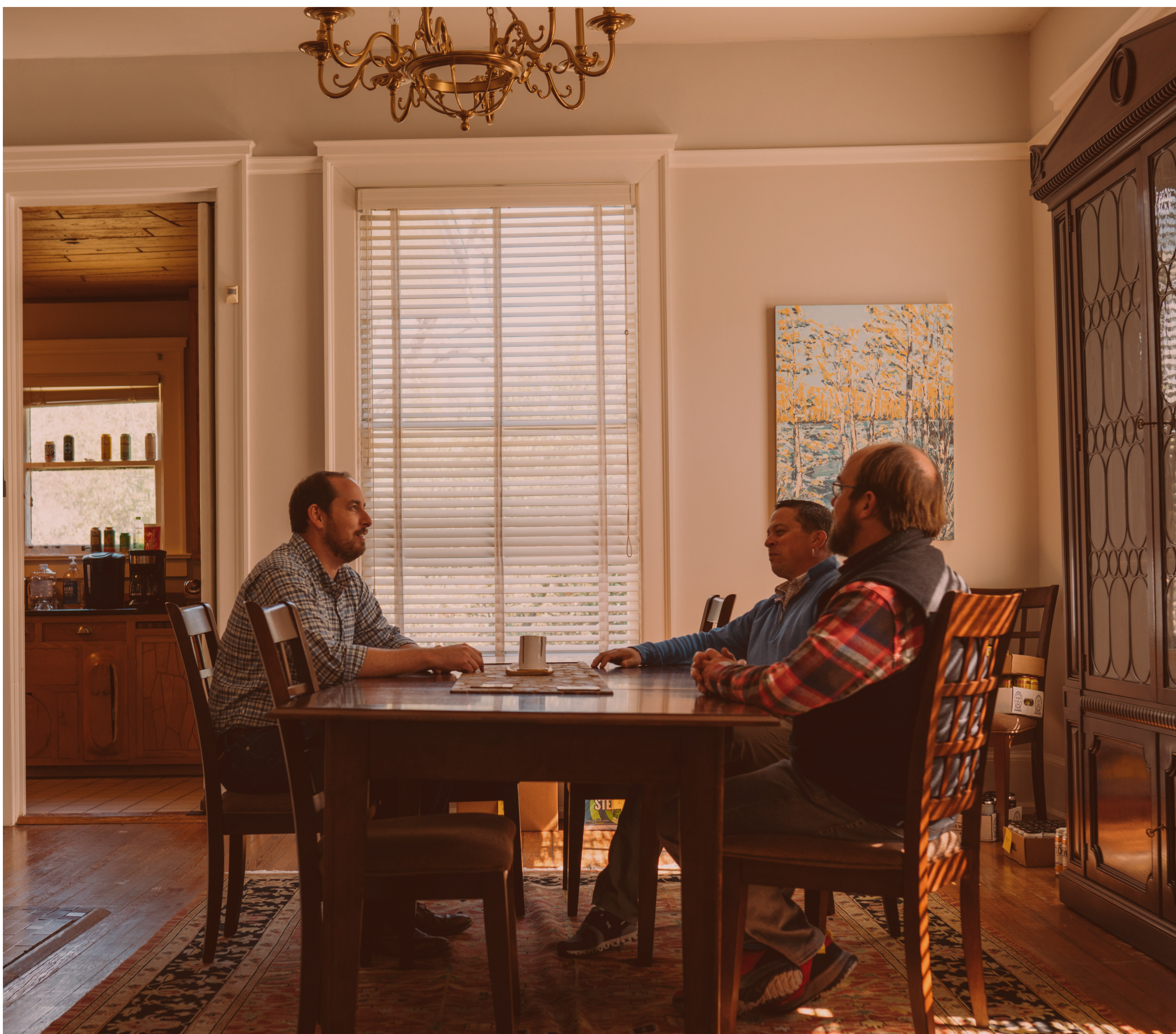
UNREGISTERED SECURITIES OFFERINGS

An unregistered offering is the offer and sale of securities in a transaction that is not registered with the Securities and Exchange Commission (the “SEC”) under Section 5 of the Securities Act of 1933, as amended (the “Securities Act”), in reliance on an exemption from registration under that act. The following provides an overview of the types of unregistered offerings commonly used as alternatives to SEC-registered offerings, with a focus on unregistered offerings by domestic issuers unless otherwise indicated.



WHY ISSUE UNREGISTERED SECURITIES?

Companies issue securities in private placements to avoid the time and expense of the registration process, including SEC review and prospectus delivery requirements. For non-reporting companies in particular, preparing a registration statement (including the required financial statements) and undergoing the SEC review and comment process to clear the registration statement can take at least four to six months. Preparing private placement documents usually takes less time.

Regardless of whether the issuer is a reporting or non-reporting company, it is often easier to document a private placement than a registered offering because there are limited specific disclosure requirements for private placement documents.

In practice, because the general standard for disclosure under the antifraud provisions of the federal securities laws remains the same, parties seek to prepare private placement disclosure that closely resembles the disclosure required in registered offerings. Nevertheless, the limited specific disclosure requirements provides more flexibility in preparing private placement disclosure than the disclosure for registered offerings.

The success of a public offering depends on broad market demand for the securities. As a result, private placements are especially useful during market downturns. Issuers that may be unable to complete a broader public offering because of a lack of demand for the securities can choose not to register the offering and instead raise capital with a private placement of securities to a more limited group of sophisticated investors.

An unregistered offering allows an issuer to avoid liability specifically associated with SEC-registered offerings, such as liability under Section 11 of the Securities Act. In addition, an unregistered offering allows an issuer to limit its exposure to liability (particularly class action securities litigation) to the extent that securities are issued to a smaller number of institutional investors who are sophisticated market actors accustomed to assessing investments and fending for themselves.

However, some of the new registration exemptions created under the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”) provide for issuer liability under Section 12(a)(2) of the Securities Act.

TYPES OF ISSUERS AND SECURITIES

The type of issuer or security can affect the availability of particular registration exemptions under the Securities Act. Equity private placements are typically done by private companies. Examples include: a company's issuances of equity to its founders or a start-up company obtaining venture capital financing or just emerging from the venture capital stage.

Debt private placements are done by both public and private companies. Examples include: large capitalization public companies offering investment grade securities to institutional investors worldwide, companies offering investment grade notes to a small group of insurance companies, companies offering non-investment grade high-yield bonds or convertible notes to institutional investors or companies that have gone private and are trying to raise additional capital or finance their leveraged buyout.

Section 5 of the Securities Act requires all offers and sales of securities to either be registered or exempt from registration with the SEC. The two main sources of statutory exemptions from Securities Act registration are: Section 3 of the Securities Act, which exempts certain securities from having to be registered with the SEC, and Section 4 of the Securities Act, which exempts specific transactions in securities from registration.
The most commonly used exemptions are: (a) the issuer private placement exemption under: Section 4(a)(2) (formerly Section 4(2)) of the Securities Act, which provides a statutory exemption for "transactions by an issuer not involving any public offering"; and (b) Regulation D of the Securities Act (particularly, Rule 506 of Regulation D), which provides regulatory safe harbors for an issuer engaged in an unregistered offering.
These registration exemptions only exempt the initial unregistered sale of securities by the issuer. Any investors, including affiliates of the issuer, who buy these unregistered securities from the issuer and want to resell them to others must register their resale or have an available registration exemption.
The most common investor private resale exemptions are: (a) Rule 144A of the Securities Act, which provides a regulatory safe harbor for resales of unregistered securities to qualified institutional buyers ("QIB"s); and (b) the so-called Section "4(1½)" exemption, which is neither a statutory exemption nor a regulatory safe harbor, but rather a set of procedures developed by securities attorneys to permit limited resale transactions among sophisticated investors.

SECTION 4(A)(2)

Section 4(a)(2) provides a statutory exemption for transactions by an issuer not involving a public offering. It is not available for resales of these unregistered securities. While the term "public offering" has never been formally defined by the SEC, several factors have emerged from case law and SEC rulings establishing how transactions avoid involving a public offering for purposes of Section 4(a)(2):

- Sophisticated investors: Limiting offerees and purchasers to investors able (or deemed to be able) to "fend for themselves." Such investors are sophisticated enough not to need the type of information required in registered offerings to make an informed investment decision.
- Limited offerees: Limiting the number of offerees and purchasers to decrease the likelihood an offer is made to an unsuitable investor.
- No general solicitation or advertising: Prohibiting general solicitation or advertising of the offering by the issuer or anyone acting on behalf of the issuer. The SEC has reaffirmed that changes to Rule 506 of Regulation D mandated by the JOBS Act do not amend the Section 4(a)(2) exemption or affect this factor.
- Provide information: Providing offerees and purchasers with information about the issuer and the securities being offered.
- Transfer restrictions: Making the securities subject to transfer restrictions and placing restrictive legends on the securities to ensure the securities are purchased by suitable investors who are aware they are buying restricted securities that cannot be freely resold to the public without registration or an available exemption. This requirement applies to the purchasers who initially buy from the issuer, as well as investors who buy the securities in private resales later.
- Not for resale: Requiring investors to buy the privately placed securities for their own account, without a view to immediately resell or distribute to others.
- Integration: Determining whether the issuer's private placement, when viewed together with the issuer's other similar offerings made closely in time and that are part of the same financing plan, could be integrated into a single offering and would not, therefore, qualify for the Section 4(a)(2) registration exemption.

These factors, while helpful, do not provide clear direction to issuers on how to conduct private placements. As a response, the SEC adopted Regulation D to provide issuers with more certainty in conducting a valid private placement

REGULATION D

The issuer can offer any type of debt or equity security in a Regulation D private placement. Regulation D contains four regulatory safe harbor rules, each with its own offeree qualifications and limitations.

Rule 504 exempts offerings with an aggregate price of up to $1 million during any 12-month period. Rule 504 does not limit the number of investors or impose any sophistication requirements on the investors participating in the offering.

Rule 505 exempts offerings with an aggregate price of up to $5 million during any 12-month period. Rule 505 permits an unlimited number of accredited investors (which include most institutions, high net worth individuals and entities with at least $5 million in assets) and up to 35 non-accredited investors to participate in the offering.

Rules 504 and 505 were adopted to help small businesses raise capital. Their $1 million and $5 million respective caps, however, impact their utility in practice because they constrain the amount of capital that a company can raise at one time.

Rule 506(b), like Section 4(a)(2), does not limit the amount of capital an issuer can raise in a private placement. Also, it permits an unlimited number of accredited investors and up to 35 non-accredited investors that are sophisticated investors to participate in the offering. The absence of a cap and generous accredited investor base makes Rule 506 an important safe harbor. Any issuer, whether it is a reporting or non-reporting company, can use this safe harbor to issue any type of debt or equity security. This has been the most commonly-used method of ensuring that a private placement has a valid Section 4(a)(2) exemption.

Rule 506(c) does not limit the amount of capital an issuer can raise in a private placement. It permits an unlimited number of accredited investors but prohibits any non-accredited investors from participating in the offering. In addition, Rule 506(c) permits the use of general solicitation during the offering as long as the issuer takes reasonable steps to verify that each purchaser is an accredited investor. Any issuer can use this safe harbor to issue any type of security as long as it satisfies all of the conditions of the rule.

Regulation D requires an issuer (whether or not it is a reporting company) to file with the SEC a notice on Form D no later than 15 days after the first sale of securities made under Regulation D. At the same time as it adopted new Rule 506(c), the SEC also proposed additional changes to Regulation D, including changes to Form D requirements.

RULE 144A

The field of private placements has been transformed by Rule 144A, a rule initially adopted by the SEC in 1990. Rule 144A provides a safe harbor for persons other than the issuer to resell certain eligible securities to institutions reasonably believed to be QIBs. The rationale behind Rule 144A is that by limiting sales to the most sophisticated investors, many of the mechanisms designed to ensure compliance with resale restrictions on privately placed or unregistered securities are unnecessary.

Rule 144A is only a resale safe harbor. However, the term "Rule 144A offering" is often used to refer to offerings that typically rely on the following two steps:

- An issuer private placement of securities to one or more investment banks or broker-dealers, called initial purchasers under Section 4(a)(2) or Regulation D.
- Resales of those securities by the initial purchasers to QIBs under Rule 144A. In these resale transactions, the initial purchasers act in substantially the same role as the underwriters of an SEC-registered offering. However, offers and sales to QIBs that comply with Rule 144A are not deemed to be "distributions" for purposes of the statutory underwriter definition that would require Securities Act registration.

Rule 144A is important because it permits a financial intermediary to buy unregistered securities from an issuer on a firm commitment basis and resell them to an unlimited number of QIBs in transactions that comply with Rule 144A.

SECTION "4(1½)"

Before the SEC enacted the Rule 144A safe harbor, securities attorneys developed the Section "4(1½)" resale procedure to permit unregistered resales among sophisticated investors, such as institutional accredited investors (“IAI”s). This resale procedure is not formally established by any written SEC rule or regulation. It has developed over time and is only discussed in case law.

Since Rule 144A was enacted, this resale procedure is used less frequently. Often, its use is relegated to when Rule 144A is unavailable (because either the securities are fungible with the issuer's listed securities or the purchaser does not qualify as a QIB). To use the Section "4(1½)" resale procedure, a seller often relies on procedures applicable to issuer private placements under Section 4(a)(2) and Regulation D.

WHO CAN BUY UNREGISTERED SECURITIES?

The basic premise of most unregistered offerings is that only sophisticated investors who are able to "fend for themselves" can buy these securities. Investor suitability looks to whether an investor needs the type of information required in a registered offering to make an informed investment decision. Potential investors must have the knowledge and experience in financial and business matters to evaluate the risks and merits of the proposed unregistered offering.

The Securities Act registration exemptions recognize the following as sophisticated investors:

- QIBs. The most important category of QIBs includes any bank, savings and loan association or other institution that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers not affiliated with the QIB and have an audited net worth of at least $25 million.
- Accredited investors. These include IAIs, registered broker-dealers and key employees of the issuer.

The type of sophisticated investors permitted to buy unregistered securities depends on the registration exemptions being relied on and the structure of the transaction. For example, securities eligible for resale under Rule 144A of the Securities Act can only be sold to QIBs, certain types of securities may be sold only to IAIs and certain offerings of limited partnership interests are typically sold only to high net worth individuals who qualify as accredited investors.

HOW ARE THESE EXEMPTIONS USED?

Because of the advantages of conducting unregistered offerings, a fluid private placement, resale and offshore securities market has developed that relies on the registration exemptions noted above. How an unregistered offering is structured depends on the type of securities being offered, the registration exemptions being relied on and the time frame involved.

The most common unregistered offerings to institutions in capital markets include: traditional private placements of debt or equity securities sold to a limited number of institutional investors under Section 4(a)(2) or Regulation D; Rule 144A offerings of eligible debt or equity securities to large institutional investors, with disclosure, documents, due diligence and other practices that closely resemble registered offerings; and, continuous or periodic offerings of short- and medium-term debt securities, such as medium-term notes ("MTN"s) or commercial paper, under Section 4(a)(2), Regulation D or Rule 144A.

HOW ARE THESE EXEMPTIONS USED?

TRADITIONAL SECTION 4(A)(2) OR REGULATION D PRIVATE PLACEMENTS

Issuers use Section 4(a)(2) or Regulation D to conduct so-called "traditional" private placements to a limited number of sophisticated investors. For example, issuers make private placements of long-term debt securities to insurance companies who obtain their investment funding from sources such as pension funds, trust funds and other accounts subject to fiduciary duties.

Issuers can also make private placements to individuals or groups of individuals who are sophisticated investors with whom they have a preexisting relationship. These private placements to individuals (rather than institutional investors) carry greater risks and demand careful offering procedures, controls and documents.

RULE 144A OFFERINGS

Rule 144A offerings are widely used by issuers to offer debt securities and certain convertible securities. Public companies do not typically offer common stock in a Rule 144A transaction because their common stock is already listed on a securities exchange and Rule 144A is unavailable for securities substantially identical to or fungible with or of the same class or series as any listed security.

IMPACT OF THE JOBS ACT

On April 5, 2012, the JOBS Act was signed into law by President Obama. The purpose of the JOBS Act is to expand and ease methods of capital raising by, and relax the regulatory burden on, smaller companies. Title II of the JOBS Act, Access to Capital for Job Creators, directs the SEC to issue rules eliminating the prohibition against general solicitation and general advertising under Rule 506 and Rule 144A.

In particular, Section 201(a)(1) of the JOBS Act directs the SEC to revise Regulation D by July 4, 2012 to:

- Remove Regulation D's prohibition on general solicitation and general advertising in offerings and sales made under Rule 506, provided that all purchasers of the securities sold in these offerings are accredited investors.
- Require issuers to take reasonable steps to verify that purchasers are accredited investors, using methods that the SEC determines. Currently Rule 506 of Regulation D provides that if an issuer sells securities to a purchaser the issuer reasonably believes is an accredited investor, that sale will count as a sale to an accredited investor even if it turns out the purchaser was not, in fact, an accredited investor. This is because the issuer's reasonable belief is built into the definition of accredited investor contained in Rule 501(a) of Regulation D.

In addition, Section 201(a)(2) of the JOBS Act directs the SEC to amend Rule 144A by July 4, 2012 to permit securities sold under Rule 144A to be offered to persons other than QIBs, including through general solicitation or general advertising, provided the securities are sold only to purchasers whom the seller reasonably believes to be QIBs.

AMENDMENTS TO REGULATION D

On July 10, 2013, the SEC adopted final rules implementing Section 201(a)(1). The rule amendments created subsection (c) of Rule 506, effective on September 23, 2013. Rule 506(c) permits issuers to use general solicitation in Rule 506 offerings if three conditions are met:

- Each purchaser in the offering is an accredited investor (either because the purchaser falls into one of the Rule 501(a) categories, or because the issuer reasonably believes the purchaser falls into one of those categories at the time it sells securities to the purchaser).
- The issuer takes reasonable steps to verify that each purchaser is an accredited investor. The amendments do not require specific verification procedures. However, Rule 506(c) offers non-exclusive, non-mandatory steps that an issuer can take to verify that a natural person is an accredited investor. In addition, the final rules release discusses other considerations, factors and weights that an issuer can evaluate in taking reasonable steps to verify purchasers' status.
- All other terms and conditions of Rule 501, 502(a) and 502(d) are satisfied.

Importantly, the pre-existing Rule 506 safe harbor is preserved. This means that issuers can choose to either comply with Rule 506(c) or conduct offerings without general solicitation in compliance with Rule 506(b). An issuer might choose to comply with Rule 506(b), for example, because it wants to sell securities to non-accredited investors, finds the additional verification steps burdensome or simply does not need or want to market its offering through general solicitation.