KAY GORDON
BRITANI PETERSON

FEDERAL SECURITIES LAW
Kay Gordon, Esq.
Co-Head, Investment Management Group at Nelson Mullins Riley & Scarborough

Education
- University of Pennsylvania Law School, JD
- Allegheny College, BA, magna cum laude, Phi Beta Kappa

Recognition
- The Legal 500, Leading Lawyer in Investment Fund Formation and Management (2009)

Representation Includes
- Private equity & hedge funds
- Myriad of investors – institutional to seed
- Investment managers

Practice Areas:
- Financial services advisory
- Corporate & securities opportunity zones
- Emerging companies
- General counsel services
- Investment management
- Private equity
- Securities offerings
Security Regulations: Generally

- Security defined
- Major Federal Regulations

Exemptions from Registration Requirement

- Most common exemptions:
  - Statutory Exemptions
  - Regulation D

Misc. Exemptions:

- Wholly Intrastate Offerings
- Regulation Crowdfunding
- Amended Regulation A: “Regulation A+”
- Resale Exemptions

Related Federal Securities Legislation
Threshold Question of Applicability: Federal Securities Regulations

Whether the new business proposes to issue a security as a part of its capital-raising transactions
WHAT IS A SECURITY?

SECURITY: A FUNGIBLE, NEGOTIABLE FINANCIAL INSTRUMENT THAT HOLDS SOME TYPE OF MONETARY VALUE

• USED TO RAISE CAPITAL IN PUBLIC AND PRIVATE MARKETS.¹

§2(a)(1) OF THE 1933 ACT

• BROAD DEFINITION OF “SECURITY”

• …ANY NOTE, STOCK, TREASURY STOCK, SECURITY FUTURE, SECURITY-BASED SWAP, 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…

¹Investopedia
**Does the equity investment qualify as a security?**

**Equity Financing**

**Ownership Interest of an Entity**

| Corporation issuing stock = enumerated in statutory definition | Equity interests in other business entities *not* specifically enumerated in statutory language |

**Howey “Investment Contract” Analysis**

- **Determine whether unusual arrangements nonetheless qualify as a security**

**Four elements of an “Investment Contract” as used in §2(a)(1)**

- The investment of money,
- In a common enterprise,
- With a reasonable expectation of profits,
- To be derived from the efforts of others
DOES THE DEBT FINANCING QUALIFY AS A SECURITY?

REVES FOUR-FACTOR TEST

• A NOTE WITH A MATURITY DATE >9 MONTHS IS ASSUMED TO BE A SECURITY UNLESS REBUTTED BY SHOWING THE NOTE BEARS A “STRONG RESEMBLANCE” TO ENUMERATED LIST OF “JUDICIALLY DETERMINED NON-SECURITIES”

Four Factor test:

• The purpose of the transaction;
• The plan of distribution of the instrument;
• The reasonable expectations of the investing public and
• Whether some other fact significantly reduces the risk of the instrument (e.g., regulatory scheme)

DEBT FINANCING
BORROWED MONEY THAT MUST BE REPAYED
SECURITIES LAW:
ORIGINALLY A PATCHWORK OF STATE LAWS
(BLUE SKY LAWS)
ORIGIN OF FEDERAL SECURITIES REGULATIONS
PRE-FEDERAL REGULATIONS

- Post WWI ➔ Roaring 20’s
- Everybody is investing
  - Stocks bought on margin
  - Uninformed investors
- Relaxed state security laws
  - Blue Sky Laws
  - Little to no restrictions for issuers

Sum: the American economy was a time bomb
Enter: Stock Market crash (1929)
Securities Act of 1933

- Broadly defines security
- Issuers must affirmatively disclose financial info
- Prohibits fraud and misrepresentation

Securities Exchange Act of 1934

- Established Securities Exchange Commission
- SEC may require periodic reporting and provides SEC with disciplinary powers

The offer or sale of capital raising transactions must be registered with the SEC unless an exemption applies.

Registration includes:

- A description of the company's properties and business;
- A description of the security to be offered for sale;
- Information about the management of the company; and
- Financial statements certified by independent accountants.
EXEMPTIONS FROM REGISTRATION REQUIREMENTS: GENERALLY

- Burden of Proof
- Strict Liability
- Integration Principle
# Main Sources of Statutory Exemptions

<table>
<thead>
<tr>
<th><strong>Section 3 of Securities Act</strong></th>
<th><strong>Section 4 of Securities Act</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Generally exempts certain securities from having to be registered with the SEC</td>
<td>Generally exempts specific transactions in securities from registration</td>
</tr>
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</table>
REGULATION D

• Promulgated by the SEC in 1982

• Established an “integrated, consistent set of rules” for the application of statutory exemptions found in the 1933 Act
  • Section 4(a)(2) private placement exemption
  • Section 3(b)(1) small offering exemption

• Rules 501-508
  • Substantive exemptions: Rule 504 and Rule 506

• Contains 3 Regulatory Safe Harbor Rules
# PRIVATE PLACEMENT EXEMPTION

<table>
<thead>
<tr>
<th>Type of Offering</th>
<th>Dollar Limit</th>
<th>Manner of Offering</th>
<th>Issuer and Investor Requirements</th>
<th>Filing Requirement</th>
<th>Restriction on Resale</th>
<th>Blue Sky Exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 4(a)(2)</td>
<td>None</td>
<td>No general solicitation or general advertising</td>
<td>Investors must meet sophistication and access to information test so as not to need protection of registration.</td>
<td>None</td>
<td>Restricted securities</td>
<td>No need to comply with SBSL</td>
</tr>
<tr>
<td>Rule 506(b)</td>
<td>None</td>
<td>No general solicitation or general advertising</td>
<td>Unlimited number of accredited investors and 35 non-accredited investors that are sophisticated.</td>
<td>File Form D with SEC not later than 15 days after first sale.</td>
<td>Restricted securities</td>
<td>No need to comply with SBSL</td>
</tr>
<tr>
<td>Rule 506(c)</td>
<td>None</td>
<td>General solicitation permitted, provided all purchasers are accredited investors.</td>
<td>All purchasers must be accredited investors. Issuer must take reasonable steps to verify accredited investor status. Certain “bad actors” are disqualified from participating in Rule 506(c) offerings.</td>
<td>^</td>
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<td>^</td>
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</tbody>
</table>
SMALL OFFERINGS EXEMPTION

“EXEMPTS FROM REGISTRATION THE OFFER AND SALE OF UP TO $5 MILLION OF SECURITIES IN A 12-MONTH PERIOD”

SECTION 3(b)(1) OF THE 1933 ACT
- authorizes SEC to adopt exemptions for small offerings
SEC PROMULGATED RULE 504 PURSUANT TO §3(b)(1)
- $1 MILLION → $5 MILLION THRESHOLD
# SMALL OFFERINGS EXEMPTION

<table>
<thead>
<tr>
<th>Type of Offering</th>
<th>Rule 504 Regulation D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dollar Limit</td>
<td>$5 million within prior 12 months.</td>
</tr>
<tr>
<td>Manner of Offering</td>
<td>No general solicitation or general advertising unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sales to accredited investors with general solicitation.</td>
</tr>
<tr>
<td>Issuer and Investor Requirements</td>
<td>Available to non-reporting companies only that are not investment companies or blank check companies. Certain “bad actors” are disqualified from participating in Rule 504 offerings.</td>
</tr>
<tr>
<td>Filing Requirement</td>
<td>File Form D with SEC not later than 15 days after first sale. Filing not a condition of the exemption.</td>
</tr>
<tr>
<td>Restriction on Resale</td>
<td>Restricted unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sale to accredited investors with general solicitation.</td>
</tr>
<tr>
<td>Blue Sky Exemption</td>
<td>Need to comply with SBSL by registration or state exemption.</td>
</tr>
</tbody>
</table>
WHOLLY INTRASTATE EXEMPTIONS

- **Section 3(a)(11)** exempts “purely local in-state offerings”
- **Rule 147 safe harbor**: bright-line standards to define scope of “purely local offerings”
- **Rule 147A**
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<th>Filing REQ.</th>
<th>Restriction on Resale</th>
<th>Blue Sky Exemption</th>
</tr>
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<tr>
<td><strong>Section 3(a)(11)</strong></td>
<td>None</td>
<td>No limitation other than to maintain intrastate character of offering</td>
<td>Issuer and investors must be resident in state. No limitation on # of investors.</td>
<td>None</td>
<td>Securities must rest within the state</td>
<td>Must comply with SBSL by registration or state exemption.</td>
</tr>
<tr>
<td><strong>Rule 147</strong></td>
<td>None</td>
<td>No limitation other than to maintain intrastate character of offering</td>
<td>Issuer must be resident in state, using “principal place of business” and jurisdiction of organization to determine residency, and meet at least one “doing business” requirement. Investors must be resident in state, using “principal place of business” to determine residency. No limitation on number of investors.</td>
<td>None</td>
<td>Limits on resales to persons residing within the state or territory of the offering for 6 months.</td>
<td>Must comply with SBSL by registration or state exemption.</td>
</tr>
<tr>
<td><strong>Rule 147A</strong></td>
<td>^</td>
<td>General solicitation permitted, provided sales are made only to residents of the state or territory in which the issuer is resident. Offers may be made to out-of-state residents.</td>
<td>^</td>
<td>^</td>
<td>^</td>
<td>^</td>
</tr>
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</table>
“a method of collecting many small contributions, by means of an online platform, to finance or capitalize a popular enterprise”
Title III of the JOBS Act created new exemption under §4(a)(6)

- Limit on offerings
- Limit on investments
- Online intermediaries
- Inner disclosure requirements
- Ongoing annual reporting
- Intermediary requirements
- Funding portal restrictions
- Advertising
- Resale restrictions
- Excluded issuers

Regulation Crowdfunding
# Regulation Crowdfunding

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<tr>
<th>Type of Offering</th>
<th>Regulation Crowdfunding</th>
</tr>
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<tbody>
<tr>
<td>Dollar Limit</td>
<td>$5 million within prior 12 months.</td>
</tr>
<tr>
<td>Manner of Offering</td>
<td>Offering must be made solely through a platform</td>
</tr>
<tr>
<td>Issuer and Investor Requirements</td>
<td>Issuers that are not reporting companies, not funds, and not subject to disqualification</td>
</tr>
<tr>
<td>Filing Requirement</td>
<td>Requires the preparation of a Form C, which resembles a Form 1-A.</td>
</tr>
<tr>
<td>Restriction on Resale</td>
<td>Securities sold in an offering are subject to certain transfer restrictions for one year.</td>
</tr>
<tr>
<td>Blue Sky Exemption</td>
<td>No need to comply with SBSL</td>
</tr>
<tr>
<td>Type of Offering</td>
<td>Dollar Limit</td>
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| **Tier 1**
Regulation A | $20 million within prior 12 months, but no more than $6 million by selling security holders. | “Testing the waters” permitted before and after filing Form 1-A. Sales permitted after Form 1-A qualified. | Issuer must be eligible issuer. No investor requirement. | File test-the-waters documents, Form 1-A, any sales material and report of sales and use of proceeds with the SEC. | Not restricted securities | Subject to SBSL regarding pre-offering review, filing, and anti-fraud. |
| **Tier 2**
Regulation A | $50 million within the prior 12 months, but no more than $15 million by selling security holders. | ^ | Issuer must be eligible issuer. No investor requirement; however, investors who are natural persons and are not accredited investors are subject to an investment limit. | File test-the-waters documents, Form 1-A, any sales material and report of sales and use of proceeds with the SEC. Issuer subject to ongoing reporting requirements. | ^ | Not subject to SBSL regarding pre-offering review; however, subject to state blue sky filing and anti-fraud requirements. |
RESALE EXEMPTIONS: RESTRICTED SECURITIES AND RULE 144

What are restricted securities? Securities that were originally acquired in a §4(a)(2) private placement or in a Regulation D offering. I.e., previously issued securities that are not freely tradable.

Five Requirements of Rule 144

1. Current public information
2. Holding period
3. Volume limitation
4. Manner of sale
5. Notice of sale
SARBANES-OXLEY ACT (SOX)

**Background:** Enron and WorldCom scandals

**Codified:** Section 307 of the Sarbanes-Oxley Act of 2002

- Defines “standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers.”

- Requires attorneys to report corporate misconduct “up the ladder”
QUESTIONS?