

## SEC Adopts Final Rules Updating Intrastate and Regional Offering Rules

Recently the Securities and Exchange Commission (“SEC”) adopted final rules to amend Rule 147 under the Securities Act of 1933, as amended (“Securities Act”) and to create an intrastate offering exemption under new Rule 147A of the Securities Act. The SEC also amended Rule 504 to increase the amount of securities that may be sold from \$1 million to \$5 million and repealed Rule 505 of Regulation D under the Securities Act. These final rules are substantially similar to the rules the SEC proposed on October 30, 2015.

### Background

In 1974, the SEC adopted Rule 147, which provides an integration safe harbor and objective standard for intrastate offerings exempt from registration under Section 3(a)(11) of the Securities Act. Section 3(a)(11) exempts from SEC registration securities offered and sold only to persons residing in a single state by a company incorporated by, and doing business within that state or territory, reflecting a policy position set forth in the Securities Act that intrastate offerings were best regulated at the state level. In other words, to qualify for the Section 3(a)(11) exemption, the securities may not be offered or sold to non-residents. While this seems straightforward, the advent of the Internet made the exemption much more difficult to comply with since the Internet transcends state boundaries and the exemption became limited to companies that were willing to avoid using modern electronic means of offering securities.

### Amendments to Rule 147

Under the amended rules, Rule 147 still provides a safe harbor for companies that are both incorporated in and doing business within the state in which the offerings and sales take place. Rule 147A is substantively similar to amended Rule 147 except that Rule 147A allows companies to offer securities to out-of-state residents provided that all sales are limited to residents located in the state in which the company is doing business. These changes open the doors to companies to use the Internet to offer securities in intrastate offerings. In addition, Rule 147A no longer requires a company to be incorporated in the state, instead the company must only demonstrate that it does business in the state. For example, if a corporation is incorporated in Delaware and has its principal place of business in New York, it may offer securities over the Internet provided that sales are made to New York residents only.

Both amended Rule 147 and new Rule 147A contain provisions that:

- Require the issuer to satisfy at least one “doing business” condition in the state of the offering, such as deriving 80% of its consolidated gross revenues from operations or real property within the state, or having a majority of its employees based in the state;
- Create a new “reasonable belief” standard, allowing issuers to rely on their reasonable beliefs when determining a purchaser’s residence at the time the securities are sold;
- Require issuers to obtain written representations from purchasers regarding their residency at the time of sale;
- Define the residency of a non-natural purchaser (such as a corporation) as the location where it has its principal place of business;
- Restrict resales made in the first six months after the initial sale to just persons residing in the state of the offering;
- Provide an integration safe harbor for any prior offers or sales of securities and certain subsequent offers or sales of securities; and

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- Prescribe disclosure in the offering documents and a legend required on all stock certificates (or other document evidencing the security).

## Amendments to Rule 504

Rule 504 provides an exemption from registration under the Securities Act to any company that is not a reporting company under the Securities Exchange Act of 1934, as amended (“Exchange Act”), an investment company or a blank check company and allows such companies to offer and sell securities not exceeding \$1 million in any twelve-month period. Unlike Rule 506 of Regulation D, companies that rely on Rule 504 of Regulation D are still subject to state regulation requirements in all states where offers and sales are made. In order to assist companies in raising capital, the SEC amended Rule 504 to increase the aggregate amount of securities that may be offered and sold in any twelve-month period from \$1 million to \$5 million. The SEC also repealed the rarely used exemption in Rule 505 of the Securities Act<sup>1</sup> because the increase in the Rule 504 threshold rendered the exemption obsolete. Similar to Rule 506 of Regulation D, the new amendments will disqualify certain bad actors from participating in Rule 504 offerings, providing more consistency and uniformity throughout Regulation D.

## Conclusion

The recently adopted final rules regarding Rule 147 and Rule 147A will be effective on April 20, 2017. Amended Rule 504 became effective on January 20, 2017. In addition, Rule 505 will be repealed as of May 22, 2017, and thus, companies will no longer be able to rely on that exemption. If you would like more information regarding these final rules and how they may apply to your company, please contact a member of our firm’s Securities Group at 585-232-6500. ■

<sup>1</sup> Rule 505 of the Securities Act exempted offerings of \$5 million or less provided securities were sold to no more than 35 non-accredited investors.



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