



The Revised Regulation D Rule 504 Exemption-Bigger And Better

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The Securities and Exchange Commission adopted final rules on October 26, 2016 modifying certain intrastate and limited offering exemptions. The final rules affected Rule 147¹, as well as Rule 504 and Rule 505 of Regulation D (“Regulation D”), each under the Securities Act of 1933 (the “Act”). This Client Alert focuses on the amendment of Rule 504, which increases the aggregate offering price of securities in offerings under Rule 504 from \$1 million to \$5 million in any 12-month period. Along with the amendment of Rule 504, the final rules also repeal Rule 505 of Regulation D under the Act, whose provisions are further described below.

Background

Historically, both Rules 504 and 505 were exemptions from registration for offerings of limited size and character. Rule 505 had provided a safe harbor for offerings of up to \$5 million in any twelve month period in an offering that could be sold, subject to restrictions on advertising (or “general solicitation”), to an unlimited number of accredited investors, and no more than 35 non-accredited investors. Rule 504 had a \$1 million limit but no limit on the number of investors or whether they were or were not accredited. However, Rule 505 had the added burden of the expansive disclosure requirements of Rule 502(b) in the event any unaccredited investors were part of the offering. Rule 504 did not include any specific disclosure requirements.

Revised Rule 504

With the increase in the offering limits of Rule 504, Rule 504 becomes a much more useful exemption. An issuer that is eligible to utilize Rule 504² can now include in an offering of up to \$5 million (in any twelve month period) any number of investors (accredited or not) without Rule 502(b)’s specific disclosure requirements. These disclosure requirements are expensive to comply with and have proven incompatible with small offerings which include non-accredited investors. Now without these disclosure requirements but with a more robust maximum offering size, Rule 504 may end up being a more useful exemption for companies seeking to include unaccredited investors in funding efforts. The adoption of the final rules with regard to Rule 504 serves to eliminate the need for Rule 505, whose only historical advantage was its higher maximum offering limit. The amendments to Rule 504 also subject issuers to Rule 506(d) bad actor disqualifications, providing additional investor protection.

¹Rule 147, and a new companion Rule 147A, deals with intrastate offerings.

²Ineligible issuers are reporting companies under the Securities Exchange Act of 1934, investment companies and development stage companies with no specific business plan or whose plan is to combine with an unidentified business.

Rule 504 historically permitted (and continues to permit), under limited circumstances, public solicitation of investors where Rule 505 did not. The limited circumstances are when the offering is registered under state law or when the offering is permitted under a state law that allows general solicitation solely to accredited investors. Aside from these limited circumstances, the utility of Rule 504 remains confined to offerings conducted without the use of general solicitation.

Coordination with State Blue Sky Laws

The Rule 504 offering exemption does not, however, preempt state blue sky laws as does Rule 506 of Regulation D. Thus, an issuer utilizing Rule 504 needs to ensure that an appropriate state securities law exemption is available. Many states have an exemption for offerings to a limited number of purchasers when no general solicitation is involved. A few states have an explicit coordination to Rule 504 which provides a state exemption for an offering complying with Rule 504.

Amended Rule 504 becomes effective on January 20, 2017, while the repeal of Rule 505 becomes effective on May 22, 2017.

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