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SECURITIES RULES FOR PRIVATE EQUITY FINANCINGS©

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Registration of the Sales of Securities

In order to sell securities (e.g., notes, common stock, preferred stock, membership interests in an LLC), a company must either register the sale under federal and state securities laws or find an exemption from such registration requirements. Complying with the securities registration provisions of federal and state law is a time-consuming and costly process. Most small to mid-size companies do not want to spend the money or time it would take to register such sales. In addition, the registration of such sales with the SEC may subject the company to continued SEC reporting requirements.

Federal law offers a number of exemptions from registration. These exemptions exempt the particular transaction (e.g., a sale to an investor in a private placement) not the underlying security.

Even if a federal exemption is available, a company must also comply with the securities laws of the state where the purchaser resides and obtain an exemption under the laws of that state. Furthermore, even though the sale may be exempt under federal and state law, the company is still subject to the anti-fraud rules and may face liability for securities fraud.

This article will review some common federal exemptions as well as exemptions provided under Illinois law.

What is a Security

Section 2(a)(1) of the Securities Act of 1933, as amended (the "1933 Act"), defines a "security" to include "any note, stock, bond, evidence of indebtedness, participation in a profit sharing agreement (or) investment contract…. or in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

The most expansive element of the definition of "securities" under the 1933 Act is the term "investment contract." The Supreme Court has ruled that an investment contract consists of (i) an investment of money (or other value) (ii) in a common enterprise (iii) for profit (which may be solely tax benefits) (iv) that will come solely from the efforts of others. The courts have held that a common enterprise generally involves either a pooling of more than one investor's funds or in some circumstances a connection between the success of the promoter and the success of the investors. The fourth point (solely from the efforts of others) has been broadly construed so that the test is met if the investor only plays a small role in the transaction and significant efforts are made by those other than the investor, which efforts are likely to affect the success or failure of the business.

Under the definition of "security" in Section 2(a)(1) of the 1933 Act and court rulings, corporate stock is nearly always a "security". An interest as a limited partner in a limited partnership is a "security." However, an interest as a general partner in a general or limited partnership generally is not a "security" primarily because a general partner normally has the right to participate in the day-to-day management of the enterprise and is not expecting to profit solely or nearly solely from the efforts of others.

A membership interest in a LLC which is managed by managers is a "security" because the members are expecting to profit solely or nearly solely from the efforts of others and will not be involved in day-to-day management. A membership interest in an LLC which is managed by members some of whom do not actively participate in management may be a security with respect to the non-active members.

Regulation D

The SEC's Regulation D (Rules 501-508 under the 1933 Act) offers two possible federal exemptions for a company that wishes to sell securities in a private placement.

Regulation D may also be used by companies to effectuate business combinations and acquisitions (rule 500(e)). A business combination is defined to mean any transaction involving the acquisition by one company, in exchange for all or a part of its own or its parent's stock, of stock of another company if, immediately after the acquisition, the acquiring company has control of the other company (whether it had control before the acquisition).

Rule 504

Rule 504 permits sales of up to $5 million of securities during any twelve month period to an unlimited number of investors who do not have to be sophisticated.

The company must file a Form D with the SEC and comply with the Regulation D integration, resale, bad actor, advertising and other rules discussed below.

Rule 504 offerings may not be made by a company which files reports under Section 13 of 15(d) of the Securities Exchange Act of 1934 (i.e., a public company), an investment company or a development stage company which meets certain criteria (Rule 504(a)(3)).

Rule 504(b)(1) provides a separate state offering exemption for sales up to $5 million which permits some advertising and solicitation. This exemption also provides that the resale rules set out in Rule 502(d) and the advertising prohibition contained in Rule 502(c) do not apply.

In order to claim this exemption, the offers and sales of securities under Rule 504(b)(1) must be made:

- Exclusively in one or more states that provide for the registration of the securities, and require the public filing and delivery to investors of a substantive disclosure document before sale, and are made in accordance with those state provisions;

- In one or more states that have no provision for the registration of the securities or the public filing or delivery of a disclosure document before sale, if the securities have been registered in at least one state that provides for such registration, public filing and delivery before sale, offers and sales are made in that state in accordance with such provisions, and the disclosure document is delivered before sale to all purchasers (including those in the states that have no such procedure); or

- Exclusively according to state law exemptions from registration that permit general solicitation and general advertising so long as sales are made only to "accredited investors" as defined in Rule 501(a).

All sales under Rule 504 are subject to anti-fraud rules. Even though the transaction may be exempt, the company may be subject to liability for securities fraud.

Rule 505

Former Rule 505 allowed a company to sell up to $5 million of securities in a single offering. Rule 505 will be repealed effective May 22, 2017.

Rules 506(b) and (c)

Rules 506(b) and (c) permit sales of any amount of securities in a single offering. Securities sold under these Rules are exempt under Section 4(a)(2) of the 1933 Act from the registration requirements of the such act and are deemed to be "Covered Securities." Covered Securities sold under these Rules are largely exempt from state regulation (see "**Covered Securities"**).

Offers and sales under Rule 506(b) and Rule 506(c) may be made an unlimited number of accredited investors. **Offers** under Rule 506(b) may be made to an unlimited number of non-accredited investors but **sales** may only be made to 35 non-accredited investors.

A company relying on Rule 506(c) **may not offer or sell securities to non-accredited investors**.

There are special rules involved in counting the number of non-accredited investors (see "***Purchasers and Offerees***"). For a description of who is an accredited investor, see "***Accredited Investor***" and **Appendix A**.

Non-accredited investors must be reasonably sophisticated. A company should use a questionnaire or subscription form to satisfy itself that investors are accredited or that non-accredited purchasers are sophisticated. Unsophisticated non-accredited investors can use a purchaser's representative (Rule 501(h)).

If non-accredited investors are going to purchase shares, specified disclosures must be made (Rule 502(b)). These disclosures are fairly extensive and are set out at **Appendix B**.

If only accredited investors are involved, no set disclosures are required but the company is still subject to anti-fraud rules. The company still has a duty to describe material facts. Even though the transaction may be exempt, the company is still subject to liability for securities fraud.

Companies relying on the exemption offered by Rule 506(b) may not conduct any general solicitation or advertising.

Companies relying on the exemption offered by Rule 506(c) may conduct general solicitation and advertising (see "***Advertising***") but may not sell securities to non-accredited investors.

The company must file a Form D with the SEC and comply with the Regulation D integration, resale, bad actor, advertising and other rules discussed below.

All sales under Rule 506(b) or (c) are subject to the anti-fraud rules. Even though the transaction may be exempt, the company may be subject to liability for securities fraud.

Accredited Investors

There are a number of categories of accredited investors (Rule 501(a)). The most common ones for individuals are set forth below:

- A natural person whose individual net worth, or joint net worth with his/her spouse, at the time of purchase exceeds $1 million **(excluding as an asset the fair market value of such person's or persons' primary residence, and excluding as a liability the amount of indebtedness secured by the primary residence up to its fair market value. Indebtedness secured by the primary residence in excess of fair market value should be deducted from net worth. Unless the primary residence was purchased within 60 days prior to the date of the offering, indebtedness incurred within 60 days prior to the date of the offering should also be deducted from net worth)**.

- A natural person who had an individual income in excess of $200,000, or joint income with his/her spouse in excess of $300,000, in each of the two most recent years and reasonably expects the same income level in the current year.

- Any director, executive officer or general partner of the company of the securities being sold. The term "executive officer" is defined in Rule 501(e).

Additional categories of accredited investors are set out in **Appendix A**.

Purchasers vs. Offerees

For purposes of Rule 506(b), when counting non-accredited investors, a company counts non-accredited **purchasers** not **offerees**. Under this Rule, a company may **sell** to up to 35 non-accredited investors but can **offer** to more than 35.

For purposes of calculating the number of non-accredited purchasers under Rule 506(b), the following rule applies:

- The following purchasers shall be excluded when counting non-accredited purchasers:

    - Any relative, spouse or relative of the spouse of a purchaser who has the same primary residence as the purchaser;

- Any trust or estate in which a purchaser and any of the persons related to him as specified in the first and third bullet points collectively have more than 50% of the beneficial interest (excluding contingent interests);

- Any corporation or other organization of which a purchaser and any of the persons related to him as specified in the first and second bullet points collectively are beneficial owners of more than 50% of the equity securities (excluding directors' qualifying shares) or equity interests; and

- Any accredited investor.

- A corporation, partnership or other entity shall be counted as one purchaser. If, however, that entity is organized for the specific purpose of acquiring the securities offered and is not an accredited investor (because all of the equity holders are not accredited investors), then each beneficial owner of equity securities or equity interests in the entity shall count as a separate purchaser for all provisions of Regulation D.

- A non-contributory employee benefit plan within the meaning of Title I of ERISA shall be counted as one purchaser where a trustee makes all investment decisions for the plan.

Under Rule 506(b) or (c), a company can **offer** and **sell** to an unlimited number of accredited investors.

Integration

On occasion, a company may complete an offering and shortly thereafter determine it needs additional capital. If different offerings are integrated, the company could lose its federal exemption.

Rule 502(a) of Regulation D provides that **offers and sales** (i) that are made more than six months before the start of a Regulation D offering or (ii) that are made more than six months after completion of a Regulation D offering, will not be considered part of that Regulation D offering, so long as during those six-month periods there are no offers or sales of securities by or for the company that are of the same or a similar class as those offered or sold under Regulation D, other than those offers or sales of securities under an employee benefit plan.

Because of financing needs, it may not be possible for a company to comply with the six-month safe harbor rule. If the safe harbor is not available, the determination as to whether separate sales of securities are part of the same offering (and, therefore, integrated) depends on the particular facts and circumstances. The SEC will look at the following factors when determining whether offers and sales should be integrated for purposes of the exemptions under Regulation D:

- Whether the sales are part of a single plan of financing;

- Whether the sales involve issuance of the same class of securities;

- Whether the sales have been made at or about the same time;
- Whether the same type of consideration is being received; and
- Whether the sales are made for the same general purpose.

Resales

Securities sold in a Regulation D transaction are "restricted" and cannot be resold without registration under the 1933 Act or an exemption therefrom. Generally speaking, investors who resell their shares after holding them for a reasonable period of time should qualify for the private placement exemption available under Section 4(a)(1) of the 1933 Act which exempts any sale of securities by a person other than the issuing company, underwriter or dealer.

Under Rule 502(d), a company must exercise reasonable care to insure that the purchasers of its securities are not viewed as buying the securities for the purpose of reselling them to others (thereby acting as underwriters). Reasonable care can be demonstrated by the following:

- The company must make reasonable inquiry to determine if the purchaser is acquiring the securities for himself or for other persons.
- The company should provide written disclosure to each purchaser prior to sale that the securities have not been registered under the 1933 Act and, therefore, cannot be resold unless they are registered under the 1933 Act or unless an exemption from registration is available.
- The company must place a legend on the certificate or other document that evidences the securities stating that the securities have not been registered under the 1933 Act and setting forth or referring to the restrictions on transferability and sale of the securities.

Bad Actors

Rule 504(b)(3) incorporates Rule 506(d) which disqualifies a company from relying on the exemption provided by Rule 504 if the company or any covered person--certain individuals (including directors and officers who participate in the offering, promoters and shareholders who own more than 20% of the company) or entities--have been subject to a disqualifying event that occurred after January 17, 2017. Disqualifying events include a conviction for securities fraud, certain criminal convictions and certain SEC disciplinary orders.

Events that occurred prior to the effectiveness of this rule (January 17, 2017) are not deemed to be disqualifying events; however, they will have to be disclosed in the offering materials. If a company can demonstrate that it did not know and, in the exercise of reasonable care, could not have known, that a covered person with a disqualifying event participated in the offering, it may rely on Rule 504.

Under Rule 506(d), a company cannot rely the exemption provided by Rule 506(b) or (c) if the company or any covered person--certain individuals (including directors and officers who participate in the offering, promoters and shareholders who own more than 20% of the company) or entities--have been subject to a disqualifying event after September 23, 2013. Disqualifying events include a conviction for securities fraud, certain criminal convictions and certain SEC disciplinary orders.

Events that occurred prior to the effectiveness of this rule (September 23, 2013) are not deemed to be disqualifying events; however, they will have to be disclosed in the offering materials. If a company can demonstrate that it did not know and, in the exercise of reasonable care, could not have known, that a covered person with a disqualifying event participated in the offering, it may rely on Rule 506b) or (c).

Advertising

Companies relying on the exemption offered by Rule 506(b) or Rule 504 (except as permitted by Rule 504(b)(1)) may not conduct any general solicitation or advertising. This rule prohibits any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media, or broadcast over TV or radio.

General. Rule 506(c) allows the use of general solicitation and general advertising in the offer and sale of securities provided:

- **all purchasers of securities are accredited investors**, either because they qualify as accredited investors under Regulation D or the company reasonably believes that they do at the time of the sale of the securities; and

- the company takes reasonable steps to verify that the purchasers of the securities are accredited investors.

Because Rule 506(c) eliminates the prohibition on general solicitation and advertising, a number of forms of solicitation (e.g., advertisements, email, social media such as Facebook and Twitter, internet media, television, radio and direct mail marketing) can be used. Companies would also be able to conduct seminars where prospective purchasers are invited by general advertising. It should be noted, however, that SEC rules still prohibit the making of false or misleading statements.

In addition, a company relying on Rule 506(c) must comply with all of the other applicable requirements of Regulation D discussed herein.

Verification Process. Companies planning to take an advantage of Rule 506(c) will have "to take reasonable steps to verify that purchasers of the securities are accredited investors." In the SEC's view, whether the steps taken are "reasonable" is an objective determination, based on the particular facts and circumstances of each transaction. Under these standards, companies may not be able to rely on the certificate of a purchaser of the purchaser's accredited investor status. Additional steps may have to be taken.

Rule 506(c) includes specific, non-exclusive and non-mandatory methods of verifying accredited investor status, including:

- when determining whether an individual meets the accredit investor income test, reviewing any IRS forms that report the investor's income for the two most recent years and obtaining a written representation from the individual;

- when determining whether an individual meets the accredited investor net worth test, reviewing certain bank, brokerage and similar documents issued within the previous three months and obtaining a written representation from the individual; and

- obtaining written confirmation from a registered broker-dealer or an SEC registered investment adviser, a licensed attorney or a CPA that has taken reasonable steps to verify that the purchaser is an accredited investor.

Third party verification services can be used to verify a person's accredited investor status for purposes of Rule 506(c). For example, this may be used by companies relying on web-based Rule 506 offering portals that include offerings for multiple companies. The third party service could obtain the needed documents or take steps to verify accredited investor status.

A number of other factors should be considered when determining the reasonableness of the steps to verify that a purchaser is an accredited investor. Some examples of these factors include:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;

- the amount and type of information that the company has about the purchaser; and

- the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

If a company has conducted a Rule 506(b) offering prior to September 23, 2013, an individual who qualified as an accredited investor in the earlier offering and still holds the company's securities may qualify as an accredited investor in the same company's Rule 506(c) offering if the investor certifies that he or she is still an accredited investor.

Record Keeping. Companies must retain adequate records that document the steps taken to verify that a purchaser was an accredited investor. A company claiming an exemption has the burden of showing that it is entitled to that exemption.

Misrepresentation by a Purchaser. It is possible that a purchaser could circumvent measures put in place by a company to verify the purchaser’s status. If a purchaser is not an accredited investor, the company would be able to rely on the Rule 506(c) exemption, so long as the company took reasonable steps to verify that the purchaser was an accredited investor and had a reasonable belief that the purchaser was an accredited investor.

Notice of Sales -- Filing of Form D with the SEC -- Rule 503

General. A notice on Form D must be filed with the SEC within 15 days of the first sale under Rules 504 and 506. If funds are being held in escrow, the first sale is deemed to occur when funds and subscription agreement are deposited in escrow. As discussed below ***(Rule 508)***, the failure to file a Form D will not render the Regulation D exemption void, but continued filing violations could be a problem because Rule 507 provides that a company cannot rely on Rule 504 or 506 if the company is subject to any order, judgment or decree preliminary or permanently enjoying the company for failing to comply with Rule 503.

Amendments. A company may file an amendment to a previously filed notice of sales on Form D at any time. A company **must** file an amendment to a previously filed notice of sales on Form D for an offering:

- To correct a material mistake of fact or error in the previously filed notice of sales on Form D, as soon as practicable after discovery of the mistake or error.

- To report material changes in business transactions being financed or changes in the maximum on a mini-max offer.

- Annually, on or before the first anniversary of the filing of the notice of sales on Form D or the filing of the most recent amendment to the notice of sales on Form D, if the offering is continuing at that time.

- To reflect a change in the information provided in the previously filed notice of sales on Form D, as soon as practicable after the change, except as discussed below.

An amendment need not be filed to reflect a change that occurs after the offering terminates or a change that occurs solely in the following information:

- The address or relationship to the company of a related person identified in Item 3 of the notice of sales on Form D;

- A company's revenues or aggregate net asset value;

- The minimum investment amount, if the change is an increase, or if the change, together with all other changes in that amount since the previously filed notice of sales on Form D, does not result in a decrease of more than 10%;

- Any address or state(s) of solicitation shown in response to Item 12 of the Form D;

- The total offering amount, if the change is a decrease, or if the change, together with all other changes in that amount since the previously filed on Form D, does not result in an increase of more than 10%;

- The amount of securities sold in the offering or the amount remaining to be sold;

- The number of non-accredited investors who have invested in the offering, as long as the change does not increase the number to more than 35;

- The total number of investors who have invested in the offering; or

- The amount of sales commissions, finders' fees or use of proceeds for payments to executive officers, directors or promoters, if the change is a decrease, or if the change, together with all other changes in that amount since the previously filed on Form D, does not result in an increase of more than 10%.

A company that files an amendment to a previously filed on Form D must provide current information in response to all requirements of the Form D regardless of why the amendment is filed.

Electronic Filing. A company must file the Form D electronically with the SEC by means of the agency's Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) in accordance with EDGAR rules set forth in Regulation S-T (Rule 503(b)(1)). In order to do so, a company must register with the SEC and obtain special access codes.

Failure to File Form D -- Rule 507

As discussed below ***(Rule 508)***, the failure to file a Form D will not render the Regulation D exemption void, but continued filing violations could be a problem because Rule 507 provides that a company cannot rely on Rule 504 or 506 if the company is subject to any order, judgment or decree preliminary or permanently enjoying the company for failing to comply with Rule 503.

Insignificant Deviations from Regulation D -- Rule 508

A failure to comply with a term, condition or requirement of Rule 504 or Rule 506 will not result in the loss of the exemption for any offer or sale to a particular individual or entity, if the person relying on the exemption shows:

- The failure to comply did not pertain to a term, condition or requirement directly intended to protect that particular individual or entity;

- The failure to comply was insignificant with respect to the offering as a whole, provided that any failure to comply with: (1) the prohibition against advertising or general solicitations in Rule 504 or 506(b); (2) sales made under Rule 504 which exceed $5 million; and (3) sales under Rule 506(b) to more than 35 non-accredited investors and sales under Rule 506(c) to non-accredited investors shall be deemed to be significant to the offering as a whole; and

- A good faith and reasonable attempt was made to comply with all applicable terms, conditions and requirements of Rule 504 or Rule 506.

A failure to file (or timely file) a Form D will not cause the loss of the exemption if the conditions described above are satisfied. However, continued filing violations could be a

problem because Rule 507 provides that a company cannot rely on Rule 504 or 506 if the company is subject to any order, judgment or decree preliminary or permanently enjoying the company for failing to comply with Rule 503.

The loss of Regulation D exemption does not mean sales are not exempt. There may be other exemptions (Note 3 to Regulation D).

Compliance with State Securities Laws

Even if a federal exemption is available under Rule 504, a company must also comply with the securities laws of the states where the purchasers reside and obtain an exemption under the laws of those states. Securities sold under Rule 506(b) or 506(c) are Covered Securities and are generally exempt from state securities laws ("**Covered Securities**").

Rule 701- - Offers to Employees, Officers, Directors or Consultants

Rule 701 exempts sale of securities pursuant to written benefit plans and compensation contracts for the benefit of employees, officers, directors, consultants or advisors and family members of these individuals who acquire the shares through gifts or domestic relations orders. The benefit plan or contract cannot be used as a capital raising device.

Rule 701 is not available to public companies (Rule 701(b)(1)).

All sales under Rule 701 are subject to anti-fraud rules. Even though the transaction may be exempt, the company may be subject to liability for securities fraud.

Offering Limits

Any amount of securities can be offered under exemption (Rule 701(d)(1)). However, sales during any 12-month period may not exceed the greater of:

- $1 million;
- 15% of the company's total assets; or
- 15% of the outstanding securities of that class (Rule 701(d)(2)).

Disclosures

The company must deliver a copy of the plan to the investors. Specific disclosure must be made to participants if the aggregate sales exceed $5 million during any 12-month period (see **Appendix C)**.

Transfers to Family Members

Rule 701 securities may be transferred to family members (as defined in Rule 701(c)(3)) in the form of gifts or pursuant to a domestic relations order (Rule 701(c)).

Integration with Other Offerings

A company does not count Rule 701 sales when aggregating sales under other exemptions and does not count sales under other exemptions when calculating the 701 sales limit (Rules 701(d)(3)(iv) and 701(f)). Thus, a company can raise capital in a private placement under Regulation D and issue Rule 701 shares to employees at the same time.

Consultants and Advisors

Using securities to compensate consultants and advisors is a very tricky issue. SEC is very wary of compensating consultants or advisors for selling stock by giving them Rule 701 shares. Rule 701 shares may be provided to consultants and advisors, provided:

- they are natural persons;
- they provide bona fide services to the company, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the company's parent; and
- the services are not in connection with the offer or sale of securities in a capital-raising transaction, and do not directly or indirectly promote or maintain a market for the company's securities.

Resales

Rule 701 securities are "restricted securities" (701(g)(1)). Resales of the securities must be registered or exempt.

Compliance with State Securities Laws

Even if a federal exemption is available under Rule 701, a company must also comply with the securities laws of the states where the purchasers reside and obtain an exemption under the laws of those states.

Rule 147 - - Intrastate Offers and Sales.

Rule 147 was recently amended by the SEC. The discussion set forth below addresses these new rules which will become effective on April 20, 2017.

Rule 147 provides an exemption for securities **offered to offerees and sold to purchasers** who are residents of the state where the selling company is resident and doing business (Rule 147(a)). If an offer is made to a non-resident, the Rule 147 exemption may be lost.

All sales under Rule 147 are subject to anti-fraud rules. Even though the transaction may be exempt, the company may be subject to liability for securities fraud.

Residency

The company must be a resident of the state where offer is made (Rule 147(c)(1)). To be deemed a resident, a company must be incorporated in the state and have its principal place of business in the state. In addition, this state must be where the officers, partners or managers primarily direct, control and coordinate the company's activities. (Rule 147(c)(1)). A company will be deemed to be doing business in a state if it meets one of the following requirements:

- The company must derive at least 80% of its consolidated gross revenues within the state within specified time frames (Rule 147(c)(2)(i));

- 80% of the company's assets (and those of its subsidiaries on a consolidated basis) must be located within the state at the end of the most recent semi-annual period prior to the initial offer of securities (Rule 147(c)(2)(ii));

- The company must use at least 80% of net proceeds from the sale within the state (Rule 147(c)(2)(iii)); or

- A majority of its employees must be located in the state (Rule 147(c)(2)(iv)).

As noted above, **offerees and purchasers** must be residents of the same state as the company. The selling company must reasonably believe at the time of the offer and the sale that the offerees and purchasers are residents of the same state (Rule 148(d)).

- A corporation is a resident of the state where its principal offices are located (see Rule 147(d)(1)).

- An individual is a resident of the state where the individual's principal residence is located (see Rule 147(d)(2)).

Resales

During the six month period from the date of the sale by this company, resales can only be made to persons residing within same state (Rule 147(e)).

The company must establish safeguards to police this requirement (Rule 147(f)). These include:

- placing a legend on the certificate or other document evidencing the security stating that the securities have not been registered under the 1933 Act and setting forth the limitations on resale contained in Rule 147(e) (Rule 147(f)(1)(i));

- issuing stop transfer instructions to the company's transfer agent, if any, with respect to the securities, or, if the company transfers its own securities, make a notation in the appropriate records of the company (Rule 147(f)(1)(ii)); and

- obtaining a written representation from each purchaser as to his residence (Rule 147(f)(1)(iii)).

The company must, in connection with the issuance of the new certificates for any of the securities that are part of the same issue that are presented for transfer during the six month period specified in Rule 147(e), take the steps required by the first and second bullet points.

The offering materials must contain the notice specified in Rule 147(f)(3) which notifies the investors of these restrictions.

Integration

Offers or sales made in reliance on Rule 147 will not be integrated with:

- Offers or sales of securities made prior to the commencement of offers and sales of securities pursuant to Rules 147; or
- Offers or sales made after completion of offers and sales of securities pursuant to Rule 147 that are:
    - Registered under the 1933 Act, except as provided in Rule 147(h);
    - Exempt from registration under Regulation A ("**Regulation A**");
    - Exempt from registration under Rule 701 ("**Rule 701**");
    - Made pursuant to an employee benefit plan;
    - Exempt from registration under Section 4(a)(6) of the 1933 Act ("**Crowdfunding**"); or
    - Made more than six months after the completion of an offering conducted pursuant to Rule 147.

If none of the safe harbors applies, whether subsequent offers and sales of securities will be integrated with any securities offered or sold pursuant to Rule 147 will depend on the particular facts and circumstances ("**Regulation D – *Integration***").

Compliance with State Securities Laws

Even if a federal exemption is available under Rule 147, a company must also comply with the securities laws of the state where the purchaser resides and obtain an exemption under the laws of that state.

Rule 147A – Intrastate Sales Exemption

Rule 147A was recently adopted by the SEC, and will become effective on April 20, 2017.

Rule 147A is substantially similar to Rule 147 in that it provides for an exemption for sales made to residents of one state by a company that is a resident of the same state and has its principal place of business in that state. The main difference is that a company conducting an

offering pursuant to 147A may use any form of general solicitation or advertising (Rule 147A(b)).

The SEC recognized that allowing such advertising raised the possibility that the offering company's message might be received by persons residing in other states. To address this problem, Rule 147A does not require that offers only be made to residents of one state. **However, it does require that the purchase may only be made by residents of one state**.

All sales under Rule 147A are subject to the anti-fraud rules. Even though the transaction may be exempt, the company may be subject to liability for securities fraud.

Residency

The company must be a resident of the state where offer is made (Rule 147A(c)(1)). To be deemed a resident, a company must have its principal place of business in the state. In adition, this state must be where the officers, partners or managers primarily direct, control and coordinate the company's activities (Rule 147A(c)(1)). Unlike Rule 147, the company does not have to be incorporated in that state.

A company will be deemed to be doing business in a state if it meets one of the following requirements:

- The company must derive at least 80% of its consolidated gross revenues within the state within specified time frames (Rule 147A(c)(2)(i));

- 80% of the company's assets (and those of its subsidiaries on a consolidated basis) must be located within the state at the end of the most recent semi-annual period prior to the initial offer of securities (Rule 147A(c)(2)(ii));

- The company must use at least 80% of net proceeds from the sale must be used within the state at the end of the most recent semi-annual period prior to the initial offer of securities (Rule 147A(c)(2)(iii)); or

- A majority of its employees must be located in the state (Rule 147A(c)(2)(iv)).

In addition, **purchasers must be residents of the same state as the selling company**. The selling company must reasonably believe at the time of the offer and the sale that the purchasers are residents of the same state (Rule 147A(d)).

- A corporation is a resident of the state where its principal place of business is located (see Rule 147A(d)(1)).

- An individuals is deemed to be a resident of the state where the individual's principal residence is located (see Rule 147A(d)(2)).

Resales

During the six month period from the date of the sale by this company, resales can only be made to persons residing within same state (Rule 147A(e)).

The company must establish safeguards to police this requirement (Rule 147A(f)). These include:

- placing a legend on the certificate or other document evidencing the security stating that the securities have not been registered under the 1933 Act and setting forth the limitations on resale contained in Rule 147A(e) (Rule 148(f)(1)(i));

- issuing stop transfer instructions to the company's transfer agent, if any, with respect to the securities, or, if the company transfers its own securities, make a notation in the appropriate records of the company (Rule 147A(f)(1)(ii)); and

- obtaining a written representation from each purchaser as to his residence (Rule 147A(f)(1)(iii)).

The company must, in connection with the issuance of the new certificates for any of the securities that are part of the same issue that are presented for transfer during the six month period specified in Rule 147A(e), take the steps required by the first and second bullet points.

The offering materials must contain the notice specified in Rule 147A(f)(3) which advises investors of such resale restrictions.

Integration

Offers or sales made in reliance on Rule 147A will not be integrated with:

- Offers or sales of securities made prior to the commencement of offers and sales of securities pursuant to Rules 147; or

- Offers or sales made after completion of offers and sales of securities pursuant to Rule 147 that are:

    - Registered under the 1933 Act, except as provided in Rule 147(h);

    - Exempt from registration under Regulation A ("**Regulation A**");

    - Exempt from registration under Rule 701 ("**Rule 701**");

    - Made pursuant to an employee benefit plan;

    - Exempt from registration under Section 4(a)(6) of the 1933 Act ("**Crowdfunding**") ; or

- Made more than six months after the completion of an offering conducted pursuant to Rule 147.

If none of the safe harbors applies, whether subsequent offers and sales of securities will be integrated with any securities offered or sold pursuant to Rule 147 will depend on the particular facts and circumstances ("**Regulation D – *Integration***").

Compliance with State Securities Laws

Even if a federal exemption is available under Rule 147A, a company must also comply with the securities laws of the state where the offerees or purchasers reside and obtain an exemption under the laws of those states.

Private Placement -- Section 4(a)(2)

General

Section 4(a)(2) of the 1933 Act exempts transactions by a company not involving a public offering. This was the traditional private placement exemption before Regulation D was adopted. The exemption offered by Section 4(a)(2) is still available. When determining whether the exemption is available, the factors to be examined are:

- manner of offering—how are the purchasers identified—e.g., general solicitation, advertising, seminars, etc.?

- eligibility of the purchasers—does each purchaser **(not all offerees)**, either alone (or with a qualified advisor), have such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of the investment?

- information—does each purchaser (or his qualified advisor) receive, or has meaningful access to, such information so that the purchaser may make an informed decision?

- resales—Are appropriate steps taken to prevent resales that are not registered or exempt?

  All sales under Section 4(a)(2) are subject to the anti-fraud rules. Even though the transaction may be exempt, a company may still be subject to liability for securities fraud.

Manner of Offering

The company may not offer or sell the securities by any form of "general solicitation" or "general advertising," including, but not limited to:

- any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and

- any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.

Although Section 4(a)(2) in theory allows **offers and sales** to a large number of investors, offers to a large number of prospective buyers may violate prohibitions against advertising and solicitation. The SEC prefers for companies to have a "nexus" to offerees.

Eligibility of Purchasers

Purchasers, either alone or with their qualified advisors, must have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of the prospective investment.

Information

In the case of a non-reporting company, the company should consider furnishing to non-accredited investors substantially the same information as is contemplated by Rule 502(b) of Regulation D to the extent material to an understanding of the company, its business, and the securities being offered. The disclosures to be made to non-accredited investors are fairly extensive and are set out at **Appendix B**.

The company should also consider: (1) furnishing to each purchaser that is not an accredited investor a brief written description of any material written information provided to any accredited investor and, upon request, furnishing this information to the non-accredited investor; (2) advising each purchaser of the limitations on resale of the securities; and (3) making available to each purchaser the opportunity to ask questions and receive answers concerning the terms and conditions of the offering and obtain any additional information the company possesses, or can acquire without unreasonable effort or expense, that is necessary to verify the accuracy of the information furnished.

Resales

Securities sold under Section 4(a)(2) are "restricted securities". Rule 502(d) sets forth procedures that should be followed to insure that buyers are aware of the resale restrictions ("**Regulation D** -- ***Resales***").

Integration

A company needs to be careful to insure that the Section 4(a)(2) offering and another offering are not integrated. If a Section 4(a)(2) offering and another offering are integrated, the company might lose the exemption. See "**Regulation D** -- ***Integration***" above for a discussion of the factors considered by the SEC when considering whether to integrate two offerings.

Compliance with State Securities Laws

Even if a federal exemption is available under Section 4(a)(2) of the 1933 Act, a company must also comply with the securities laws of the state where the purchaser resides and obtain an exemption under the laws of that state.

Sales to Accredited Investors

Section 4(a)(5) of the 1933 Act permits sales by a company to accredited investors where total sales do not exceed $5 million. Under this exemption:

- No advertising or public solicitation is allowed.
- The company must file a Form D with the SEC.
- Section 4(a)(5) purchasers acquire "restricted securities" and the company must ensure that the purchasers are aware of these restrictions and take steps to enforce them as discussed above. Rule 502(d) sets forth procedures that should be followed to insure that buyers are aware of the resale restrictions ("**Regulation D -- *Resales***").

All sales under Section 4(a)(5) are subject to anti-fraud rules. Even though the transaction may be exempt, the company may be subject to liability for securities fraud.

Even if a federal exemption is available under Section 4(a)(5) of the 1933 Act, a company must also comply with the securities laws of the states where the purchasers reside and obtain an exemption under the laws of these states.

Covered Securities

With the passage of the National Securities Markets Improvement Act in 1996 ("NSMIA"), jurisdiction over the issuance of "covered securities" has been taken away, to a large extent, from the states. Covered securities include the following types of securities:

- Securities listed on the national stock exchanges and NASDAQ.
- Securities exempted by the SEC under Section 4(a)(2) of the 1933 Act.
- Securities sold pursuant to Rule 506 of Regulation D.

NSMIA preempts: (1) the application of state registration requirements with respect to covered securities; (2) state regulations relating to the content of any offering document used with respect thereto; and (3) state regulations relating to the merits of a sale of covered securities. Therefore, sales of securities under Rule 506 of Regulation D are exempt from state regulation.

States may require a company selling securities under Rule 506 to file with the state the documents filed with the SEC (Form D) and may require the payment of limited fees set out in NSMIA.

Sales of covered securities are still subject to the anti-fraud rules.

Regulation A

This section provides a very brief discussion of Regulation A. **For a more detailed discussion of Regulation A, see http://www.hinshawlaw.com/newsroom-publications-alerts-661.html.**

Regulation A creates two tiers of offerings:

- Tier 1 offerings will consist of securities offerings of up to $20 million in a 12-month period, including sales for the account of selling security-holders equal to the lesser of $6 million or 30% of the aggregate offering price (including sales by the issuer).

- Tier 2 offerings will consist of securities offerings of up to $50 million in a 12-month period, including sales for the account of selling security-holders equal to the lesser of $15 million or 30% of aggregate offering price (including sales by the issuer).

- For offerings up to $20 million, a company could elect to proceed under either Tier 1 or 2.

The rules require issuers to electronically file disclosure documents with the SEC but impose different disclosure requirements for issuers involved in Tier 1 and Tier 2 offerings. In addition, the rules allow issuers to submit offerings to the SEC on a confidential basis. An issuer completing a Tier 2 offering will be required to comply with periodic reporting rules.

The rules permit “test-the-waters” communications for Tier 1 and 2 offerings and disqualify issuers involved with bad actors.

Tier 2 offerings will be exempt from the state registration and qualification rules. Tier 1 offerings are subject to regulation and qualification requirements in the state where the offering is conducted unless a state-level exemption is available.

The rules permit brokers to rely on reports filed by a Regulation A issuer making a Tier 2 offering to satisfy the broker’s obligations under Rule 15c2-11 and impose restrictions on secondary sales by security-holders following the completion of a Tier 1 or 2 offering.

Companies relying on Tier 2 of Reg A are not subject to the reporting and most other requirements of the Securities Exchange Act of 1934 (the "1934 Act"). As a result, Tier 2 companies will not be subject to, among other rules, Sarbanes-Oxley, insider trading and reporting rules, or SEC proxy rules.

An issuer completing a Tier 2 offering will not have to register under Section 12(g) of the 1934 Act as long as it complies with certain stockholder limits.

The Regulation A exemption only applies to offerings of equity securities, warrants, convertible equity securities, debt securities, and debt securities convertible or exchangeable into

equity interests, including any guarantees of such securities. Asset-backed securities may not be sold in a Regulation A offering.

Crowdfunding

General

This section contains a brief discussion of the SEC's crowdfunding rules. **For a more detailed discussion of the crowdfunding rules, see http://www.hinshawlaw.com/newsroom-publications-alerts-SEC-Adopts-JOBS-Act-Crowdfunding-Rules.html.**

The crowdfunding rules require the selling company to file an offering circular with the SEC that complies with the SEC disclosure rules and place restrictions on advertising and the payment of compensation and requires a company selling securities to use intermediaries. Companies relying on the crowdfunding rules are also subject to bad actor disqualifications.

Offering and Investment Limits

The crowdfunding rules contain the following thresholds and limits:

- The aggregate amount of securities that may be sold by a company within a 12-month period in crowdfunding transactions may not exceed $1 million.

- During any 12-month period, the aggregate amount of securities sold to any investor **by all companies in crowdfunding transactions** must not exceed the greater of:

  (i) $2,000 or 5% of either the annual income or net worth of such investor (and his spouse), if both the annual income and the net worth of the investor is less than $100,000;

  (ii) 10% of either the annual income or net worth of such investor (and his spouse), if either the annual income or net worth of the investor is equal to or more than $100,000; and

  (iii) a maximum aggregate amount of $100,000 for all crowdfunding purchases in the 12-month period.

The investor purchase limits are calculated on all crowdfunding purchases made by an investor during any 12-month period. Thus, an investor's purchases **in all crowdfunding transactions during such** period must be **aggregated** (and not just from the offering in which the investor is participating).

The net worth and annual income tests are calculated using the accredited investor tests contained in Rule 501 of Regulation D ("**Regulation D -- *Accredited Investors***"). Before accepting any investment commitment, an intermediary must have a reasonable basis to believe that the investor satisfies the investment requirements under the crowdfunding rules, including the investment limits set forth above. The intermediary may rely on the investor's

representations that the investor so qualifies unless the intermediary has reason to believe otherwise.

Intermediaries

Under the crowdfunding rules, a crowdfunding transaction must take place exclusively online through platforms operated by a single SEC registered intermediary, either a registered broker-dealer or a new type of SEC registrant called a "funding portal". An intermediary must be a member of FINRA or any other applicable national securities association registered under Section 15A of the 1934 Act.

State Blue Sky Laws

Registration requirements under state securities laws will be preempted for securities issued in crowdfunding offerings that comply with the crowdfunding requirements. Some states, including Illinois, have adopted rules to permit purely intrastate crowdfunding offerings.

Restrictions on Resales

Crowdfunding securities may not be transferred by the purchaser for one year after the date of purchase, except when transferred:

- to the company that issued the securities;
- to accredited investors ("**Regulation D -- *Accredited Investors***");
- as part of an offering registered with the SEC; or
- to a family member of the purchaser or the equivalent, or in connection with certain events (e.g., death or divorce).

It is important to note that this restriction applies not only to the original purchaser, but to any holder of such shares during the one-year period.

Illinois Exemptions

Once an exemption from the federal securities laws has been secured, the company needs to review the laws of the states where the securities will be sold in order to determine if there is a corresponding exemption under state law. For purposes of this presentation, only Illinois will be considered.

Under Illinois law, there are a variety of exemptions available from registration. These are set out in Section 4 of the Illinois Securities Law of 1953, as amended (the "Illinois Act"). These exemptions exempt the transaction (e.g., a sale to an existing shareholder) not the underlying security. Subsequent transactions may have to be registered if no exemption is available. Generally speaking, investors who resell their shares after holding them for a reasonable period of time should qualify for the private placement exemption available under

Section 4(a)(1) of the 1933 Act and Section 4(A) of the Illinois Act which exempt any sale of securities by a person other than the issuing company, underwriter or dealer.

Sales exempted under Illinois law are still subject to the anti-fraud rules.

Set forth below the most commonly used exemptions available under Illinois law. Other exemptions are available.

Sales to Existing Shareholders

Offers, sales, issuances or exchanges with existing shareholders are exempt, if no commission is paid (Section 4B).

Sales to Corporations, Banks, etc.

Offers, sales or issuances to certain entities as described in Section 4C of the Illinois Act (e.g., banks, savings and loans, employee benefit plans) are exempt.

Rule 506

Companies relying on Rule 506 of Regulation D (issuing covered securities) need only file a Form D and pay a $100 fee (Regulation 130.293(a)(1) of the Illinois Blue Sky Regulations).

Exchange Traded Securities

Regulation 130.293(d) exempts exchange traded (NYSE, NASDAQ, etc.) securities from the Illinois filing requirements.

Section 4G-Limited Offering

Section 4G exempts offers, sales or issuance to residents (or non-residents) as follows:

- If all sales to Illinois residents during the preceding 12 months have been made to fewer than 35 persons or all sales to Illinois residents in the last 12 months totaled less than $1 million (regardless of how many people in Illinois purchased shares), the sales are exempt (Section 4G).

- When counting the 35 people or the amount of the sales, the company may exclude sales exempted under other subsections of Section 4.

    - A sale to joint tenants with right of survivorship is one sale (Regulation 130.441(a) of the Illinois Blue Sky Regulations).

    - Purchases by relatives or spouses who share same residence shall not be a sale to an additional purchaser (Regulation 130.441(b)).

- No general advertising or solicitation is permitted.

- Commissions may not exceed 20% of the sale price.
- A report on Form 4G must be filed (alternatively a company may file a Form D (Regulation 130.440(a)).
    - A $100 fee must be paid.
    - The report is due within 12 months of first sale.
    - The company need only report 4G sales (it does not need to report sales exempted under other subsections of Section 4).
    - A failure to file report or filing of an inaccurate report does not give a right of rescission to the purchaser.
    - By filing, the company agrees to deliver disclosure materials to the Illinois Securities Department if so requested.

Accredited Investors

Section 4H exempts sales to accredited investors who meet income and net worth tests discussed above or sales to an entity where 90% of the equity interests are owned by accredited investors ("**Regulation D -- *Accredited Investors***"). Securities may not be sold by means of general advertising or solicitation.

Shareholder Approval

Offers, sales or issuance pursuant to shareholder vote, e.g., a merger, consolidation, etc. are exempt (Section 4I).

Preincorporation Sales

Offers or sales of preorganization subscriptions prior to incorporation or organization are exempt (Section 4M).

- Limited to 25 people.
    - A sale to joint tenants with right of survivorship is one sale (Regulation 130.441(a) of the Illinois Blue Sky Regulations).
    - Purchases by relatives or spouses who share same residence shall not be a sale to an additional purchaser (Regulation 130.441(b)).
- No commission can be paid, except as indicated below.
- If commissions are paid, the securities may not be sold by way of general advertising or solicitation.

Minimum Purchase Requirement

Any offer, sale or issuance to anyone who purchases more than $150,000 is exempt provided that the purchase does not exceed 20% of buyer's net worth and no advertising is undertaken (Section 4R).

Sales to Executive Officers and Directors

Offers, sales or issuances to any person who is a director, executive officer or general partner of the company are exempt (Section 4S). The term "executive officer" is defined in the statute and could include an executive officer of a subsidiary provided that the officer performs policy making functions for the parent ("**Regulation D -- *Accredited Investors***").

Crowdfunding

Illinois has enacted legislation that permits crowdfunding offerings. These offerings must also be exempt from the federal securities laws. Properly structured offerings under the Illinois crowdfunding rules could be exempt under Rule 504, Rule 147 or Rule 147A discussed above.

Under the Illinois crowdfunding rules, a company can sell up to $4 million of debt or equity during a 12-month period to Illinois residents.

The selling company must be incorporated in and doing business in Illinois, meeting the business tests specified in the rules. In addition, sales may only be made to Illinois residents.

Non-accredited investors can purchase up to $5,000 per year. There are no limits on purchases made by accredited investors.

Crowdfunding sales must be conducted through a registered internet portal.

The selling company must establish a maximum and minimum amount and a closing deadline for sales. The minimum must be at least 50% of the maximum. The funds must be deposited with an escrow agent and will be held until the company reaches the minimum sales amount.

Company must file a notice with the Illinois Secretary of State at the start of the sales, along with a copy of the escrow agreement and a $100 filing fee.

The company will have to provide specified information in its offering materials and amendments as needed, all of which will be reviewed by the Illinois Secretary of State. The company will have to file quarterly and annual reports for as long as the securities remain outstanding.

Exempt Securities

Both federal law (Section 3(a) of the 1933 Act) and the Illinois Act (Section 3 of the Illinois Act) designate certain types of securities that are deemed to be "exempt" from the

registration requirements. These securities may be issued without the company having to secure an exemption or registering them under federal or Illinois law.

One of the more common type of exempt security is bank stock. It should be noted, however, that if a bank has more than 500 shareholders of record it becomes subject to the SEC's rules which rules will be administered by the appropriate federal bank regulator.

Even though these securities are exempt from the registration requirements, they are still governed by the anti-fraud rules.

Appendix A -- Accredited Investors

(a) *Accredited investor.* *Accredited investor* shall mean any person who comes within any of the following categories, or who the company reasonably believes comes within any of the following categories, at the time of the sale of the securities to that person:

(1) Any bank as defined in Section 3(a)(2) of the 1933 Act, or any savings and loan association or other institution as defined in Section 3(a)(5)(A) of the 1933 Act whether acting in its individual or fiduciary capacity; any broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934; any insurance company as defined in Section 2(a)(13) of the Act; any investment company registered under the Investment Company Act of 1940 or a business development company as defined in Section 2(a)(48) of that Act; any Small Business Investment Company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958; any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in excess of $5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in Section 3(21) of such Act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are accredited investors;

(2) Any private business development company as defined in Section 202(a)(22) of the Investment Advisers Act of 1940;

(3) Any organization described in Section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5,000,000;

(4) Any director, executive officer, or general partner of the company of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that company;

(5) Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds $1,000,000;

(i) Except as provided in paragraph (a)(5)(ii), for purposes of calculating net worth under this paragraph (a)(5);

(A) The person’s primary residence shall not be included as an asset;

(B) Indebtedness that is secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, shall not be included as a liability (except that if the amount of such indebtedness outstanding at the time of sale of securities exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and

(C) Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities shall be included as a liability;

(ii) Paragraph (a)(5)(i) of this section will not apply to any calculation of a person's net worth made in connection with a purchase of securities in accordance with a right to purchase such securities, provided that:

(A) Such right was held by the person on July 20, 2010;

(B) The person qualified as an accredited investor on the basis of net worth at the time the person acquired such right; and

(C) The person held securities of the same issuer, other than such right, on July 20, 2010.

(6) Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

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

(8) Any entity in which all of the equity owners are accredited investors.

Appendix B -- Information Requirements for Rule 506(b) Offerings When Securities Are To Be Sold To Non-Accredited Investors

If sales are being made under Rule 506(b) to any purchaser that is not an accredited investor, the company must furnish the information described below to such purchaser a reasonable time prior to the sale (Rule 502(b)(1)).

The company is not required to furnish the specified information to purchasers when it sells securities under Rule 504 or to any accredited investor.

When a company provides information to non-accredited investors pursuant to this rule, it should consider providing such information to accredited investors as well, in view of the anti-fraud provisions of the federal securities laws.

Non-SEC Reporting Companies

Non-financial statement information

If the company is eligible to use Regulation A, the same kind of information as would be required in Part II of Form 1-A.

If the company is not eligible to use Regulation A, the same kind of information as required in Part I of a registration statement filed under the 1933 Act on the form that the company would be entitled to use.

Financial statement information

Offerings up to $2,000,000

The information required in Article 8 of Regulation S-X, except that only the company's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited.

Offerings up to $7,500,000

The financial statement information required in Form S-1 for smaller reporting companies. If a company, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the company's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited. If the company is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant.

Offerings over $7,500,000

The financial statement as would be required in a registration statement filed under the 1933 Act on the form that the company would be entitled to use. If a company, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or

expense, then only the company's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited. If the company is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant.

Public Companies

If the company is a public company, it must provide the information specified in Rule 502(b)(2)(ii).

Information; Communications

At a reasonable time prior to the sale of securities to any purchaser that is not an accredited investor in a transaction under Rule 506(b), the company shall furnish to the purchaser a brief description in writing of any material written information concerning the offering that has been provided by the company to any accredited investor but not previously delivered to such unaccredited purchaser. The company shall furnish any portion or all of this information to the purchaser, upon his written request a reasonable time prior to his purchase.

The company shall also make available to each purchaser at a reasonable time prior to his purchase of securities in a transaction under Rule 506(b) the opportunity to ask questions and receive answers concerning the terms and conditions of the offering and to obtain any additional information which the company possesses or can acquire without unreasonable effort or expense that is necessary to verify the accuracy of information furnished under Rule 502(b)(2)(i) or (b)(2)(ii).

For business combinations or exchange offers, in addition to information required by Form S-4, the company must provide to each purchaser at the time the plan is submitted to security holders, or, with an exchange, during the course of the transaction and prior to sale, written information about any terms or arrangements of the proposed transactions that are materially different from those for all other security holders. For purposes of this subsection, a company which is not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act may satisfy the requirements of Part I.B. or C. of Form S-4 by compliance with Rule 502(b)(2)(i).

At a reasonable time prior to the sale of securities to any purchaser that is not an accredited investor in a transaction, the company shall advise the purchaser of the limitations on resale.

Appendix C -- Information Requirements for Rule 701

1. If the plan is subject to the ERISA, a copy of the summary plan description required by ERISA.

2. If the plan is not subject to ERISA, a summary of the material terms of the plan.

3. Information about the risks associated with investment in the securities sold pursuant to the compensatory benefit plan or compensation contract.

4. Financial statements required to be furnished by Part F/S of Form 1-A (Regulation A Offering Statement) under Regulation A. The financial statements must be as of a date no more than 180 days before the sale of securities in reliance on this exemption.

If the sale involves a stock option or other derivative security, the company must deliver the disclosure a reasonable period of time before the date of exercise or conversion.

For deferred compensation or similar plans, the company must deliver disclosure to investors a reasonable period of time before the date the irrevocable election to defer is made.