1149 (N.D. Ill. 1970), aff'd, 457 F.2d 274 (7th Cir. 1972). The registration process is designed to provide potential investors with substantial information about the issuer prior to commencement of a securities transaction. This information must be distributed to potential investors in the form of a prospectus which must be filed along with the registration statement. See 15 U.S.C. §§77e, 77j. The Act proscribes the sale of securities prior to the effective date of the registration statement. See 15 U.S.C. §77e. Substantial criminal and civil sanctions are provided for willful violations of any provisions of the Act, including the filing of a registration statement containing false statements or the distribution of a prospectus which makes an untrue statement of a material fact or omits to state a material fact. See 15 U.S.C. §§77x, 77k, 771, 77o. See also *Rubin v. United States*, 449 U.S. 424 (1980), holding that even a pledge of stock as collateral for a loan constitutes an offer or sale of a security for purposes of the antifraud provisions of the Securities Act of 1933.

The registration requirement of the Securities Act of 1933 applies to all securities and transactions, except those which are specifically exempt. A person who uses interstate commerce or the mails to sell nonexempt unregistered securities or to offer or sell securities by a written or oral communication which contains an untrue statement of material fact may be liable to purchasers of the securities. The issuer will escape liability only if he sustains the burden of showing that he did not know of the untruth and could not have known of it after exercising reasonable care. See 15 U.S.C. §771. Violators of the Act are subject to severe penalties. See *SEC v. Murphy*, 626 F.2d 633 (9th Cir. 1980).

Security Defined

Statutory Definition

For purposes of the Securities Act of 1933 a security is defined as:

. . . any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege entered into on a national securities exchange relating to a foreign currency or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Case Law Interpretation

The definition of the term "security" has generally been construed liberally by the courts to include a wide variety of investment transactions. The leading case of *SEC v. W.J. Howey Co*., 328 U.S. 293 (1946), involved an offering of units in a citrus grove development. The SEC brought an action to restrain the issuers from using the mails and interstate commerce in connection with the offer to investors since it was unregistered and not exempt from registration requirements of the Securities Act of 1933. The Commission's position was upheld by the United States Supreme Court which observed that securities are involved whenever individuals are led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of someone other than themselves. See *Howey*, 328 U.S. 293, 298. Cases subsequent to the *Howey* decision have relaxed the requirement that the seller exercise sole control over the investment interest. Under the modified standard a security may be found where the seller exercises primary control of the investment interest. See *SEC v. Glenn W. Turner Enters., Inc*., 474 F.2d 476 (9th Cir. 1973); *LTV Fed. Credit Union v. UMIC Gov't Sec., Inc*., 523 F. Supp. 819 (N.D. Tex. 1981), aff'd, 704 F.2d 199 (5th Cir. 1983).

The catchall provision of the Act under which a security is defined to include all investment contracts is often relied upon by courts to expand the term "security." Accordingly,

real estate lots, franchises, and condominiums have been deemed securities under specified circumstances. See *Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981).

Exemption of Designated Securities and Transactions

The Securities Act of 1933 does not require that all sales of securities be registered with the SEC. Congress has provided certain exemptions in the Act which exempt transactions from the registration requirement where there would be no practical need for registration or where the public benefits of registration are too remote. Many securities issued by a small business entity may be eligible for one or more of the exemptions. However, exemptions available under federal laws are generally limited to the registration exemptions. They provide no exemption from civil liability or antifraud provisions of the securities laws. The following will provide a general discussion of the commonly available exemptions. Any transaction purporting to rely upon any exemption should involve a careful review of statutory provisions, judicial and administrative interpretations, and the rules adopted by the SEC.

Regulation D Offerings

In response to criticisms that the regulations of the Securities Act impose disproportionate restraints on the ability of small businesses to raise capital, the SEC has adopted Regulation D. See 17 C.F.R. §230.501-230.508. The regulation is comprised of eight rules, designated Rules 501-508, and establishes three exemptions from the registration requirements of the Securities Act. Rules 501-503 set forth definitions, terms, and conditions that are generally applicable to all Regulation D offerings. The operative exemptions of Regulation D are contained in Rules 504-506.

Regulation D, which became effective on April 15, 1982, is designed to simplify existing regulations, eliminate unnecessary restrictions that existing rules place on issuers, and achieve uniformity between state and federal exemptions in order to facilitate capital formation consistent with the protection of investors. In conjunction with the adoption of Regulation D, the SEC has rescinded Rules 146, 240, and 242, as well as Forms 146, 240, and 242. Although June 30, 1982, is the effective date of these rescissions, the SEC takes the position that no registration is required under the Securities Act for those offerings made in compliance with the terms of Rules 146, 240, and 242, which commence prior to April 15, 1982, the effective date of Regulation D. See SEC Rel. No. 33-6389.

The SEC has also amended Rules 144 (see 17 C.F.R. §230.144), and 148 (see 17 C.F.R. §230.148), to conform their definitions of restricted securities with Regulation D. Notice of sales under Regulation D must be made on Form D (see 17 C.F.R. §230.503), adopted along with the regulation. This form is also used in connection with offerings under section 4(6) of the Securities Act.

Preliminary Considerations

In the preliminary notes set forth in connection with Regulation D, the SEC lists seven factors that should be considered with any offering under the regulation. They are

summarized as follows:

(1) although Regulation D offerings are exempt from Section 5 of the Securities Act, they are not exempt from the antifraud or civil liability provisions of the federal securities laws;

(2) compliance with the provisions of the regulation does not obviate the need to comply with applicable state laws;

(3) reliance upon any exemption under Regulation D does not act as an election, and issuer may always claim the availability of any other applicable exemption;

(4) Regulation D is a transactional exemption; it is available only to the issuer of the securities and not to its affiliates or others for resales of the issuer's securities;

(5) Regulation D may be used in business combinations, see #17 C.F.R. §230.501(d);

(6) Regulation D may not be used in any plan or scheme to evade the registration requirements of the Securities Act; and

(7) securities offered and sold outside the United States in accordance with Regulation S are not counted in the calculation of the number of purchasers under Regulation D and the proceeds of such sales are not included in the aggregate offering price.

Terms and Definitions

Rule 501 of Regulation D sets forth several definitions that apply to the entire regulation. The rule provides detailed meanings for such key terms as accredited investor and purchaser representative, and it also includes a formula for calculating the number of purchasers involved in a transaction. See 17 C.F.R. §230.501. Rule 501 also defines the following terms:

(1) "Affiliate" means a person that directly or indirectly through one or more intermediaries control, is controlled by, or is under the control of the person specified.

(2) "Aggregate offering price" means the sum of all cash, property, services, debt cancellation, or other consideration received by an issuer for the issuance of its securities. Where securities are offered for both cash and noncash consideration, the aggregate offering price is based on the price at which the securities are offered for cash. If securities are not offered for cash, the offering price is based on the value of the consideration as established by bona fide sales of the consideration made within a reasonable time.

(3) "Business combination" means any transaction of the type specified in SEC Rule 145, paragraph (a) and any transaction involving the acquisition by one issuer of stock of another issuer in exchange for all or part of the former's stock if, immediately after the acquisition, the acquiring issuer has control of the other issuer.

(4) "Executive officer" is defined as the president, any vice president in charge of a principal business unit, or any officer or other person who performs a policy making function for the issuer. (Executive officers of subsidiaries may be deemed executive officers of the issuer if they perform policy making functions for such issuer).

(5) "Issuer" is defined in the manner prescribed by section 2(4) of the Securities Act except where proceedings have been commenced under the Federal Bankruptcy Code. In such cases, the trustee or debtor in possession is considered the issuer in an offering under a plan of reorganization if the securities are to be issued under the plan. See 17 C.F.R. §230.501(a)-(h).

The definition of accredited investors under Regulation D is identical to the combined provisions of Section 2(15) of the Securities Act and SEC Rule 215, and is uniformly applicable to Section 4(6) of the Act and Regulation D. The term is defined to include any person who comes within any one of eight categories at the time of the sale of the securities to that person. A person's status as an accredited investor may be based upon the issuer's reasonable belief at the time of the sale. See 17 C.F.R. §230.501(a).

The eight categories of accredited investors under Regulation D include the following:

(a) Institutional Investors. This category includes banks, investment companies, and employee benefits plans.

(b) Private Business Development Companies.

(c) Exempt organizations under Internal Revenue Code Section 501(c)(3) with total assets in excess of $5,000,000.

(d) Directors, executive officers, or general partners of the issuer.

(e) $1,000,000 Net Worth Individuals. Accredited investor status is extended under this test to any natural person whose net worth at the time of purchase is $1,000,000. All assets of the investor and his or her spouse may be included for purposes of determining accreditation under this category.

(f) Income Test. Accredited investor status is extended to any individual who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year. The term income rather than gross income is used; and the test is not keyed to federal income tax returns.

(g) Any trust, with total assets in excess of $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii).

(h) Entities Comprised of Certain Accredited Investors. Under this category, accredited investor status is extended to entities in which all the equity owners are deemed accredited investors under one or more of the preceding tests. See 17 C.F.R. §230.501(a).

A purchaser's status as an accredited investor can significantly affect the validity of offerings under Regulation D. Sales to accredited investors under Rules 505 and 506 are excluded for purposes of computing the thirty-five-purchaser limitation of those exemptions. See 17 C.F.R. § 230.501(e)(1)(iv). Additionally, the regulation does not mandate any specific disclosure to purchasers where the sale of securities is limited to accredited investors. See 17 C.F.R. §230.502(b)(1). No distinction is made, in connection with disclosures to accredited investors, between investors who are natural persons and those who are not.

Rule 501(e) sets forth the principles for computing the number of purchasers under Rules 505 and 506. See 17 C.F.R. §§230.505(b), 230.506(b). No ceiling is imposed on the number of purchasers under Rule 504. For purposes of calculating the number of purchasers under those two exemptions, the following purchasers are excluded:

(1) designated family members who have the same principal residence as the purchaser;

(2) trusts or estates in which the purchaser and designated relatives are more than 50% beneficial owners;

(3) corporations and other organizations in which the purchaser and prescribed relatives are more than 50% beneficial owners; and

(4) any accredited investor.

A corporation, partnership, or other entity is counted as one purchaser. However, where such an entity is organized for the specific purpose of acquiring the securities offered and is not an accredited investor, each beneficial owner of equity securities or equity interests in the entity is counted as a separate purchaser under Regulation D. See 17 C.F.R. §230.501(e)(2).

The term "purchaser representative" is only germane in connection with the business acumen test of Rule 506(b)(2)(ii). The definition of the term includes all persons who satisfy four conditions or who are reasonably believed by the issuer to satisfy such conditions. The status of a purchaser representative is extended to a person if he or she

(1) is not an affiliate, director, or other employee of the issuer, or beneficial owner of 10% or more of the equity interest in the issuer (an exception to this condition is applicable where the purchaser is (a) a close relative of the purchaser representative, (b) a trust or estate in which the purchaser representative and related persons collectively have more than a 50% beneficial interest or in which the representative serves as trustee or executor, or (c) a corporation or other organization of which the purchaser representative and related

persons are collectively the owners of more than 50% of the equity interest);

(2) has that degree of knowledge and experience in financial and business matters which renders him or her capable of evaluating the merits and risks of the prospective investment;

(3) is acknowledged in writing by the purchaser to be his or her purchaser representative in connection with evaluating the merits and risks of the investment; and

(4) discloses to the purchaser in writing prior to the aforementioned written acknowledgment (a) any material relationship which he or she may have with the issuer or its affiliates that then exists, is mutually understood to be contemplated, or that has existed at any time during the previous two years; and (b) any compensation received or to be received as a result of any such relationship.

Requirements Applicable to All Regulation D Offerings

Rule 502 of Regulation D sets forth a number of general conditions which apply to all offerings under the regulation pursuant to Rules 504-506. The regulatory framework established by this rule includes (a) guidelines for determining whether separate offers and sales constitute part of the same offering under principles of integration, (b) limitations on the manner of conducting the offering and on the resale of securities acquired in an offering, and (c) provisions detailing the specific disclosure requirements of Regulation D. Restrictions are imposed on the payment of commissions in connection with offers and sales under the regulation.

All sales that are part of the same Regulation D offering must meet all of the terms and conditions of the regulation. See 17 C.F.R. §230.502(a). The combining or integration of two or more Regulation D sales, therefore, may result in the unavailability of a claimed exemption. In determining whether offers and sales should be integrated for purposes of the exemptions provided by Regulation D, the five factors set forth in SEC Release No. 33-4552 should be considered.

A safe harbor is provided for offers and sales that are made more than six months before the start of a Regulation D offering or more than six months after completion of a Regulation D offering. Offers and sales made before or after such six month periods will not be integrated with an intervening Regulation D offering, provided that 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. See 17 C.F.R. § 230.502(a). An exception to this provision applies to offers or sales of securities under employee benefit plans.

It is important to distinguish the concepts of integration and aggregation as they relate to Rules 504 and 505. Integration relates to the principle by which an issuer determines the overall characteristics of its offering. Aggregation, on the other hand, is the principle by which an issuer determines the monetary worth of exempt sales available under section 3(b) of

the Securities Act. To illustrate the application of those concepts, the SEC has provided the following examples:

(1) An issuer that has conducted an offering under Rule 505 in May, 1986, must aggregate the proceeds from that offering with those of a Rule 505 offering conducted in December, 1986. However, there would be no aggregation with the December offering if the May offering has been made under Rule 506. In either case, the May offering should be exempt from the principle of integration by virtue of the safe harbor provision.

(2) Where an issuer conducts a Rule 505 offering in December, 1986, after conducting a July, 1986, offering under Rule 506, the integration safe harbor would not be available as to the subsequent offering due to failure to observe the six-month requirement of Rule 502(a). Although the proceeds from the July 506 offering would not be added to the December 505 offering price under aggregation principles, they would have to be included if the two offerings could be integrated. Assuming the two offerings are integrated, the issuer would have to evaluate all characteristics of the combined transactions when determining the availability of the exemption.

Except in certain cases under Rule 504, the use of general solicitation or advertising is prohibited in connection with Regulation D offerings. See 17 C.F.R. §230.502(c). The rule expressly proscribes offers made by means of

(1) any advertisement, article, notice, or other communication published in any newspaper, magazine or similar medium or broadcast over television or radio; or

(2) any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.

With the exception of certain offerings under Rule 504, securities acquired in a transaction under Regulation D have the status of securities acquired in a transaction under section 4(2) of the Securities Act and cannot be resold without registration under the Act unless an exemption from registration is available. See 17 C.F.R. §230.502(d). An issuer is required to use reasonable care to assure that purchasers of securities under Regulation D are not underwriters. Reasonable care is defined to entail, but is not limited to

(1) reasonable inquiry to determine if the purchaser is acquiring the securities for himself or for other persons;

(2) written disclosure to each purchaser prior to sale that the securities have not been registered under the Securities Act and, accordingly, cannot be resold unless they are registered or an exemption from registration is available; and

(3) placement of a legend on the certificate stating that the securities have not been registered under the Act and setting forth or referring to the restrictions on transferability and the sale of the securities.

See 17 C.F.R. §230.502(d). In addition, section 230.502(b)(2)(vii) requires the delivery of written disclosure of the limitations on resale to investors in certain instances.

In exercising reasonable care to assure purchasers are not underwriters, an issuer should obtain an investment letter from each purchaser. This letter states that the purchaser is holding the stock for investment and not for resale.

Rule 502(b) sets forth the timing and nature of information which must be furnished in Regulation D offerings. The type of information to be furnished varies and generally depends on the size of the offering and whether or not the issuer is a reporting company. Where an issuer sells securities only to accredited investors, the rule does not require any specific disclosure. However, as a practical matter, disclosure is recommended because Rule 10b-5 is a general prohibition against fraud in connection with the sale of any security. See 17 C.F.R. §230.502(b)(1).

A detailed treatment of the multi-level disclosure requirements is provided in SEC Release No. 33-6389. The basic disclosure requirements are found at 17 C.F.R. §230.502(b) and may be summarized as follows:

(1) For offerings up to $2,000,000, an issuer must provide the information required in Item 310 of Regulation S-B, except that only the issuer's balance sheet, dated within 120 days of the start of the offering, must be audited. See 17 C.F.R. §230.502(b)(2)(i)(B)(1).

(2) For offerings up to $7,500,000, an issuer who is not subject to the reporting obligations of the Exchange Act must provide the same kind of information as required in Form SB-2. If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, the issuer may instead provide an audited balance sheet dated within 120 days of the start of the offering. A limited partnership that cannot obtain audited financial statements without unreasonable effort or expense may furnish financial statements based on federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant. See 17 C.F.R. §230.502(b)(2)(i)(B)(2).

(3) In offerings over $7,500,000, nonreporting companies must furnish a financial statement as would be required in a registration statement filed under the Act on the form that the issuer would be entitled to use. If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, the issuer may instead provide an audited balance sheet dated within 120 days of the start of the offering. A limited partnership that cannot obtain audited financial statements without unreasonable effort or expense may furnish financial statements based on federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant. See 17 C.F.R. §230.502(b)(2)(i)(B)(3).

(4) Companies that are subject to the reporting obligations of the Exchange Act must make the same kind of disclosures regardless of the size of the offering. Such issuers, however, may make the required disclosure either by furnishing to the purchaser: (a) the issuer's annual report to shareholders for the most recent fiscal year, if the report meets the requirements of §240.14a-3 or §240.14c-3 of the Exchange Act, the definitive proxy statement filed in connection with that annual report, and, if requested in writing, a copy of the most recent Form 10-K and Form 10-KSB under the Exchange Act; or (b) the information contained in an annual report in Form 10-K or 10-KSB under the Exchange Act or in a registration statement on Form S-1, SB-2 or S-11 under the Act or on Form 10 or Form 10-SB under the Exchange Act, whichever form is the most recent required to be filed. See 17 C.F.R. §230.-502(b)(2)(ii)(A) and (B). Regardless of the form of disclosure selected, the basic information provided must be supplemented by information contained in designated Exchange Act reports filed with the distribution or filing of the report or registration statement in question. The issuer must also furnish to the purchaser a brief description of the securities being offered, the use of the proceeds from the offering, and any material changes in the issuer's affairs that are not disclosed in the documents furnished. See 17 C.F.R. §230.502(b)(2)(ii)(C).

Rule 502 further provides that exhibits required to be filed with the SEC need not be furnished to each purchaser if the contents of the exhibits are identified and made available to a purchaser upon written request. See 17 C.F.R. § 230.502(b)(2)(iii). At a reasonable time prior to purchase, and upon written request, an issuer must furnish a purchaser who is not an accredited investor, in a transaction under Rule 505 or 506, a brief written description of any written information concerning the offering that has been provided by the issuer to an accredited investor. See 17 C.F.R. §230.502(b)(2)(iv).

Rule 508 affords an affirmative defense to civil liability for failure to comply with Regulation D. Rule 508 provides that if a requirement of Regulation D is not specifically designed to protect the complaining person, the failure to comply is insignificant to the offering as a whole and there has been a good faith and reasonable attempt to comply with all the requirements of the regulation, then an exemption from the registration requirements will be available despite the failure to comply with Regulation D. A transaction made in reliance on Rules 504, 505, and 506, however, shall comply with all applicable terms, conditions, and requirements of Regulation D. In addition, Rule 508 does not provide a defense to enforcement proceedings by the SEC. See 17 C.F.R. §230.508.

Notice of Sales-Form D

Notice of sales in offerings under Regulation D must be made on Form D, which was adopted by the SEC along with the regulation. The form must also be filed in connection with offerings under Section 4(6) of the Securities Act. In completing the form, an issuer must indicate the specific exemption being claimed and furnish other information by checking appropriate boxes.

Five copies of Form D, one of which must be manually signed by a person duly authorized by the issuer, must be filed with the SEC within fifteen (15) days after the first sale of securities under Regulation D. See 17 C.F.R. §230.503(a), (b).

Amendments to the notices need only report the issuer's name, the information required by Part C of the form, and any material change in the facts set forth in Parts A and B of the initial notice. See 17 C.F.R. §230.503(d). Upon written request of the commission, an issuer must undertake to furnish to SEC staff personnel the information provided to purchasers that are not accredited. Such an undertaking, however, is limited to offerings under Rule 505. See 17 C.F.R. §230.503(c).

A 1989 amendment to Regulation D eliminates the requirement to file Form D within fifteen days of the first sale of securities as a condition to establish an exemption under Regulation D, but the filing is still required. In other words, failure to file will not automatically disqualify an issuer from an exemption even though the filing requirement remains. See 17 C.F.R. §230.501(c); Schneider, *A Substantial Compliance (I&I) Defense and Other Changes Are Added to SEC Regulation D*, 44 Bus. Law. 1207 (Aug. 1989). Rule 507 will disqualify an issuer from using Regulation D for future transactions if the issuer has been enjoined by a court for violating the filing obligation required by Rule 503. See 17 C.F.R. §230.507.

Rule 504 Offerings

Rule 504 under Regulation D provides an exemption under Section 3(b) of the Securities Act for certain offers and sales of securities. The exemption is not available to investment companies, issuers subject to Exchange Act reporting obligations, or any development stage company that either has no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or other entity or person. See 17 C.F.R. § 230.504(a). To qualify for a Rule 504 exemption, offers and sales must satisfy the terms and conditions of Rules 501 and 502 except for 502(c) on the general limitations on the manner of offering and 502(d) on the limits on resales.

Although the Rule 504 exemption does not mandate specific disclosure requirements, the issuer remains subject to the antifraud and civil liability provisions of the federal securities laws as well as state requirements.

Offers and sales made pursuant to Rule 504 may not exceed an aggregate offering price of $1,000,000. Proceeds from securities sold within the preceding twelve months in any transaction exempt under section 3(b) or in violation of section 5(a) of the Securities Act must be included in calculating the aggregate offering price under the rule. See 17 C.F.R. 230.504(b)(2); SEC Rel. No. 33-6389, 45 Fed. Reg. 11251, 11266.

Rule 505 Offerings

Offers and sales of securities by an issuer that is not an investment company in accordance with the provisions of Rule 505 are exempt from the registration requirements of the Securities Act. Rule 505 provides an exemption under section 3(b) of the Act and replaces Rule 242. To qualify for the Rule 505 exemption, offers and sales must comply with specific limitations as well as the terms and conditions of Rules 501 and 502. See 17 C.F.R. §230.505(b); this chapter. The exemption provided by Rule 505 is also unavailable to any issuer described in

§ 230.262 of Regulation A. See 17 C.F.R. §230.505(b)(2)(iii).

The aggregate offering price of an offering of securities under Rule 505 must not exceed $5,000,000. In computing the aggregate offering price for the purpose of the exemption, the offering price of all securities sold within the twelve months before the start of and during the offering of securities under Rule 505 in reliance upon any exemption under section 3(b) of the Act or in violation of section 5(a) of the Act must be included. See 17 C.F.R. §230.505(b)(2). For example, if Issuer A sold $500,000 of its securities on June 1, 1986, under Rule 504, and an additional $4,500,000 of its securities on December 1, 1986, it could not sell any of its securities under the rule until June 1, 1987.

The issuer must reasonably believe that there are no more than thirty-five purchasers of its securities in any offering under a Rule 505 exemption. See 17 C.F.R. §230.505(b)(2)(ii). In calculating the number of purchasers under a Regulation D exemption, prescribed purchasers, including accredited investors, are excluded.

Rule 506 Offerings

Rule 506 of Regulation D provides an exemption for offers and sales of securities pursuant to section 4(2) of the Securities Act without regard to the dollar amount involved. To qualify for the Rule 506 exemption, offers and sales must satisfy all the terms and conditions, including the disclosure requirements, of Rules 501 and 502. Unlike Rules 504 and 505, however, Rule 506 imposes no limitation on the type of issuer that may avail itself of the exemption.

Rule 506 modifies and replaces Rule 146. Similar to its predecessor, Rule 506 exempts offers and sales to no more than thirty-five unaccredited purchasers. The issuer must reasonably believe that there are no more than thirty-five purchasers (in addition to accredited investors) of its securities in any offering under the rule. See 17 C.F.R. §230.506(b)(2)(i). Rule 501(e) sets forth guidelines for calculating the number of purchasers.

In any offering under Rule 506, the issuer must reasonably believe that each purchaser who is not an accredited investor, either alone or with his or her purchaser representative, has such experience in financial and business matters that he or she is capable of evaluating the merits and risks of the prospective investment. See 17 C.F.R. §230.506(b)(2)(ii). This standard modifies the offeree qualification provisions of Rule 146 in two significant ways. Initially, only purchasers are required to meet the sophistication standards under Rule 506. Second, the 506 standard eliminates the economic risk test formerly imposed under Rule 146.

Integration of Offerings

An issuer of securities may not separate an offering into several transactions in an effort to circumvent the registration requirements of the Securities Act. What may appear to be a separate offering to a properly limited group will not be so treated if such offering is merely one in a series of related offerings. See *SEC v. Murphy*, 626 F.2d 633 (9th Cir. 1980). This consolidated treatment of ostensibly single offerings stems from the SEC integration doctrine,

which cumulatively considers single offerings that have similar characteristics. In Securities Act Release Number 4552 (November 6, 1962), the SEC deemed the following factors to be relevant in determining whether offers and sales should be regarded as part of a larger offering for purposes of invoking the integration doctrine:

(1) whether the offerings are part of a single plan of financing;

(2) whether the offerings involve issuance of the same class of security;

(3) whether the offerings are made at or about the same time;

(4) whether the same type of consideration is to be received; and

(5) whether the offerings are made for the same general purpose.

In a hypothetical situation involving offerings of fractional interest in petroleum properties where promoters are required to constantly find new participants for each new venture, the SEC has concluded that it would be appropriate to consider the entire series of offerings to determine the scope of this solicitation. See 27 Fed. Reg. 11316 (1962).

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Note: The reader should recognize that laws and court decisions regarding securities – as stated above - are subject to change. If you have questions as to a current issue, please contact Mark Alexander.