

INSIGHTS

SEC Amends Rules Affecting Intrastate and Small Exempt Offerings

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By: [Jason M. Jean](#)

On October 26, 2016, the Securities and Exchange Commission (“SEC”) announced amendments to certain rules exempting intrastate offerings and other limited offerings from federal registration requirements. The SEC modernized Rule 147, added new Rule 147A, increased the offering ceiling for Rule 504 and repealed Rule 505. We’ve summarized the amendments below, and the SEC’s adopting release can be found [here](#).

These amendments and new rule are consistent with recent efforts by the SEC to assist smaller companies in accessing capital while maintaining the SEC’s public policy objective of investor protection.

Rules 147 and 147A – Intrastate Offerings.

Section 3(a)(11) of the Securities Act of 1933, as amended (the “Securities Act”), provides an exemption from registration for securities offered and sold to persons resident within a single state if the issuer does business in such state and is organized under the laws of such state. Rule 147 promulgated under the Securities Act was adopted to provide objective standards for issuers seeking to rely on Section 3(a)(11). The amendments to Rule 147 are designed to modernize the safe harbor and make its terminology and manner of sale requirements consistent with the more expansive exemption now available through new Rule 147A.

The SEC adopted new Rule 147A pursuant to its general exemptive authority under Section 28 of the Securities Act. Rule 147A will be essentially the same as amended Rule 147 except that (i) issuers need not be organized under the laws of the state where the offering takes place so long as they can demonstrate the in-state nature of their business and (ii) *offers* may be accessible to out-of-state residents, so long as *sales* are limited to in-state residents. The new rule will allow companies who are incorporated in one state, but transact their business in another state, to utilize the exemption in the state where their business is focused. It will also allow for more flexibility in the use of online communications where an issuer might previously have been worried about inadvertently offering the securities to an out-of-state resident.

To qualify as “doing business” within a state, an issuer must satisfy one of the following requirements:

- Derive 80% of its consolidated gross revenues from operations or real property within the state;
- Hold 80% of its consolidated assets within the state;
- Intend to use and use at least 80% of the net proceeds from the sale made pursuant to the exemption in connection with the operation of a business, the purchase of real property, or the rendering of services within the state; or
- Have a majority of its employees based in the state.

Both the amended Rule 147 and the new Rule 147A include manner of sale requirements, such as the inclusion of a prominent legend, as well as a mandate that issuers require each purchaser to submit written representations as to his or her residency or its principal place of business. Both rules also state that an issuer who conducts an intrastate offering pursuant to either rule will not be able to conduct another subsequent intrastate offering pursuant to either rule in a different state for a period of six months.

The above amendments will become effective 150 days after publication in the Federal Register.

Rules 504 and 505 – Small Offerings.

Rule 504 and former Rule 505, each promulgated under the Securities Act, were adopted by the SEC pursuant to Section 3(b)(1) of the Securities Act, which provides that offerings of limited size and character may be exempt from registration requirements. Rule 504 provides an exemption from registration for small offerings made by issuers that are not reporting companies, investment companies or blank check companies. The amendment to Rule 504 increases the aggregate amount of securities that may be offered and sold pursuant to Rule 504 in any twelve-month period from \$1 million to \$5 million. The amendment also disqualifies certain bad actors from taking advantage of the exemption. Because the increased aggregate offering ceiling under Rule 504 will diminish the utility of Rule 505 (which previously provided for a very similar \$5 million limited offering exemption), the SEC has chosen to repeal Rule 505.

Amended Rule 504 will become effective 60 days after publication in the Federal Register, and the repeal of Rule 505 will become effective 180 days after publication in the Federal Register.