PRIVATE PLACEMENT OVERVIEW

The term "private placement" refers to the offer and sale of any security by a company, not involving a public offering, hence it's a 'private offering'. Private placement offerings are not the subject of a registration statement filed with the SEC under the 1933 Act. Private placements are done in reliance upon Sections 3(b) or 4(2) of the 1933 Act as construed or under Regulation D as promulgated by the SEC, or both. Regulation D, promulgated in 1982, sets forth certain guidelines for compliance with the Private Offering Exemption. Any registered representative who are involved in the private placement process are expected to have a working familiarity with Regulation D.

To qualify as a private placement, an offering by an issuer must meet either the requirement of Sections 3(b) or 4(2) of the 1933 Act as developed through SEC interpretation and court decisions or must follow the conditions set out under Regulation D of the 1933 Act. Persons claiming the exemption from the 1933 Act carry the burden of proving that its activities came within that exemption.

Regulation D is a series of six rules, Rules 501-506, establishing three transactional exemptions from the registration requirements of the 1933 Act.

Accredited Investor

"Accredited Investor" is defined in Rule 501(a). The principal categories of accredited investors are as follows:

1) Directors, executive officers, and general partners of the issuer, including general partners of general partners in two-tier syndicating. (The term "executive officers" is more fully defined in the Regulation.)

(2) Purchasers whose net worth either individually or jointly with their spouse equals or exceeds $1 million. It is important to note that while there is no definition of "net worth" in Regulation D, there similarly is no requirement of liquidity in the calculation of net worth for this accreditation standard. Thus, a purchaser's home, furnishings, etc. are includable in the determination of net worth.

(3) Natural person purchasers who have "income" in excess of $200,000 in each of the two most recent years and who reasonably expect an income in excess of $200,000 in current year (or $300,000, jointly with their spouse).

(4) A business entity will be treated as a single accredited investor unless it was organized for the specific purpose of acquiring the securities offered, in which case each beneficial owner of the security is counted separately.

(5) There are more requirements to be considered an Accredited Investor. Contact me for more information.

Additional Compliance Considerations Under Regulation D

The SEC has pointed out the following regarding Regulation D:

1. Regulation D does not exempt offerings from the anti-fraud and civil liability provisions of the various federal securities laws.

2. Further, Regulation D in no way relieves issuers of their obligation to furnish to investors whatever material information may be needed to make any required disclosures not misleading.

3. Similarly, notwithstanding exemption from registration at the federal level, Regulation D in no way obviates an issuer's obligation to comply with applicable state law.

4. Regulation D is interpreted as providing "transactional" exemptions to issuers only. An investor whose purchase was exempt from registration cannot resell his or her interest without establishing an independent basis of exemption.

5. The three exemptions are not intended to be mutually exclusive, that a reliance on one exemption is not deemed to be an election to the exclusion of any other applicable exemption.

6. Finally, the exemptions of Regulation D may not be claimed with respect to any plan or scheme to evade the registration provisions of the act.

Existing state securities regulations at times impose substantially more onerous limitations on issuers than Regulation D. Issuer's counsel must be consulted regarding the requirements of the securities law of each state in which a private placement offering is going to be sold.

Private Placement of Restricted Securities Outside Regulation D

The specific requirements to be satisfied in establishing an exemption under Section 4(2) for a private placement are not stated in that section of the Securities Act of 1933. By studying SEC interpretations and court decisions dealing with Section 4(2), the basic requirements which a private placement must meet can be determined.

They are summarized below:

1. All the offerees and purchasers must have access to the same kind of information concerning the issuer which would appear in an SEC registration statement, and these persons must be able to comprehend and evaluate such information (all prospects must be given the same information and private placement memorandum offering document). It must be kept in mind that any offer to an offeree who would not qualify, as well as a sale to a purchaser who would not qualify, may destroy the private placement exemption and result in a violation of Section 5 of the 1933 Act.

2. The issuer and any parties acting for the issuer, including a broker-dealer, must take all reasonable steps to ensure that the information given to the offerees and purchasers is complete and accurate. This is "due diligence." All information passed on in the course of the private placement, either orally or by memorandum (or offering circular or private placement memorandum), is subject to the anti-fraud provisions of the federal securities laws. The fact that the offering memorandum is not reviewed by the SEC does not lower the standards for accuracy which would be applicable to any registered offering.

3. All of the offerees must have access to meaningful current information concerning the issuer. The fact than an offeree has considerable financial resources or is a lawyer, accountant or businessperson, and thus may be considered sophisticated, does not eliminate the need for appropriate information to be made available. Again, all parties should receive the same information.

4. While there is no specific limitation on the number of offerees, the greater the number of offerees, the greater the likelihood that the offering will not qualify for the exemption. In this connection, a private placement cannot be the subject of advertising, general promotional seminars or public meetings in connection with the offering. This limitation does not preclude meeting with offerees to discuss the terms of the offer or to present information concerning the issuer or the offer.

5. Purchasers in a private placement must acquire the securities for investment and not for the purpose of further distribution. If the purchaser acts in such a manner so as to participate in distribution of the securities to the public, either directly or indirectly as a link between the issuer and the public, he or she will be deemed to be an underwriter and the selling broker-dealer and other participants in the distribution, including the issuer, will be in violation of Section 5 of the 1933 Act. They must be licensed and conform to other regulatory standards, i.e. FINRA. Each of the purchasers must intend to acquire for investment at the time the securities are purchased. Whether or not investment intent was present will be determined from all the circumstances surrounding the acquisition. Such circumstances would include the financial capability of the purchaser to hold the securities for the long term and whether the purchaser signed a letter of investment intent. The amount of time the securities have been held (the holding period) is one of the factors in a hindsight determination that an investment intent existed at the time of purchase. A two-year holding period is deemed to be the bare minimum, but counsel should be sought in order to determine if this time frame can be shortened, or if it needs to be lengthened.

What is apparent from the aforementioned information is that current and accurate information about the offerees in a private placement transaction is absolutely essential for the making of judgments as to suitability, ability to evaluate an offering, and investment intent.

Supplementary or Corrective Material

During the course of private placement activities on a particular issue, or prior to the closing, it may become necessary to update or correct information supplied in the private placement memorandum as originally prepared. The corrected information must be brought to the attention of the offerees by means of a cover or transmittal letter which describes the changes or additions. Depending upon the information transmitted, reconfirmation of an investors desire to invest may be required. The files maintained with respect to a particular offering must contain a record of what has been done. Prior to closing an offering of the private placement, meaning the acceptance of investors in a transaction, a brokerage firm Principal must verify that all such amendments have been sent to all subscribing offerees and that the files are accurate and complete. All offerees should be notified of any changes.

Possible Need for a Purchaser Representative

A judgment must be made as to the business “sophistication” of a purchaser. If it is determined that a particular purchaser is not sufficiently sophisticated in business matters to effectively evaluate the investment opportunity, then he or she must be assisted by a “purchaser representative,” i.e., a person possessing the requisite sophistication (chosen by the purchaser) who is able to and does assist in evaluating the investment opportunity

and who is not an affiliate of the issuer, not the brokerage firm. Also, State Blue Sky laws impose additional requirements for their investors. Only customers known to registered representative personally should be sent only brokerage firm approved private placement offering materials. If there is doubt about the individual's need for a purchaser representative, the subscriber should be required to obtain one.

Investment Intent

Purchasers of private placement securities must purchase for investment purposes and not for the purpose of resale. The typical subscription documents used in private placements contains what is called "investment letter language." This representation should be personally verified. Consideration should be given as to whether the investment representation makes sense in view of the surrounding circumstances of the proposed purchaser.

Acceptance Of Offerees As Purchasers

In all private placement offerings, the subscribers must be formally accepted by the issuer. The acceptance of subscribers is based upon a subscriber questionnaire and, possibly, the customers account information (a document signed by the client). A review of the contents of this form by a representative of the firm who is qualified to make such determinations is imperative.

Following the acceptance of the subscribers in an offering by both the issuer and the principal, the offering shall be terminated by notification to all involved sales persons or entities.

Both terms must be adhered to.

Rule 15c2-4 requires, in general, that the monies received from investors be deposited into a separate segregated bank account (Independent Bank as Escrow Agent) and held for the investors' benefit until the "all or none" or "part or none" terms have been complied with. If the terms of the offering are met, the money is to be transmitted to the issuer. If not, the monies are to be returned to subscribers.

The specific procedures to be followed in the handling of escrow accounts for "all or none" or "part or none" transactions are as follows:

1. When an "all or none" or "part or none" private placement offering is commenced, an escrow agreement shall be created. This document should be executed by the brokerage firm and the bank. The brokerage firm is required to keep a copy of all escrow agreements on file to demonstrate compliance with Rule 15c2-4.
2. An escrow account should be opened by the bank. The escrow account is governed by the escrow agreement. The account typically requires signatures of representatives of both the brokerage firm and the Issuer before any checks can be issued from the account.

3. Incoming monies should be deposited immediately into the escrow account, along with the purchaser's name, address, social security number and number of shares/units.

4. Upon the completion of the "all or none" or "part or none" terms of the agreement or upon the expiration of the specified time period, the escrow agent verifies that the terms of the escrow agreement have been or have not been met by the designated date and that the funds should be released from escrow.

5. The issuer then transmits written confirmation stating that a determination has been made that the conditions of the escrow have or have not been complied with and request a release of the funds.

6. Upon receipt of the written confirmation described above, the funds are transmitted to the proper entity or persons.

7. The documentation created by these procedures is then retained in a segregated file for audit or regulatory review.

8. In a “best efforts” offering, the brokerage firm is contractually bound to use its “best efforts” to place the securities with suitable investors. The brokerage firm will follow the procedures as outlined above regarding private placement of subscriber’s funds in an independent bank escrow account.

The preceding information, including all information in this document is not legal advice, and is intended solely for information and educational purposes. If you are contemplating a private placement, or any legal transaction, you should consult a consultant or an attorney who can provide you with the advice that you need, for your specific circumstances. InfoCentre is not a law firm nor a substitute for a law firm. I have specialists who I have used numerous times in the past and who I trust, who assist in the drafting of the actual Private Placement Memorandums that we use.

Additional Resources:

http://www.InfoCentre.biz/RaisingMoney.htm
http://www.securities.utah.gov/industry/corpfin_raisingcapital.html
http://www.sec.gov/
http://www.sec.gov/answers/rule504.htm
http://www.sec.gov/answers/rule505.htm
http://www.sec.gov/answers/rule506.htm