RAISING CAPITAL THROUGH PRIVATE PLACEMENTS: DEAL POINTS

January 2024

Executive Summary

Any attempt to raise capital by the offer and sale of debt or equity securities in the U.S. market must be made with a publicly filed registration statement pursuant to section 5 of the U.S. Securities Act of 1933, as amended (the "Securities Act"), which governs the initial issuance of securities, unless an exemption from registration is available. Exemptions from the registration requirement are valuable because the registration process, especially for an initial public offering, or "IPO," is costly, rigorous, and leads to extensive ongoing compliance obligations under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which regulates both offers and sales of securities after their initial issuance and the reporting obligations of public companies.

Exemptions from the registration requirement fall into two main categories: securities that are always exempt from registration pursuant to section 3 of the Securities Act (for example, government securities and short term commercial paper), and certain transactions in securities that are not themselves generally exempt from registration requirements, but which for that specific transaction are exempted pursuant to section 4 of the Securities Act.

For most companies attempting to raise capital without public registration, the most important section 4 exemption is section 4(a)(2), which exempts from the registration requirement the sale of securities by a securities-issuing company (or "Issuer") "not involving any public offering," meaning generally a "private placement" of the securities without solicitation or advertising to the general public. Section 3(b) provides another route for Issuers to offer exempt securities (as opposed to exempt transactions in securities) when the aggregate amount and nature of the offering is limited. Registration-exempt securities offerings can be made pursuant to the relevant Securities Act provisions themselves, and also pursuant to rules and regulations that the U.S. securities regulatory agency, the Securities and Exchange Commission ("SEC") has promulgated pursuant to the Securities Act. Following is a discussion of the principal Securities Act sections, rules and regulations that may be used for registration-exempt offers and sales of securities for the purpose of raising capital and their respective requirements, advantages and disadvantages. In each case, the discussion of the exemption is organized in the same categories and order to facilitate their comparison and determination of which may be the appropriate choice for the Issuer seeking outside investment capital, as follows:

(a) Aggregate Offering Limitation (the amount of capital that can be raised at one time using that exemption);

(b) Issuer and Investor Requirements (restrictions on what kinds of Issuer can use each exemption and what kinds of investors can buy the securities issued);

(c) Limitations on Manner of Offering (restrictions on how the securities may be offered);

(d) SEC and State Filing Requirements (federal and state filings, if any, required to use each exemption);

(e) Limitations on Resales (restrictions on resale of the securities issued using each exemption);

(f) Information Requirements (what information must be furnished to prospective investors using each exemption);

(g) Advantages (positive reasons for using each available exemption); and

(h) Disadvantages (negative reasons militating against use of each available exemption).

Appendix 1 at the end of this advisory presents a condensed version of the same information in chart form. Following the discussion, are "Deal Points" on important considerations in the exempt-from-registration offering process and *what at all costs not to do*. New to this edition are "Special Topics," appearing throughout in gray boxes.

About Us

Kurtin PLLC is a New York City-based law firm founded in 2008 and celebrating its 15th anniversary this month. Our practice focuses on corporate, finance, commercial and regulatory representation for both mature and early stage companies, investment funds, investors and lenders in the Biotechnology & Life Sciences; Communications & Media; Information Technologies & Internet; Satellites & Space; and Venture Capital & Private Equity sectors. Among our key values, none rank higher than creative and individualized solutions to business issues, absolute client discretion and unsurpassed responsiveness. Since our founding in 2008, we have represented clients in over 40 countries on six continents and across the United States on transactional and dispute resolution matters.

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I. Regulation D, Rule 506: the Securities Act Section 4(a)(2) Safe Harbor for Private Placements

a. Aggregate Offering Limitation: Rule 506 has no aggregate offering limitation; if the other requirements of the Rule are met, an unlimited dollar amount of securities may be offered in a single Rule 506 offering. The unlimited aggregate offering amount is a material and nearly unique advantage of Rule 506 compared to the other Securities Act exemptions covered here. The unlimited aggregate offering amount, the non-exclusive "safe harbor" for Securities Act section 4(a)(2) that Rule 506 provides (section 4(a)(2) also provides an unlimited aggregate offering amount; see Section V) and the lack of ongoing reporting obligations account for the popularity and frequent use of Rule 506 compared to the other exemptions (see Section XI on FY 2021 SEC Data Metrics), and is the reason to discuss it here before all the other exemptions. Rule 506 has two important subsections, Rule 506(b), the "traditional" rule, which prohibits general solicitation of investors, subject to some new limited exceptions; and Rule 506(c), a relatively new rule that permits general solicitation under more stringent conditions. The differences are discussed in the Special Topics box below.

b. Issuer and Investor Requirements:

Issuers

There are no Issuer qualifications to issue securities under Rule 506, although an Issuer may be disqualified under Rule 506(d) "bad actor" provisions. Issuers may be U.S. or foreign (non-U.S.), private or Exchange Act reporting companies. As we will see, many of the other Securities Act exemptions are not available to foreign issuers, Exchange Act reporting companies, certain investment funds and "blank check" companies, defined by Securities Act Rule 419 as companies formed without a specific business purpose or with a business plan to go public in an IPO and then merge with or acquire an operating company, such as "SPACs," or "Special Purpose Acquisition Companies." Any of those entities, as well as more typical early stage private company Issuers, may use Rule 506, which accounts for the nearly universal use of Rule 506 in Mergers & Acquisitions, or "M&A"; "PIPE," or "Private Investment in Public Equity," transactions; financings of Exchange Act reporting companies; and SPACs during or after their IPOs.

Investors

Accredited Investors

The distinction between potential purchasers of securities who are "Accredited Investors" and those who are not is central to the Securities Act registration exemption scheme. The focus of the securities laws and the SEC regulatory regime is investor protection, mainly achieved by ensuring adequate disclosure by the Issuer to prospective purchasers in order to allow them to make an informed decision about whether to invest. For Securities Act section 5 public offering registration statements, the disclosure requirements, both of financial and accounting information and of qualitative, or unquantifiable, information are extensive. However, "Accredited Investors," defined in Securities Act section 2(a)(15) and Regulation D, Rule 501(a) to include institutions such as banks and insurance companies; registered broker-dealers, investment advisors and investment companies; certain companies, trusts, and family offices; and persons who, by reason of their income, net worth, financial sophistication or certifications, or "insider" status such as director or officer of the Issuer company, are deemed not to need the benefit of the Securities Act's full disclosure scheme. The net worth and net income requirements are relatively modest for any individual investor who is likely to be a potential private placement investor: at least $1 million in net worth (excluding primary residence) or net income of more than $200,000 in each of the two most recent years (or $300,000 including spousal/spousal equivalent income). Rule 502 of Regulation D contains rules against general solicitation of prospective purchasers of securities in most private placements (but see discussion of Rule 506(c) in Section I(c)), financial and non-financial information required to be offered to prospective purchasers and restrictions on resale of exempted securities sold under Regulation D.

Reg. D, Rule 506(b) v. 506(c)

Rule 506(b): there may be unlimited Accredited Investors and up to, but no more than, 35 "sophisticated" but non-accredited investors (in fact or in Issuer's "reasonable belief") (but see Section I(h) and Section XII, "Deal Points" no. 2 on why as a general rule not to sell to non-accredited investors) in any 90-calendar-day period. Investors may "self-certify" their Accredited Investor status with subscription documents, questionnaires or stock purchase agreements, a relatively small due diligence burden for Issuers and a significant time and cost advantage over Rule 506(c).

Rule 506(c): all purchasers must be Accredited Investors, and Issuer must also take Rule-specified "reasonable steps" to confirm their Accredited Investor status, a heavier burden on Issuer not required under Rule 506(b)'s "self-certification" regime. The Rule 506(c) reasonable steps can include detailed investor financial and tax disclosures and their review by Issuer.

c. Limitations on Manner of Offering:

Reg. D, Rule 506(b) v. 506(c)

Rule 506(b): no general solicitation or advertising to the public at large in the terms of Rule 502(c) is permitted. New Rule 148 permits Issuers to engage in "Test-the-Waters" and "Demo Day" (organized pitch presentations by one or a series of Issuers under the auspices or sponsorship of a university, investment bank or fund, accelerators, incubators and other parties) communications with generic solicitation-of-interest materials for a prospective exempt sale of securities prior to determining which exemption it will use without violating the no "general solicitation"/"general advertising" prohibitions of Rule 506(b) if that exemption (by far the most popular) is eventually chosen, provided, among other things, that the "Demo Day" sponsor made no investment recommendations at the event, received no payments like a brokerage commission, nor charged a fee to attend it *See,* "SEC Rule 148, the New Exception to the General Solicitation or Advertising Prohibition," available at Kurtin PLLC Raising Capital).

Rule 506(c): general solicitation and advertising under Rule 506(c) *is* permitted as long as *all* eventual actual purchasers are Accredited Investors. In practice, under Rule 506(b), a pre-existing relationship with or connection to the prospective investors is necessary, and no general media outreach is permitted. Under Rule 506(c), no pre-existing relationship with the investors is needed, and general media outreach is permitted, as long as the actual eventual purchasers are Accredited Investors, which explains Rule 506(c)'s more stringent and Rule-specified requirement for the Issuer to take affirmative "reasonable steps" to confirm "Accredited Investor" status, compared to Rule 506(b)'s Accredited Investor "self-certification."

d. SEC and State Filing Requirements: SEC. The Issuer must file SEC Form D within 15 days of first sale pursuant to Regulation D, Rule 503. However, the filing is not a condition of receiving the exemption. There is no ongoing reporting requirement. State. Rule 506 securities are exempt from state filing requirements as "Covered Securities" under Securities Act section 18 (Note: Broker-Dealers and others who aid in placing the securities may also have Financial Industry Regulatory Authority ("FINRA") filing obligations).

e. Limitations on Resales:

Resales of Restricted Securities

Since resales of Issuer's securities do not directly raise capital for it, discussion of resale of the Issuer's securities by their original purchaser is not specifically germane to this advisory. Nevertheless, the ability to resell those securities will obviously affect the investment market for the Issuer's original issuance of them; all purchasers prefer liquidity, and therefore the ability to resell the securities they've purchased. For that reason, a brief overview of resale restrictions is relevant here (for a more detailed description, *see* "Resales of Restricted Securities: Deal Points," available at Kurtin PLLC Raising Capital).

Securities sold under many of the Securities Act exemptions, including Regulation D, are "Restricted Securities" as defined in Securities Act Rule 144, meaning securities acquired from the issuer or its affiliate in a transaction or chain of transactions not involving a public offering. Restricted Securities cannot be resold unless they are subsequently registered or unless another exemption from registration is available for their resale. Most such resale exemptions are found under Rule 144, which relies on the Securities Act's section 4(1) exemption from registration of securities sold "by a person other than an issuer, underwriter, or dealer." The term "underwriter," defined in Securities Act section 2(a)(11), means someone who purchased the securities with the intention to distribute them to others, like a traditional investment bank underwriter. A person who is not an underwriter can therefore resell Restricted Securities without registering them under section 4(1), and Rule 144 provides a safe harbor for doing so.

As a general matter, Rule 144(d) provides that Restricted Securities issued by a company that is not a "reporting company" under Exchange Act sections 13 or 15(d) cannot be resold by the holder until at least one year from their issuance to him or her has passed (the required "holding period" is six months in the case of reporting company Issuers).

Rule 144A provides that another exemption for resale of Restricted Securities is available to "Qualified Institutional Buyers," or "QIBs." QIBs are deemed, much like Accredited Investors in the case of original issuance of securities, sufficiently sophisticated as not to need the protections provided by the disclosures required in the registration process upon their purchase by resale of those securities. QIBs include insurance companies, investment companies and small business investment companies, investment advisers, employee benefit plans, trust funds, securities dealers registered under Exchange Act section 15, banks and others. QIBs generally must own and invest on a discretionary basis an aggregate at least $100 million in the securities of Issuers unaffiliated with them (or, in the case of registered securities dealers, at least $10 million, or be acting in a "riskless principal transaction" on behalf of a QIB). For banks, there is an additional $25 million audited net worth requirement for QIB status. Obviously, QIB qualification is a far higher threshold than Accredited Investor qualification, but provides an avenue for resale of Restricted Securities when the holding period cannot be waited for to expire.

Rule 145 provides another set of rules for the resale of Restricted Securities acquired in the course of business combinations such as mergers and acquisitions, and for which Reg. D is often used as a resale exemption.

Finally, in this abbreviated discussion of resale of restricted securities, the 2015 FAST Act enacted an amendment to the Securities Act, section 4(a)(7), which provides an exemption for private resales of Restricted Securities. Section 4(a)(7) provides a safe harbor for the so-called Securities Act section 4(a)(1½) exemption, private resales by persons other than the Issuer. It is generally used for resales to Accredited Investors who are not QIBs. Because section 4(a)(7) requires Issuer information and therefore cooperation, and because the resale purchaser receives Restricted Securities (unlike purchasers who purchase Restricted Securities after the Rule 144 holding period expires), the utility of section 4(a)(7) has been limited.

f. Information Requirements: There are no information requirements if only Accredited Investors are sold to; *however*, if any – *even one* – of the permitted up-to-35 non-accredited investors is sold to under Rule 506(b), an information disclosure document – an offering circular or private placement memorandum ("PPM") – must be furnished to the non-accredited investor(s) containing quantitative financial and non-quantitative information as provided for Regulation D, Rule 502, which have been harmonized to align with the information that Issuers must provide to investors in Regulation A offerings on Form 1-A (see subsection III(f)).

The antifraud provisions of the securities laws and regulations also apply, notably Securities Act section 17, Exchange Act Rule 10(b) and Rule 10(b)(5) promulgated thereunder. As discussed in the "Deal Points" Section XII of this advisory, use of a PPM or offering circular is a good practice in most cases as both an "insurance policy" and as a "prospectus" for prospective investors, but if any non-accredited investors are sold to, the requirements for the PPM under Rule 502 and Form 1-A are mandatory and stringent, whereas they are relaxed if only Accredited Investors are sold to, meaning the antifraud provisions, which always apply, are the principal legal/regulatory concern (see Section XII, "Deal Points" nos. 4 and 5).

Why Use a Private Placement Memorandum: Best Insurance Policy and Best Prospectus

Some of the private placement/exempt from public registration methods to raise capital in the U.S. securities market require only very limited financial and other information to be disclosed to prospective investors, tempting the securities issuing company to dispense with a PPM or offering circular. That's especially the case for Accredited Investors. But even when a PPM is not required by the securities regulations, it's usually a bad and penny-wise mistake to dispense with one, *unless* selling securities only to institutional investors like private equity and venture capital firms, hedge funds and others that are not only Accredited Investors, but professional institutional investors used to doing their own due diligence, for two main reasons.

Best Insurance Policy (and Best Litigation Deterrent): A PPM disclosing basic quantitative and qualitative information about the Issuer is the best insurance policy and not expensive compared to the protection it provides. It memorializes in a way that a PowerPoint slide deck alone cannot the financial and other disclosures made pre-sale, and can serve as the best evidentiary refutation to a disgruntled investor's later claim of securities fraud, misrepresentation or omission to state a material fact in reliance upon which the investor purchased, often allowing the Issuer to avoid litigation altogether or move to summarily dismiss the investor's complaint, avoiding being dragged into the civil discovery process and ultimately forced into a nuisance settlement.

Best Prospectus: A PPM is also the best prospectus. If the Issuer has a good investment story to tell, it should tell it in a PPM; if well executed, it will encourage the prospective investors to invest. Moreover, even institutional investors, and certainly Accredited Investors, family offices, trusts, and other potential investors are used to seeing and analyzing qualitative and quantitative, including financial, information in the general PPM format, and may be disconcerted and dissuaded from investing if they are not furnished with it; they know the format and how to quickly find the information they want to see.

Explanation and Takeaways

The value of the PPM as an insurance policy has been highlighted for us at Kurtin PLLC several times. In one case, contacted by a disgruntled investor that wanted to recoup its investment, whether feeling that our Issuer client wasn't hitting its milestones quickly enough or some other cause for buyer's remorse, and the Issuer accused by investor's attorney of omission to state material facts, potentially securities fraud, we were able to quickly point to two of the PPM's statement of "risk factors," which immediately made clear to the investor's attorney that a claim of omission to state a material fact would be immediately dismissed and pointless: the complained-of risks clearly had been disclosed in the PPM. In another case, it was the PPM's business description section that made clear that no omission to state a material fact had occurred. In a third, the PPM's financial information section made clear that no fraud had occurred. But in all three cases, a well-prepared PPM made all the difference to fend off the lawsuit threat by an investor seeking a pretext to recoup its investment and avoid a nuisance lawsuit and settlement that might have ruined the company.

As for the PPM as a prospectus, of course even the best prepared one cannot guarantee a given investor will invest in a given company. But we have often seen experienced investors use the PPM to find the information they are seeking rapidly, focus on those items, and develop the indispensable sense that, of the hundred deals they looked at that week, our Issuer was one of the well-managed ones and a viable investment vehicle.

Finally, Rule 254 provides for a preliminary offering circular or PPM, a "red herring," like those used in IPOs and other Securities Act section 5 registration statements, functioning as a written offer by Issuer to sell securities. A red herring PPM can be a valuable tool in getting in front of prospective investors before all information relating to the offer pursuant to Reg. D, Reg. A, and other offerings using Form 1-A is finalized.

g. Advantages: The advantages of Rule 506 include the unlimited dollar size of the offering (no limit on the amount of capital that may be raised); the unlimited number of Accredited Investors who may be sold to, no limitations on the type of Issuer, no ongoing reporting obligations and no Rule

502 information requirements if selling only to Accredited Investors (but see Section XII, Deal Points nos. 4 and 5, recommending the use of a PPM or offering circular in nearly all cases for antifraud "insurance" and "prospectus" purposes). Also, Rule 506 is a section 4(a)(2) safe harbor, meaning that if its rules are complied with, compliance with section 4(a)(2) is presumed (see Section V). In the event of inadvertent non-compliance with Rule 506, the private placement may still comply with the underlying section 4(a)(2), a valuable "fallback" safety valve feature. Rule 506 may be combined with other exemptions on the same private placement. Finally, Rule 506(c) allows general solicitation of investors, although the eventual actual investors must all be Accredited Investors (but see subsection (h) below for the disadvantage that general solicitation brings with it). All of these advantages have combined to make Rule 506 by far the most popular Securities Act registration exemption.

h. Disadvantages: The general solicitation permission in Rule 506(c) makes it less likely that the fall back on section 4(a)(2) would be available and more likely that antifraud provisions would be breached than under Rule 506(b). Under Rule 506(c), the Issuer must take "reasonable steps" that are relatively time-consuming and burdensome to verify Accredited Investor status, raising the compliance burden. Selling to any – even one - non-accredited investors activates the Rule 502 requirement of specified Rule 502 PPM quantitative and qualitative disclosure material, somewhat increasing the expense, risk and time required for the private placement (a PPM may be provided even to Accredited Investors, of course, and notes to Rule 502 recommend furnishing information to Accredited Investors even when not required; see Deal Point no. 4, Section XII) and may encourage their investment (the PPM's "prospectus" function) as well as providing an evidentiary record of full disclosure against later claims of misrepresentation or omission to disclose material facts (the PPM's "insurance policy" function). For these reasons, we encourage the use of PPM's in all cases except (usually) when the Accredited Investors are venture capital, private equity, family office or other institutional investment professionals, which generally do their own due diligence and which are usually accustomed to make investment decisions without a PPM (see Section XII, "Deal Points" nos. 4 and 5). In sum, if the sought–for capital can be raised through only Accredited Investors without general solicitation, using Rule 506(b) instead of Rule 506(c), reduces the compliance burden and lowers the risks.

Integration

"Integration" is an SEC concept that seeks to avoid Issuers evading the aggregate offering limits of some of the Securities Act registration exemptions this advisory covers by providing that securities issuances pursuant to those exemptions are or are not "integrated" with recent prior

offerings, meaning the prior offerings do or do not count against the aggregate offering price limitation for the current offering. Integration does not matter for Rule 506, because there is no aggregate offering limitation for prior offerings to count against. However, for other exemptions that do have aggregate offering limitations, the integration rules must be kept in mind, because if the exemption becomes unavailable because of integration rules violation, the offering might be subject to registration, the whole point of the exemption scheme to avoid. In 2020, the SEC adopted a new, simplified, liberalized and harmonized integration framework in recognition that as Securities Act registration exemptions have increased, the integration rules had become more complex, disjointed and unwieldy. The new integration framework is set forth in a new Rule 152, replacing former Rules 152 and 155 for integration of non-public and public offerings.

Amended Rule 152(a) establishes a unified, facts-and-circumstances-based analysis to determine whether an issuer can establish that an offering and the prior offerings fit into an exemption or require Securities Act registration. Amended Rule 152(b) also eliminates a prior, difficult-to-apply-and-rely-upon "five-factor" test and establishes four non-exclusive safe harbors from integration, meaning that if they are complied with, the prior offering will *not* count against the aggregate offering limit, if any, of the current offering:

- Any offering made more than 30 calendar days before the commencement of another offering, or more than 30 calendar days after completion or termination of any other offering, will not be integrated with the other offering, provided that for an exempt offering for which general solicitation is not permitted, the purchasers were not solicited though general solicitation or established a substantive relationship with the issuer prior to the commencement of the offering for which general solicitation is not permitted. This safe harbor replaces a previous generally, but not universally, applicable six-month safe harbor. Former Rule 155 is eliminated, replaced by new Rule 152(b)(1).

- Rule 701 (employee benefit/stock option and other equity compensation, see Section IV) and Regulation S offerings (offshore offerings not directed to the U.S. market, see Section VIII) will not be integrated with other offerings per new Rule 152(b)(2).

- A Securities Act registered offering will not be integrated with another offering if made subsequent to (i) a terminated or completed offering for which general solicitation was not permitted; or (ii) a terminated or completed offering for which general solicitation was permitted but which was made only to QIBs or "Institutional Accredited Investors" ("IAI's"); or (iii) an offering that was terminated or completed more than 30 calendar days prior to the commencement of the registered offering, per new Rule 152(b)(3).

- Offers and sales made in reliance on an exemption for which general solicitation is permitted will not be integrated with another offering if made subsequent to any prior terminated or completed offering, per new Rule 152(b)(4).

The Rule 152(b) Integration safe harbors include offerings made under Regulation A (Section III), Securities Act section 4(a)(6) and Regulation CF (Crowdfunding) (Section VI), Securities Act section 3(a)(11) and Rules 147 and 147A (governing intrastate offerings, Section VII), and Regulation D, Rules 504 (Section II) and 506(c) (Section I).

II. Regulation D, Rule 504: a Securities Act Section 3(b) Limited Offering Exemption

a. Aggregate Offering Limitation: $10 million, less the aggregate amount of securities sold in the prior 12 months.

b. Issuer and Investor Requirements: In contrast to Rule 506 (and in consequence of being authorized under Securities Act section 3(b) rather than Rule 506's section 4(a)(2)), Rule 504 is not available to Issuer Exchange Act section 13 or 15(d) reporting companies; investment companies required to register under the Investment Company Act of 1940 ("ICA") (typically, venture capital and private equity firms are structured to be exempt from ICA registration (*see* "Forming Exempt Private Investment Funds," available at Kurtin PLLC Venture Capital & Private Equity); and "blank check" companies (companies formed without a business plan or with a business plan only to merge with or acquire another company). Rule 506(d) "bad actor" disqualifications apply. Under Rule 504, there is no limit on the number of investors and no requirement that they be

Accredited Investors or that non-accredited investors be "sophisticated." While Regulation D, Rule 506 (see Section I) is authorized under Securities Act section 4(a)(2) as not involving a public offering, Rule 504 is a Securities Act section 3(b) exemption, in which the principal protection for investors other than the antifraud rules is deemed to be the limited maximum dollar amount that may be raised.

c. Limitations on Manner of Offering: Under Rule 504, generally no general solicitation or advertising is permitted, with some state law exceptions, and with the new Rule 148 "Test-the-Waters" and "Demo Day" activities available for Rule 506(b) (Section I(c), above).

d. SEC and State Filing Requirements: <u>SEC</u>. The Issuer must file SEC Form D within 15 days of first sale. The filing is not a condition of exemption. There is no ongoing reporting. <u>State</u>. Must comply with state law.

e. Limitations on Resales: Rule 504-issued securities are Restricted Securities that can only be resold if registered or with a resale exemption.

f. Information Requirements: Rule 504 has no specific information requirements. The antifraud provisions of securities laws and regulations apply.

g. Advantages: Rule 504 has no limit on number of investors and no requirement they be accredited; no specific information requirements. There is no requirement that investors be "sophisticated." The nominal protection for investors is provided not by limitation on the kind or type of investors, but by the Securities Act section 3(b) limitation on aggregate offering size. The recent aggregate offering limit increase from $5 million to $10 million was pursuant to authority granted to the SEC by Securities Act section 28.

h. Disadvantages: The prior low aggregate price limitations led to decreased use of Rules 504 and 505 compared to Rule 506, leading to Rule 505's 2017 repeal and adoption of its $5,000,000 aggregate offering limit in amended Rule 504, which previously had a $1,000,000 limit; the current increase to a $10 million aggregate offering limit should largely eliminate this disadvantage. Rule 504 is *not* a safe harbor for Securities Act section 3(b) compliance, because section 3(b) does not itself grant a statutory exemption as section 4(a)(2) does, but only authorizes the SEC to promulgate rules like Rule 504 that provide exemptions on an aggregate offering amount-limited ($5 million) basis (Securities Act section 3(a) *does*, by contrast, offer specific exemptions, several of which have safe harbors like Rule 506). Therefore, if Rule 504 is not complied with, there is no "fallback" on section 3(b), although fallback on sections 4(a)(2) or 3(a)(11) (purely intrastate offerings) (*see* Sections V and VII below) might be available, depending on circumstances. However, Securities Act section 28 has modified the aggregate offering price limitations under section 3(b), permitting the SEC to authorize higher dollar amounts, which it has done for other rules and now Rule 504 (*see*, for example, discussion of Regulation A and Rule 701 exemptions, Sections III and IV, below).

III. Regulation A and A+, Rules 251 - 263: the Conditional Small Offerings Exemption

a. Aggregate Offering Limitation: Tier 1. No more than $20 million in the prior 12 months, including no more than $6 million by all selling Issuer-affiliated security holders. Tier 2 (often called "Reg. A+"). No more than $75 million in the prior 12 months, including no more than $22.5 million by all Issuer-affiliated selling security holders. Like Regulation D, Rule 504, Regulation A is a Securities Act section 3(b) exemption and represents a Securities Act section 28 modification of section 3(b) aggregate offering price limitations.

b. Issuer and Investor Requirements: Regulation A is only available to U.S. and Canadian Issuers, and is not available to investment companies required to register by the ICA and "blank check" companies. Like Reg. D, Rule 506 but unlike Rule 504, Reg. A is available to Issuer Exchange Act section 13 or 15(d) reporting companies. There are no requirements for number or type of investors under Tier 1; Tier 2 has restrictions on investment limits by investors who are not Accredited Investors pursuant to Regulation D, Rule 501(a) unless the offering is listed on a national securities exchange upon qualification.

c. Limitations on Manner of Offering: Rule 148 "Testing the waters" written and oral communications are permitted both before and after filing the Form 1-A offering statement or offering circular. "Testing the waters" communications are subject to the antifraud laws and rules. Sales are permitted only once Form 1-A is qualified. Written offers of sales may be made after filing the offering statement but before its qualification pursuant to a filed *"red herring"* preliminary offering circular or PPM meeting the requirements of Rule 254.

d. SEC and State Filing Requirements: SEC. The Issuer must file a Form 1-A offering statement, any sales material and Form 2-A report of sales and use of proceeds and two years of financial statements, which must be audited for Tier 2 but which may be unaudited for Tier 1. Tier 1: Must file an "Exit Report" on Form 1-Z within 30 days of completion or termination of offering, but no ongoing reporting. Tier 2: Ongoing reporting; must file annual reports on Form 1-K as well as special financial, semiannual and current reports on Forms 1-SA and 1-U, as well as Form 1-Z Exit Report. State. Tier 1: Must comply with state law. Tier 2: Exempt from state filing as "Covered Securities" under Securities Act section 18. Ongoing reporting requirements are also deemed to have been met if the Issuer is or becomes an Exchange Act section 13 or 15(d) reporting company and files the reports thereby required.

e. Limitations on Resales: None; securities are not Restricted Securities and are freely resalable.

f. Information Requirements: File detailed Form 1-A offering statement/offering circular pursuant to Regulation A, Rule 252 with the SEC, along with any sales material and Form 2-A report of sales and use of proceeds. Antifraud provisions of securities laws and regulations apply.

g. Advantages: The important thing to understand about Regulation A is that it is actually a type of public offering, but one not conducted pursuant to a Securities Act section 5 registration. There are no investor qualifications for Tier 1, and modest requirements for Tier 2. "Testing the waters" communications are permitted. Existing Issuer-affiliated security holders can sell into the offering subject to the Tier 1 and Tier 2 limits. Securities are not restricted and freely resalable. Disclosure documents, while more onerous than a typical Regulation D Rule 502 PPM or offering circular, are less onerous and costly than a full Securities Act section 5 registration statement. There is no integration of prior sales to limit aggregate size of offering, and limited integration for post-offering sales.

h. Disadvantages: Despite providing a Securities Act section 5 registration exemption, Regulation A is itself a type of public offering requiring (1) a significant public offering statement filing on Form 1-A; and (2) ongoing reporting for Tier 2 offerings. Regulation A is not available to non-U.S. or Canadian Issuers, investment companies required to register by the ICA and "blank check" companies. As with Regulation D, Rule 504, Regulation A does *not* provide a safe harbor with a fallback to Securities Act section 3(b).

IV. Rule 701: Securities Issued as Compensation Pursuant to Stock Option or Other Plans

a. Aggregate Offering Limitation: During the prior 12 months, the greater of: $1 million; or 15% of Issuer's total assets (or Issuer's parent if Issuer is a wholly-owned subsidiary of parent and parent guarantees the obligations that the securities represent); or 15% of Issuer's outstanding securities of the same class. There is no integration with any other exempt or registered offers or sales. Rule

701 is a Securities Act section 3(b) exemption and Securities Act section 28 modification of section 3(b) aggregate offering price limitations.

b. Issuer and Investor Requirements: Rule 701 is not available to Exchange Act section 13 or 15(d) reporting companies or investment companies required to register by the ICA. The investors must be officers, directors, employees and consultants or advisors of the Issuer receiving securities as compensation, for example, in a stock purchase or award, stock option plan, or as part of an individual employment agreement (consultants or advisors must be natural persons who provide bona fide services to Issuer or its majority-owned subsidiaries, or Issuer's parent or parent's majority-owned subsidiaries). There are no other investor sophistication requirements.

c. Limitations on Manner of Offering: Limited to offerings to officers, directors, employees and consultants or advisors of Issuer as compensation, for example, in a stock purchase or award, stock option plan, or as part of an individual employment agreement.

d. SEC and State Filing Requirements: SEC. None. State. Must comply with state law.

e. Limitations on Resales: Rule 701 securities are Restricted Securities that can only be resold if registered or with a resale exemption, including the exemption provided by Rule 701 itself if the Issuer becomes an Exchange Act reporting company.

f. Information Requirements: The compensatory benefit plan or contract, as the case may be, must be provided. There are no other specific information requirements unless more than $10 million in securities are offered in a 12-month period, in which case certain specific disclosure information must be provided, including financial statement required by the Form 1-A Regulation A offering statement and the information required by the Employee Retirement Income Security Act of 1974 ("ERISA"), if applicable. The antifraud provisions of securities laws and regulations apply. Rights to purchase securities granted as "incentive stock options" pursuant to Internal Revenue Code section 422 must be issued pursuant to a written "plan" and meet other qualifying conditions not required of "nonqualified" stock options.

g. Advantages: The limited applicability of Rule 701 is expressly adapted for executive and employee securities-based compensation. Because exempted securities become available for resale only 90 days after the Issuer becomes an Exchange Act reporting company, the Rule 701 exemption is ideal for executive stock awards and stock option plans for which the Issuer wishes to bind the employee to the company until it conducts an initial public offering or a reverse merger.

When the exemption is combined with vesting cliffs in a stock option plan, for example, the Issuer has extensive leverage to retain key employees.

h. Disadvantages: Rule 701 is not available for any purpose other than executive and employee-based compensation; however, it is included here as a commonly used Securities Act exemption, particularly for early stage companies, that can free up existing capital for other uses by paying key employees in stock or rights to purchase stock in lieu of cash.

V. Securities Act Section 4(a)(2): The General Private Placement Exemption

a. Aggregate Offering Limitation: No aggregate price limitation.

b. Issuer and Investor Requirements: Section 4(a)(2), like its Regulation D, Rule 506 safe harbor, has no Issuer qualifications, and is therefore available to non-U.S. Issuers (who, in the interest of U.S. investor confidence, may nevertheless choose to use or form a U.S. subsidiary as the investment vehicle. Section 4(a)(2) is also commonly used by investment professionals like venture capital and private equity firms and family offices, which are institutional Accredited Investors and accustomed to doing their own due diligence in the absence of a PPM or offering circular. Therefore, investors must meet the sophistication and access to information test, but there is no formal limit on number and quality.

c. Limitations on Manner of Offering: No general solicitation or advertising is permitted.

d. SEC and State Filing Requirements: SEC. No SEC filing. State. Must comply with state law.

e. Limitations on Resales: Section 4(a)(2)-issued securities are Restricted Securities that can only be sold if registered or with a resale exemption.

f. Information Requirements: There are no formal requirements. The antifraud provisions of securities laws and regulations apply.

g. Advantages: Section 4(a)(2) has a low documentary and regulatory burden when dealing with only institutional investors that easily pass the “sophistication” test and which do their own due diligence (venture capital funds, etc.). There are no price limitations, information requirements or SEC filing requirements. Section 4(a)(2) can be used as a stand-alone exemption, and also serves as a fallback to the Regulation D, Rule 506 non-exclusive safe harbor.

h. Disadvantages: No safe harbor, no protection if investors turn out not to have met sophistication and access to information test or if the transaction is later determined to have violated the rule of "not involving any public offering."

VI. Securities Act Section 4(a)(6) and Regulation CF (Crowdfunding)

a. Aggregate Offering Limitation: $5 million less the aggregate amount of securities sold in the prior 12 months (the Crowdfunding monetary thresholds are adjusted every five years).

b. Issuer and Investor Requirements: Issuer must be a U.S. company, and may not be an Exchange Act section 13 or 15(d) reporting company, an investment company required to register by the ICA or a "blank check" company. Issuer must register with a broker or a "funding portal" pursuant to the Exchange Act. Unlimited investment up to the aggregate offering limit for Accredited Investors; in a 12 month period, non-accredited investor individuals may invest pursuant to a formula based on the greater of their annual income or net worth.

c. Limitations on Manner of Offering: Issuance must be conducted through a broker or funding portal compliant with Securities Act section 4A(a) and in compliance with "Crowdfunding" requirements of section 4A(b). "Test-the-Waters" activity similar to that used in Regulation A prior to filing an offering document is permitted.

d. SEC and State Filing Requirements: <u>SEC</u>. Issuer must file offering statement on Form C and comply with ongoing reporting requirements. <u>State</u>. Securities are exempt from state filing as "Covered Securities" under Securities Act section 18.

e. Limitations on Resales: Section 4(a)(6)-issued securities are Restricted Securities that can only be sold if registered or with a resale exemption.

f. Information Requirements: Antifraud provisions of securities laws and regulations apply.

g. Advantages: Relatively low barriers to entry. The real attraction is being able to seek investment over an Internet portal with general solicitation and advertising, as long as it directs investors to the portal. If large numbers of non-accredited investors not known to the Issuer must be solicited and sold to Crowdfunding may be useful. But compare Regulation D Rules 506 (up to 35 non-accredited investors) and 504 (unlimited number of non-accredited investors).

h. Disadvantages: Low aggregate offering limitation; regulatory burden, including ongoing reporting requirements, may not be justified for the aggregate sale limit, especially given ongoing reporting, unless no other exemption is available (compare Regulation D, Rule 504). It is important to realize that a Crowdfunding offering, like a Regulation A offering, is a kind of public offering, albeit one exempt from the Securities Act section 5 registration requirements. In the case of Crowdfunding (and unlike Reg. A), the securities sold are Restricted Securities. If only one or a few Accredited Investors are sold to, Crowdfunding would probably not be the efficient route in terms of the Form C filing and ongoing reporting. However, for general solicitation and selling to larger numbers of non-accredited investors, perhaps mixed with Accredited Investors to fill out the offering, Crowdfunding's efficiencies may come into play.

VII. Securities Act Section 3(a)(11) and Rules 147 and 147A: the Intrastate Exemptions

a. Aggregate Offering Limitation: None, as a matter of federal law; state law may apply.

b. Issuer and Investor Requirements: Under Rule 147, the Issuer and any investors must be residents of the same state or territory. In the case of Issuer, that means that it is incorporated in, has its principal office in, and is doing the predominant amount of its business in, that state or territory (Rule 147 provides alternative metrics for judging the predominant amount of Issuer's business). Under Rule 147A, the Issuer need not be organized in-state or managed from within the state, and may not be a company registered under the ICA. Under both Rules 147 and 147A, investors must certify their resident status to Issuer's reasonable belief.

c. Limitations on Manner of Offering: Unlike Securities Act section 3(b), section 3(a) does provide statutory exemptions from the registration requirement, like those of section 4(a). In the case of section 3(a)(11) and Rule 147, which provides the section 3(a)(11) safe harbor, the exemption is for intrastate offerings, since the Securities Act's validity and the SEC's authority is founded on the U.S. Constitution's interstate commerce clause. Under Rule 147A, general solicitation is permitted, but Rule 147A is not a section 3(a)(11) safe harbor.

d. SEC and State Filing Requirements: SEC. None. State. Must comply with state law.

e. Limitations on Resales: Under both Rules 147 and 147A, securities are restricted from resale to non-residents of the state or territory for six months.

f. Information Requirements: Securities must contain a legend against interstate sales. Antifraud provisions of securities laws and regulations apply; state law applies.

g. Advantages: Relatively low regulatory burden, low barriers to entry. Rule 147 is a section 3(a)(11) safe harbor, meaning that if its rules are complied with, compliance with section 3(a)(11) is presumed. As with Rule 506 and section 4(a)(2), section 3(a)(11) can provide a fallback in case of inadvertent or technical noncompliance with Rule 147. Rule 147A is not a safe harbor.

h. Disadvantages: Limited to intrastate investor base, although Rule 147A substantially liberalizes Issuer-investor nexus of Rule 147. Issuer must take specified precautions against interstate offers or sales. The SEC has warned that a truly interstate offering cannot be disguised as a series of intrastate offerings and receive the benefit of the exemption.

VIII. Regulation S: Offshore Offerings Not Directed to U.S. Market

a. Aggregate Offering Limitation: None.

b. Issuer and Investor Requirements: Regulation S provides that securities offerings conducted pursuant to its requirements are not subject to the Securities Act at all and therefore need not be registered, if the securities are offered and sold in an "offshore transaction" and no "directed selling efforts" (both as defined in Regulation S's definitional Rule 902) are made in the United States (guidance also provides that directed selling efforts to U.S. persons outside the United States are also not permitted; for example, to U.S. military personnel stationed outside the U.S.). In addition, the Issuer, investor and other conditions of the transaction must fall into one of three categories set forth in Regulation S, Rule 903, the Regulation S offering and sale safe harbor, in part depending on whether the Issuer is a U.S. or foreign Issuer and in part how likely the securities are to enter the U.S. market (see below).

c. Limitations on Manner of Offering: Regulation S is technically not an exemption to Securities Act registration requirements, but provides rules and safe harbors – one for offerings and sales (Rule 903), one for resales (Rule 904) - to determine whether an offshore offering of securities is subject to the Securities Act at all. In practice, it is used as a Securities Act exemption, often in combination with Regulation D.

Reg. S, Rule 903 Categories

Rule 903, Category 1 is the least onerous category, because its conditions are the least likely to allow the exempted securities to "come to rest" in the U.S. market. Issuers must be "foreign Issuers" (as defined in Rule 902). The securities being offered or sold must be securities for

which there is "no substantial U.S. market interest." Rule 903, Category 1 may be satisfied by a foreign Issuer offering and selling securities in an "overseas directed offering" into a single country other than the U.S. (non-convertible debt securities by a U.S. Issuer into a single non-U.S. country may also qualify). Alternatively, Rule 903, Category 1 may be satisfied by securities backed by the full faith and credit of a foreign government; or by securities are offered by the Issuer to its employees as compensation under an employee benefit plan established under the laws of a country other than the U.S.- roughly analogous to the Rule 701 exemption.

Rule 903, Category 2 is more onerous than Category 1, but less so than Category 3. Category 2 is available if Category 1 is not available, for equity securities of an Issuer foreign reporting company – a foreign Issuer required to file periodic reports under the Exchange Act; or for the debt securities of an Issuer U.S. domestic reporting company or a foreign non-reporting company. Additionally, offering restrictions apply, and the offer and sale, if made before the expiration of a 40-day "Distribution Compliance Period" (as defined in Rule 902) may not be made to any U.S. person other than a distributor; finally, any offer and sale by a distributor to another distributor or other intermediary is followed before expiration of the 40-day Distribution Compliance Period by a notice from the seller distributor to the purchaser distributor stating that purchaser is subject to the same restrictions on offers and sales that apply to seller distributor.

Rule 903, Category 3 is the most onerous of the Rule 903 categories, because its conditions are the most likely to permit the exempted securities to come to rest in the U.S. market. Category 3 applies to securities not covered by Categories 1 and 2. The Issuer may be a foreign or domestic company. If debt securities are offered, the offer and sale, if made before the expiration of a 40-day Distribution Compliance Period, must not be made to any U.S. person other than a distributor; only a provisional, non-exchangeable "global" security certificate is given until expiration of the 40-day period and, unless sold to a distributor, certification of beneficial ownership by a non-U.S. person or by a U.S. person in a transaction not requiring registration. If equity securities are offered, the most onerous of all Rule 903 conditions applies: the offer and sale, if made prior to the expiration of a *one year* Distribution Compliance Period (six months in the case of a reporting Issuer) may not be made to a U.S. person, unless to a distributor; purchaser must certify that it is not a U.S. person (unless a distributor) or a U.S. person who purchased the securities in a transaction not requiring registration; and purchaser must agree to resell only in accordance with Regulation S or pursuant to Securities Act registration or exemption, for which the securities will bear the appropriate restrictive legend. Finally, any offer and sale by a distributor to another distributor or other intermediary must be followed before expiration of the 40-day (for debt securities) or one year or 6 month (for equity securities)

Distribution Compliance Period by a notice from the seller distributor to the purchaser distributor stating that the purchaser is subject to the same restrictions on offers and sales that that apply to the seller distributor.

d. SEC and State Filing Requirements: SEC. None, provided that Issuer is not an Exchange Act reporting company. State. Must comply with state law.

e. Limitations on Resales: As set forth in the Rule 904 and the Rule 903 categories. Rule 904 repeats the "offshore transaction" and "no directed selling efforts" into the U.S. requirements, and refers to the Rule 903 resale restrictions. Additionally, Rule 904 adds conditions for resales during the applicable Distribution Compliance Period for Rule 903 Category 2 or Category 3 resales. Regulation S Rule 905 adds that equity securities of domestic Issuers sold under Regulation S are Restricted Securities in the meaning of Rule 144, and may only be resold upon registration or an exemption from registration. If a domestic Issuer's equity securities sold under Rule 903 are resold under Rule 904, they will continue to be considered Restricted Securities.

f. Information Requirements: The antifraud provisions of securities laws and regulations apply.

g. Advantages: Regulation S provides a roadmap for how to conduct offshore transactions while avoiding the applicability of the Securities Act. Regulation S is not integrated with domestic exemptions, including under Regulation D, so that concurrent combined use of the two exemptions is permissible and sales permitted under Regulation S do not count against the Regulation D aggregate offering limitations, if any. Combination of Regulation D and Regulation S offerings for attracting both domestic and offshore investors is common.

h. Disadvantages: Regulation S has been used by fraudulent actors and is relatively strictly scrutinized by the SEC. Offer and sale of particularly of equity securities in a Rule 903 transaction (when Categories 1 and 2 are not available) is somewhat onerous, and, given the Distribution Compliance Periods, can be time consuming.

IX. Rules 801 and 802: Rules for Foreign Private Issuers in Rights Offerings, Stock Exchanges and Business Combinations

a. Aggregate Offering Limitation: None.

b. Issuer and Investor Requirements: Issuer must be a foreign private Issuer, meaning that it must be a company organized under the laws of a foreign country, cannot be a foreign government, and must not have more than 50% of outstanding voting securities owned directly or indirectly by U.S. residents, or, if more than 50% of outstanding voting securities are beneficially owned by U.S. residents, must not (i) have a majority of officers and directors who are U.S. citizens or residents; (ii) have a majority of assets in the U.S.; or (iii) principally administer its business in the U.S. (see Securities Act Regulation C, Rule 405). Investors must be non-U.S. holders, provided that the exemption is still available if U.S. holders own no more than 10% of the securities that are the subject of the rights offering, exchange offering or business combination.

c. Limitations on Manner of Offering: Rules 801 and 802 (which must be read with their definitional section, Rule 800) are limited exemptions intended to facilitate foreign private Issuers in rights offerings, stock exchanges and business combinations. Rule 801 exempts from registration securities offered and sold by a foreign private Issuer in a rights offering (a grant to a class of securities holders of the right to purchase additional securities of the same class in proportion to that they already hold); Rule 802 exempts from registration securities offered and sold by a foreign private Issuer in the course of an exchange offer (a tender offer in which securities are issued as consideration to be tendered) or a business combination, such as a statutory merger or reorganization. A prescribed restrictive legend on the certificates evidencing the exempted securities is required.

d. SEC and State Filing Requirements: <u>SEC</u>. If an informational statement is furnished to investors (see below), Form CB containing the information statement must be filed immediately after first publication or dissemination of the information statement. Any informational statement must be disseminated to U.S. holders. Form F-X must also be filed, to appoint an agent for service of process. <u>State</u>. Must comply with state law.

e. Limitations on Resale: Securities sold under Rules 801 and 802 are Restricted Securities. In the case of Rule 801, transfers of the rights by U.S. holders must also be in accordance with the requirements of Regulation S.

f. Information Requirements: If an optional information statement is furnished to investors, it, and any amendments, must be filed with the SEC on Form CB.

g. Advantages: For a foreign private Issuer engaged in one of the specified business transactions, a clear roadmap to avoid Securities Act registration requirements. Rule 801 and 802 offerings are not integrated with other Securities Act exemptions, and can therefore be combined with even simultaneous use of other exemptions.

h. Disadvantages: Limited to foreign private Issuers in prescribed business transactions.

X. Regulation CE Rule 1001: Exemption for Transactions Exempt Under California Corporations Code Section 25102(n)

a. Aggregate Offering Limitation: $5 million, notwithstanding the provisions of California Corporations Code section 25102(n) (Rule 1001 is a Securities Act section 3(b) exemption).

b. Issuer and Investor Requirements: Issuer must be a (i) corporation or other business entity formed under California law or (ii) non-California corporation if a majority of its outstanding voting securities are held by California residents and at least 50% of its property, payroll and sales are attributable to California. The exemption is not available to investment companies required to register under the ICA. Investors must be “Qualified Purchasers,” as defined by section 25102(n), a concept similar, but not identical, to Accredited Investors. For example, natural person Qualified Purchasers must have a $250,000 net worth and a $100,000 income, compared to the $1 million net worth and $200,000 income qualifications for Accredited Investors (see Section I, above).

c. Limitations on Manner of Offering: Compliance with California Corporations Code section 25102(n). “Testing the waters” activity is permitted by written communication containing required information.

d. SEC and State Filing Requirements: <u>SEC</u>. none. <u>State</u>. must comply with California law.

e. Limitations on Resale: Securities sold pursuant to the Rule 1001 exemption are Restricted Securities.

f. Information Requirements: For all sales to natural person qualified purchasers, including to business entities formed by natural persons to make the investment, a disclosure document containing the information required by Regulation D must be furnished (recall that Regulation D Rule 502 has a sliding scale of information statement, or PPM, disclosure requirements depending on the aggregate size of the offering under Rules 506 or 504 (see Sections I and II, above).

g. Advantages: Less restrictive than Rule 504 and Rule 506(b) in permitting limited "testing the waters" activity (although Rule 504 does have some state law exceptions). Differences between California "Qualified Purchaser" and federal "Accredited Investor" qualifications may provide advantages in individual cases; for example, the Qualified Purchaser individual net worth and income requirements are lower, and therefore easier to qualify for, than are the Regulation D Accredited Investor requirements: the California Qualified Purchaser net worth requirement is $250,000 and income requirement is $100,000 (Regulation D requires $1 million and $200,000/$300,000 respectively; see Section I, above). In other words, a potential investor might qualify as a California Qualified Purchaser but not as a federal Regulation D Accredited Investor. Of course, a natural person California Qualified Purchaser would still have to be given a PPM, which only non-Accredited Investors under Regulation D need be given, so the advantage in access to a group of investors might be partly offset by the increased cost of preparing the PPM.

h. Disadvantages: Limited to California corporations or non-California companies majority-owned by California residents with at least 50% of property, payroll and sales attributable to California. Relatively low ($5 million) aggregate offering limit. Information disclosure statement compliant with Regulation D is required for any natural person Qualified Purchaser, unlike the case for Regulation D Rule, 506 Accredited Investors. As with Securities Act section 3(b), Regulation CE is not itself an exemption, only an authorization to create exemptions, so in case of noncompliance with Rule 1001 (and the underlying California Corporations Code section 25102(n)), there is no fallback (Regulation CE indicates "Coordinated Exemptions for Certain Issues of Securities Exempt Under State Law," intended to provide a mechanism for qualifying state statutes to constitute an exemption to the federal Securities Act registration requirement; to date, only California has passed such a law).

XI. FY 2022 SEC Exemption Utilization Data Metrics (compared to FY 2021)

The SEC has compiled valuable statistics on filed exempt offerings for FY 2021, ending June 30, 2022, which give valuable information as to Issuers' assessment of their utility. The statistics were reported on December 16, 2022 in the SEC Office of the Advocate for Small Business Capital Formation. According to the Annual Report (available at https://www.sec.gov/files/2022-oasb-annual-report.pdf), in FY 2022. Highlights include:

SEC Exemption Utilization Data Metric Highlights

- Regulation D, Rule 506(b) was used to raise $2.7 trillion in capital (up from $2.3 trillion in FY 2022 and $1.trillion in FY 2021), with a median offering amount of $1.2 million, indicating that the prohibition on general solicitation (except for the Rule 148 limited exceptions) was no bar to Rule 506(b)'s dominating popularity. Use of Rule 506(b) was led by the pooled investment funds sector, followed by the tech, financial services/Fintech, real estate, healthcare and energy sectors. New investment fund formation of all kinds (venture, private equity, hedge, etc.) was increasingly dominated by family offices and high net worth individuals.

- Regulation D, Rule 506(c) was used to raise $169 billion in capital (up from $148 billion in FY 2022 and $124 billion in FY 2021), with a median offering amount of $750,000.

- Regulation A/A+, a quasi-public offering not requiring Securities Act section 5 registration, was used to raise $1.5 billion in capital (relatively unchanged from FY 2022's $1.8 billion and FY 2021's $1.7 billion), with a median offering amount of $2.2 million. Use of Reg. A was led by the real estate sector, followed by the financial services/Fintech, manufacturing and tech sectors.

- Regulation D, Rule 504 was used to raise $258 million in capital (a marked and significant decline from FY 2022's $624 million, which was up from $313 million in FY 2021, a more than 2X decline in popularity after a nearly 2X jump, raising the question of whether there were some external factors contributing to the 2022 surge, such as emergence from the Covid pandemic), with a median offering amount of $250,000.

- Regulation CF (Crowdfunding) was used to raise $352 million in capital, essentially unchanged from FY 2022's $368 million and up from FY 2021's $174 million, with a median offering amount of $100,000.

Other registration exemptions, including Securities Act section 4(a)(2), Regulation S and Rule 144A were used to raise an additional $1.3 trillion, down from FY 2022's $2.0 trillion but a return to FY 2021's $1.3 trillion.

Additionally, IPOs, including SPACs, raised $17 billion, a crash from FY 2022's $126 billion, which was less than half of FY 2021's $317 billion, with a median offering amount of $150 million, also down sharply from FY 2021's $225 million. Other registered offerings raised $1.1 trillion, with a median offering amount of $300 million, down one-third from FY 2022's $450 million. The U.S. public capital markets, now a fraction of the size of the private capital markets in both deal volume and size, have become almost exclusively the territory of large companies, which account for over two-thirds of the approximately 3,600 public registrants.

A number of things jump out from the SEC FY 2022 statistics, especially as compared to FY 2021. First of all, exempt, non-registered placements and offerings continue to dominate the capital markets. Leaving non-IPO registered offerings aside, Reg. D, Rule 506(b) alone was used to raise over 16 times the amount raised in IPOs, and the total of $4.451 trillion in exempt offerings was over 32 times the amount raised in IPOs, including SPACs. Put another way, IPOs, including SPACs, accounted for only approximately 2% of new capital formation, while exempt offerings accounted for 80%. By comparison, in FY 2019, registered offerings accounted for over 30% of new capital, compared with nearly 70% of capital raised through exempt offerings. IPOs and SPACs get a lot of press, but the level of IPO/SPAC capital formation is dwarfed by that of Rule 506(b) and the exempt-from-registration capital markets generally.

A second thing that jumps out is the continued dominance of Reg. D, Rule 506(b) among exemptions. As discussed in prior sections, the SEC has worked hard to amend other exemptions to make them more useful, available and less complicated and expensive. Reg. D, Rule 504, for example, which had an aggregate offering limit of $1 million only a few years ago, was increased first to $5 million and then to $10 million, doubled in capital raised over FY 2021. Since Rule 504 offerings can typically be done less expensively and quicker than offerings under Rule 506, Rule 504's expanding popularity is good news for businesses seeking to raise smaller amounts of capital. Crowdfunding has gone from $1 million to $5 million. Reg. A+ has been increased to a $75 million aggregate offering limit, and offers freely resalable shares. Nevertheless, Rule 506(b), which offers an unlimited aggregate offering limit, continues to dominate. The unlimited aggregate offering amount of Rule 506(b), easing of financial information required by Rule 502 to harmonize with that required by Reg. A, lower transaction costs compared to Reg. A, availability to both U.S. and foreign Issuers and increasing liberalization of resale availability for Reg. D Restricted Securities have to be assumed to be responsible for Rule 506(b)'s continuing and even increasing popularity.

It can be assumed that the $2.0 trillion in non-enumerated exempt offerings is dominated by section 4(a)(2), which we recommend only for institutional Accredited Investors, such as venture and private equity firms, that are investment professionals and which generally do their own due diligence (see Deal Points, below). However, it is worth noting that pooled investment funds is the industry sector that by far dominates Reg. D, Rule 506(b) use, so it is not as if investment funds as an industry standard are ignoring Rule 506(b) in favor of section 4(a)(2).

XII. Deal Points

Deal Point No. 1: Choose what exemption features are important and let that guide the exemption choice. For example, if issuing unrestricted securities for resale is what matters, irrespective of possible registration or availability of a resale exemption, Regulation A might be indicated. Regulation A has more extensive disclosure obligations, but a much higher aggregate offering limit than most exemptions, especially in Tier 2 (Reg. A+). If only Accredited Investors are to be sold to, and if an unlimited number of investors and an unlimited aggregate price are desired, Regulation D, Rule 506 might be indicated. The chart in Appendix 1 is intended as a graphical aide for developing a preliminary sense of the different factors, and of course experienced counsel can help weigh the factors and arrive at a decision.

Deal Point No. 2: Don't sell to non-accredited investors. It is rarely worth it. Under Regulation D, Rule 506(b), securities in unlimited dollar value can be sold to an unlimited number of Accredited Investors and to up to 35 non-accredited investors. However, if *even one* non-accredited investor is sold to, two burdensome rules come into play: first, under Rule 502, all non-accredited investors must receive a substantial disclosure document, an offering circular or PPM that strictly complies with the financial and non-financial disclosure requirements of Rule 502. This increases the time, expense and potential risk of the private placement. Second, under new Rule 506(c), while general solicitation and advertising efforts (previously one of the hallmark prohibitions for private placements, as opposed to registered securities offerings) can be made, only Accredited Investors may be sold to. Given the relatively low threshold of wealth for status as an Accredited Investor (especially for income) and the relatively low likelihood that anyone not qualifying would be a prospective purchaser anyway, it is not usually worth selling to non-accredited investors for the substantially enhanced regulatory burden of strict Rule 502 compliance, transaction costs of that strict compliance, and liability risks of non-compliance.

Deal Point No. 3: Use the safe harbors! Compliance with regulatory safe harbors does not cost much, especially in proportion to all but the smallest private placement and other exempt sales. For example, unless you are sure you are selling only to institutional investors, comply with Regulation D, Rule 506 to preserve section 4(a)(2) as a fallback.

Deal Point No. 4: Unless selling only to institutional investors and often even then, use a Private Placement Memorandum: it is the best insurance policy. A PPM or offering circular disclosing basic quantitative and qualitative information about the Issuer and securities is not expensive, compared to the protection it provides. It memorializes the disclosures made, and can serve as the best evidentiary refutation to a later fraud claim of an allegation of misrepresentation *or* omission to state a material fact, often allowing the Issuer to successfully move to summarily dismiss the investor's complaint, avoiding being dragged into the civil discovery process and ultimately forced into a nuisance settlement. SEC notes to Regulation D, Rule 502 state: "when an issuer provides information to investors pursuant to [non-accredited investors], it should consider providing such information to accredited investors as well, in view of the antifraud provisions of the federal securities laws." That's the SEC telling Issuers that using a PPM as a selling document to investors is a valuable insurance policy against later claims of fraud by a disgruntled investor trying to recoup its money. Unless selling only to institutional investors like venture capital and private equity firms, don't just provide a PowerPoint slide deck. Provide a PPM as the principal selling document, and let the PowerPoint supplement and complement it.

Deal Point No. 5: Unless selling only to institutional investors, and often even then, use a Private Placement Memorandum: it is the best prospectus. The foregoing review of exemptions from the registration requirements sets forth what information disclosure is legally mandated, not advisable; the requirements are a disclosure floor, not a ceiling. If the Issuer has a good investment story to tell, it should tell it in a PPM; if well executed, it will encourage the target investors to invest. Moreover, even institutional investors, and certainly Accredited Investors, family offices, trusts, and other potential investors are used to seeing "prospectus" qualitative and quantitative, including financial, information of the Issuer in the general PPM form and format, with elements like a description of the securities offered, risk factors, use of proceeds, financials, management, and others set out in Reg. D, Rule 502 and Form 1-A, and may be disconcerted and dissuaded from investing if they are not furnished with it.

Deal Point No. 6: Don't commit fraud! The antifraud prohibitions of the Securities Act, Exchange Act and associated rules and regulations apply to any offer and sale of securities, whether to Accredited Investors or non-accredited investors, and whether exempt from registration or not. Fraud can occur by the misrepresentation of material facts that a purchaser relies upon to its detriment in its decision to purchase the securities, *or by the omission to state material facts.* For this reason, even in sales to only Accredited Investors, it is sound practice to provide some form of PPM to memorialize what was represented about the securities being sold and what was not. This ties back to Deal Point No. 4. Inadvertent technical errors in the securities offering process can often be fixed or excused. Fraud cannot. Don't commit fraud.

Owen D. Kurtin

Appendix 1
Exemption Chart

Type of Offering	Aggregate Offering Limitation	Issuer & Investor Requirements	Limitations on Manner of Offering	SEC and State Filing Requirements	Limitations on Resales	Information Requirements
Regulation D Rule 506	None.	Rule 506(b): unlimited Accredited Investors and up to 35 non-accredited investors permitted. Rule 506(c): all purchasers must be Accredited Investors.	Rule 506(b): No general solicitation or advertising permitted; Rule 148 "Test-the-Waters" and "Demo Day" activity permitted. Rule 506(c): General solicitation and advertising permitted if all purchasers are Accredited Investors.	SEC: File Form D not later than 15 days after first sale. No ongoing reporting. State: Exempt as "Covered Securities" pursuant to Securities Act s. 18.	Restricted Securities that can only be sold if registered or with a resale exemption.	No information requirements for only Accredited Investors; if any non-accredited investors are sold to under Rule 506(b), must furnish a PPM per Rule 502 and Form 1-A.
Regulation D Rule 504	$10 million within prior 12 months.	No requirements.	No general solicitation or advertising permitted (with certain state law-based exceptions); "Test-the-Waters" and "Demo Day" activity permitted.	SEC: File Form D not later than 15 days after first sale. No ongoing reporting. State: Must comply with state law by registration or exemption.	Restricted Securities. (state law exceptions)	No specific information requirements.

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Regulation A Tier 1 Tier 2 (Reg. A+)	$20 million in prior 12 months, but no more than $6 million by selling security holders. $75 million in prior 12 months, but no more than $22.5 million by selling security holders.	Only available to U.S. and Cdn. cos., not available to investment cos. required to register by the ICA and "blank check" cos. No requirements for Tier 1 investors; Tier 2 restrictions on investment limits by non-accredited investors unless offering is listed on national exchange upon qualification.	Rule 148 "Testing the waters" permitted before filing Form 1-A. Sales permitted after Form 1-A qualified.	SEC: File Form 1-A, any sales material and Form 2-A report of sales and use of proceeds. Tier 1: No ongoing reporting. Tier 2: Ongoing Reporting. State: Tier 1: Must comply with state law. Tier 2: Exempt from state law requirements as "Covered Securities."	None; freely resalable.	File detailed Form 1-A offering statement pursuant to with the SEC, along with any sales material and Form 2-A report of sales and use of proceeds.
Rule 701	Greater of $1 million in prior 12 months, or 15% of Issuer's total assets, or 15% of Issuer's outstanding securities of the same class.	Not available to Issuer Exchange Act reporting cos. or investment cos. Investors must be officers, directors, employees or consultants in stock purchase or award, stock option plan, or employment agreement. No other investor sophistication requirements.	Limited to offerings to officers, directors, employees and consultants of Issuer as compensation, for example, in a stock purchase or award, stock option plan, or as part of an individual employment agreement.	SEC: None. State: Must comply with state law.	Restricted Securities.	Benefit or option plan or contract must be provided. No specific information requirements unless more than $10 million in securities are offered in a 12 month period.

Type of Offering	Aggregate Offering Limitation	Issuer & Investor Requirements	Limitations on Manner of Offering	SEC and State Filing Requirements	Limitations on Resales	Information Requirements
Securities Act section 4(a)(2)	None.	All investors must meet sophistication and access to information test.	No general solicitation or advertising.	SEC: None. State: Must comply with state law.	Restricted Securities.	Must comply with state law.
Securities Act section 4(a)(6) and Regulation Crowdfunding	$5 million within prior 12 months.	Issuer must be a U.S. company. Not available to Issuer Exchange Act reporting cos. or investment cos. Issuer must use registered broker-dealer or funding portal. Investors may invest greater of amount calculated by annual income or net worth.	No general solicitation or advertising except as expressly provided. "Test-the-Waters" activity similar to pre-filing under Reg. A is permitted.	SEC: File Offering Statement on Form C. Ongoing reporting. State: Exempt as "Covered Securities."	Restricted Securities for one year.	None.
Securities Act section 3(a)(11) and Rules 147and 147A	None.	Rule 147: Issuer and investors must be residents of the same state or territory. Rule 147A: Issuer need not be organized or managed in-state.	Must comply with state law. General solicitation permitted.	SEC: None. State: Must comply with state law.	Securities are restricted from resale to non-residents of the state or territory for six months.	Must comply with state law.

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Regulation S	None.	Issuer, investor and transaction must fall into one of three categories set forth in Regulation S Rule 903.	Regulation S is technically not an exemption to Securities Act registration requirements. No directed selling efforts into U.S. market.	SEC: None, provided that Issuer is not an Exchange Act reporting company. State: Must comply with state law.	Restricted Securities as per Rules 903, 904 and 905.	None.
Rules 801 and 802	None.	Issuers must be “foreign private Issuers,” as defined in Securities Act Regulation C. Investors must be non-U.S. holders, U.S. holders may hold no more than 10%.	None other than regulations governing rights offerings, exchange offerings or business combinations as the case may be.	SEC: If information statement furnished, it must be filed on Form CB; if Form CB is filed, Form F-X must also be filed. State: Must comply with state law.	Restricted Securities. For Rule 801, transfers of rights by U.S. holders must be in accordance with Regulation S.	Optional; use activates filing requirements.
Regulation CE Rule 1001	$5,000,000.	Issuer must be California business entity or non-California corporation with majority California attributes. Investors must be California “Qualified Purchasers.”	Compliance with California Corporations Code section 25102(n). “Testing the waters” activity is permitted by written communication containing required information.	SEC: None. State: Must comply with California law.	Restricted Securities.	For all sales to natural person Qualified Purchasers, a disclosure document containing the information required by Regulation D must be furnished.