FINAL TRANSCRIPT

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**ACC - The Essential Elements of Private Securities Offerings

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Brian Craig - *Lockheed Martin Corporation - Assistant General Counsel*

Hello. Good afternoon, everyone. My name is Brian Craig and I'm a member of the ACC's Business and Securities Committee. It is my pleasure to introduce this afternoon our experts, who will tell us about the essential elements of private securities offerings. Scott Meza will lead the discussion today. Scott is a partner with Mintz Levin in the Reston office for the firm. He practices in business and finances. Scott also has extensive experience in financing for companies from seed stages through the IPO stage.

During the presentations, please direct questions to Scott at his email address, smeza@mintz.com. Also joining Scott today is David Fuentes, who works with Scott in the Reston, Virginia office. He also advises clients on business and securities law matters, with an emphasis on private equity and debt financing, including venture capital transactions. Gentlemen, take it away.

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

Thank you, Brian. This is Scott Meza. Good afternoon, everybody. I have no idea whether I'm talking to a massive audience or a few people, but hopefully what we're about to say will be of some use. I'm not also sure of what the experience level of our audience is today. I assume that we've got some attorneys who are in-house with private companies that may be periodically raising equity through private sales of stock.

I'm sure that there are also some people that also work for public companies where private offerings are still relevant, maybe not the bread and butter of what they do other than perhaps the occasional PIPE which we'll talk about briefly. But hopefully there will be something here that everybody can find of value. I know, for example, if you represent a public company, sometimes it's useful to know the rules regarding private security offerings because you may be acquiring. You may have a target company that raised a significant amount of money out of their private offerings and you may want to make sure that they did it the right way since you may be inheriting some of their security's risk if they didn't.

So in any event, welcome. This is going to be a very broad scope, but we're going to give you a general introduction to some of the essential legal principals of private securities offerings, focusing principally on Regulation D offerings. The devil is always in the details, but we're hopeful that this will give you some signpost to spot issues and understand what some of the principal concerns could be and then consult either internally or with your outside counsel to try to fine tune some of these things.

As Brian mentioned, there will be a question-and-answer--there'll be questions, I can't promise what the answers will be. But if you want to submit them, Brian gave my email address, smeza@mintz.com. I don't know how much time we'll have today to try to answer questions, but people are more than welcome to email me or David after the discussion or to give us a call. My main number is 703-464-4800.

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So, let's start by just going to the very high level. I'm now on slide 3. Overall as you guys probably know Section 5 of the Securities Act of 1933 basically says when you offer to sell security you need to register it with the SEC unless that offer is exempt from the registration requirements of the Act. These rules generally apply not just to the sales of securities but to the actual offer. Even an offer that's not consummated with a sale is subject to most of these requirements. When we talk about a securities offering in sale it used to be a more academic interest whether--what is a security.

Well I think in the world that we all live in, what a security is is pretty easy to identify, I mean a security subject to the Act. It's obviously stock, it could be common stock it could be a preferred stock that has any features that resemble equity whether it's a dividend a liquidation, a voting right. It can also be instruments that are convertible into equity. Debentures that convert, warrants, even employee stock options are securities and as you'll see in a minute they're covered under a particular part of the securities laws. And sort of the last admonition at this enormously high level is don't forget about the State laws.

Unfortunately there's relatively pre-emption of State Securities Laws by the federal securities laws so when you do a private offering you need to make sure that you are compliant with the State's securities laws referred to frequently as "blue sky laws" which differ from state to state. We'll try to give you a little heads-up on that later in the discussion.

Just again at the overview stage, if you guys will turn please to Page 4, the fourth slide, this is just simply a summary of what will essentially be the exemptions from registration that are generally available to a U.S. issuer selling to U.S. investors or offering to sell to U.S. investors. They're listed here, Regulation A, we're not going to talk about, that's the small public offering exemption. It's really for offerings of no more than 5 million over a 12-month period. You can resell up to 1.5 million of securities under that registration statement. You basically file and offering statement with the SEC and the SEC eventually qualifies your statement.

It's not available to certain companies [non-34 Act] companies are not able to use that offering exemption. I've done a couple over the years it's not frequently done often because Regulation D and Rule 506 are much--so much simpler to follow, for an issuer. Rule 147 is an Intra-State Offering. In the modern day of commerce are extremely hard to meet the requirements which is you must be organized and do business in the State you're doing the offering in and your offerees must be located in that State. Just a very hard thing to pull off, its one of those things that occasionally you might find a company that can do that but I don't think it's a practical thing for most of the folks on the phone.

Regulation D we're going to talk about more, it's the most frequently used exemption under that Regulation, from registration. Probably because there are no disclosure filings required by the SEC other than generally a post-sell simple Form D you file, we'll talk more about that.

Section 4.2 is really a sale that's a public offering, but Regulation is really the Safe Harbor for Section 4.2, we won't spend any time on 4.2. Four.6 is a--I don't think it's a much--valued much anymore with Reg D, but it's for sales to accredited investors of up to $5 million and I think it's really rarely used as a result of Rule 505, that we'll get to.

The last one that should be of interest to a lot of people is Rule 701, that's an exemption for offering sales under compensatory benefit plans or compensation agreements with employees, consultants, directors. So frequently that's what your option plan when you do--if you're not a public company and you haven't registered your plan frequently your plan, your issuance of options and restricted shares, you're hopefully relying on that exemption.

So let's turn now to a little bit more detail. I'm on the fifth slide on Regulation D. I give you the CFR sites there these are Safe Harbors where the SEC has said if you do these things you don't have to worry about whether or not you should have registered your securities for sale with the SEC. Rule 504, very small, talk about that in a minute. It is of some utility frequently to early-stage companies who are just getting off the board and raising a little bit of walking-around capital, but the maximum offering of a $1 million in 12-months is obviously a severe limitation.

Rule 505, offerings up to $5 million and Rule 506 that we'll probably talk the most about because I think it's the most common, are unlimited offerings in size, but have limitations on who the offerees can be as does Rule 505. So that's meant nothing to be

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more than sort of a framework for the people on the phone to categorize things. Now we're going to try to fill in some of that framework with details.

So let's go to Rule 504 that's the next slide which is Slide 6. As a lawyer I do a lot of private equity work and a lot of venture capital, investment-banking type work and it's rare for me to find an early-stage company that maybe has matured to a mature company that somewhere down the line didn't sell shares, and knowingly or not, hopefully sell under Rule 504.

Here's how it works, again as I mentioned earlier, it's a $1 million exemption from shares offered up to $1 million, the aggregate offering price. That's the gross offering price, you can't sort of back out commission. Sell $1.1 million worth of securities, pay $200,000 in commission and say you met Rule 504. You did not because your gross offering price, in that example, was above $1 million.

It also doesn't cover resale of securities so if you've already go shares issued they're not going to be resaleable under Rule 504. Rule 504 is not available for 34 Act reporting companies, investment companies or blank check companies. It really was intended by the SEC to be for the earlier-stage, private companies who are not "seasoned issuers". You'll see some of the features are you could sell to an unlimited number of people, which is quite interesting there's no limit on that. And you can sell to non-accredited investors, we'll get to that later, you can sell to Moms & Pops and pension plans, to large investors and small and you don't even have to know that they are not only not accredited or whether they're sophisticated financially.

However, while there are an unlimited number of investors you cannot broadly advertise. You used to be able to do that on 504, there was an amendment several years ago that took away the right to engage in general advertising or solicitation to sell.

The second thing is that there is an exception to that and I think the last 2 bullet points on this 504 I want to make clear. Generally when you sell shares in a 504 offering they are restricted securities. The person who buys them may not freely resell those shares, however the limitation on general solicitation and on the restricted securities features of this has an exception if you're doing a registration that's made under State law, if you actually register your offering under State law you may be able to avoid those last 2 bullet points. Very technical exception but one worth considering if it's available to you.

Remember to with a Reg D, Rule 504 offering you can sell only up to $1 million and also the SEC looks back an entire year to see whether you made any other essentially exempt offerings in that prior year. If you did, and they aggregate over $1 million with your current offering, that rule is no longer available.

I've had people in my office before who told me they'd done a Rule 504 offering and actually they failed to qualify because they had done a smaller offering 9-months earlier. So it's just something for probably most of you not that relevant, but for the smaller company it can be a very flexible easy tool to do an acceptable, exempt offering, but it has its limitations.

The next one I want to talk about is on Slide 7, this is Rule 505. I'm going to turn it over to my colleague David Fuentes to talk about.

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Thank you Scott. If you turn to Slide 7 and Rule 505 there, this is an exemption that's used less and less for reasons we'll discuss in a minute. But one of the requirements is that 10(c), the $5 million maximum offering price, that's fairly straightforward. It's not available to certain investment companies and not available to certain companies that are disqualified under Regulation A of the Securities Laws. Basically those are, what is commonly referred to as "The bad boy provisions". If a company or any of it's officers, directors, stockholders that hold more than 10%, promoters, or if you're using selling agents of any kind, those individuals and the issuer, if they have been subject to any convictions, orders, judgements, from either a State agency or the SEC you will not be able to use that provision.

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Those are orders or convictions that relate to securities laws. Obviously you could take a look at Rule 262 under Regulation A and it enumerates specifically what's provided, but the gist of it is if there has been some bad acts relating to securities, for the issuer it goes back five years and for individuals, directors, officers it goes back as far as ten years in some cases. Then you will not be able to use Rule 505. Another requirement is that there may only be 35 non-accredited investors. There's an unlimited amount of accredited investors, but only 35 non-accredited purchasers can participate in a 505.

We'll discuss very briefly what accredited investor means in a couple of minutes. Worthy of mention, with respect to accounting of those 35 non-accredited, Regulation D does provide how that number can be calculated, namely relative, spouse, spouse of relative don't count so if a husband and a wife invest separately they count as only one non-accredited investor. Similarly for entities in which a purchaser purchases more--I'm sorry, owns more than 50% of that entity so an individual that may invest separately but also may invest in a family trust. That only counts as one, as well.

Another requirement is that there is no general solicitation or advertising per Rule 502(c). That's in essence what the private offering is, and Scott will talk in more detail what a general solicitation in advertising really means. There is a delivery requirement as far as what you need to deliver to accredited investors under a Rule 505 and that's spelled out under Rule 502. So non-accredited investors must receive substantive disclosure document per Rule 502. Technically, if you're offering it simply only to accredited investors, there's really no requirement that any information be delivered. But of course, that's rarely the case and Scott will discuss briefly on what you want to actually present to an investor.

The other item on here is that obviously Rules 505 offering of securities issued under that are restricted securities. Securities that are acquired in the Reg D basically cannot be resold unless there is a registration or exemption from registration. An issuer has to exercise reasonable care to determine that there are no underwriters that are acting as purchasers. By underwriters in this case, I mean an individual or an entity that is going to buy shares with the intention of reselling that.

Very briefly, there are certain guidelines that are provided in Reg D, which the SEC has said "this demonstrates reasonable care," which is first that you ask the purchaser whether they are acting as an underwriter. That you disclose to them in writing that these securities are not registered and that they'll be subject to registration or exemption from resale, if they want to get rid of them. Thirdly, that there--on the stock certificate for the security that you're issuing, you put a legend, which is very commonly referred to as a 33 Act legend which specifies that it's an unregistered security and you have to register it or seek an exemption of registration for further transfer.

We can jump over to slide number 8 and Rule 506, 506 differs-- very similar to 505, but differs in two very important ways. The first is that there is no limit on offering size, absolutely no limit. Technically, it could be a billion dollars. There's no limit on that. The second is, with respect to the non-accredited investors that can participate in a 506. There is an added criteria that the investor has to have the knowledge and experience in financial matters, such that the investor is capable of evaluating the merits and risks of the perspective investment. Or the issuer needs to reasonably believe that at the time of sale. Those are the two big differences.

So really, if you look at Rule 505 and you look at Rule 506, you actually ask where are you ever going to use 505? And there is certainly differing opinions as to that. But in reality, the only real reason that you would tend to gravitate towards it would be that you get rid of the certification requirement. Of course, we'll discuss later that State securities laws are always implicated in even a private offering. So sometimes that one sole advantage even goes away if a State securities law requires that certification under a Rule 505.

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

And we're talking a little bit--this is Scott speaking-- a little bit about what kind of documentation, if you're representing, if your company is the issuer, what kind of documentation do you need to get from your investors not just to confirm they're accredited. But it's frankly a little bit more complex is that they are sophisticated. Because again, if you sell, if you have a 50, $75 million

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dollar offering and you sell to everybody and then one non-accredited investor you're going to have to know they're sophisticated and you're going to have some more information delivering requirements. So you really have to do your homework as to who you're offering and ultimately who your buyer is.

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Finishing up that slide, the same as 505 no general solicitation or advertising with the same delivery requirements as the 502(b) or is what you have to deliver to non-accredited investors. The securities are restricted as in the 505 and we'll discuss later there is a significant--in the opinion of many people, significant State securities law advantage. And as we'll see later there is a partial pre-emption of State law with respect to [inaudible] so to the extent that State can go in and actually regulate a [inaudible] offering is minimized.

Jumping to the next slide we can just talk about what an accredited investor actually is. You can find the definition under Rule 501 of Regulation B. Here and in Slide 9 it references certain special entities that--and aren't all that common, but are defined as accredited investors.

Jumping to Slide 10 we have a couple of accredited--types of accredited investors that are much more common, 501(c)(3) "organization, a corporation, partnership or other legal entities with total assets exceeding $5 million", but it's important to note that these entities cannot be formed for the specific purpose of acquiring securities. So an example would be you can't have a whole bunch of non-credited investors putting in money for the--into a corporation, as you'll all see, it's for the purpose of investing and an issuance.

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

An example of that that's useful is we represent some of these investor clubs of accredited investors who get together and make private equity investments in companies and will typically form a special purpose entity to make the investment. That entity, depending on the size of the investment, may have assets well in excess of $5 million, but because it's formed specifically for purposes of the targeted investment we really have to rely on a different definition for accredited status and that is that basically all of the equity owners of that special purpose entity are themselves accredited. So it's--you can look up the chain to get there, but it's frequent that we'll have people say I want to put together an investment group, I've got five or six wealthy friends and I want to get my nephews and nieces in on it as well. Well, it may be that one nephew or one niece whose not accredited, who owns an interest in that family LLC or partnership is going to blow the status of that whole organization--or that whole corporate entity or LLC as an accredited investor which of course can have catastrophic implications to the issuer whose trying to do a Reg D offering.

So if you're the issuer you've got to really look behind who your investor is if it's a corporation, we'll talk about that in a minute.

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Another one worthy of special note on Slide 10 in the middle is "director, executive officer or general partner" so even though that individual may not qualify as an accredited investor for other issuances if they're a director or executive officer of the company they are able to participate in that offering as an accredited investor.

Looking to Slide 11 we have the qualifications for individuals. An natural person with a net worth of $1 million. An natural person with an income exceeding $200,000 individually in each of the two most recent years or joint income exceeding $300,000 with a spouse, for the same years and there has to be the reasonable expectation of that same level of income in the current year. And I think those are pretty straightforward.

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Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

Right. Interestingly that--the category of a natural person with a net worth of at least $1 million, based on the run up of the stock market, I should mean of the housing market, there are quite a number of people that will now come to your office and tell you that they are accredited because their home is worth $900,000 and they've got a 401K with another $100,000 in it.

Well I tell you, that maybe correct, but if you're selling an ill-liquid investment to this person and this person does not have significant income you have to take into account while that persons accredited are they really--this is a practical judgement not a legal judgement, are they the right person to invest in your illiquid offering where they're going to have a long-term holding person and high risk of capital gains loss, losing their investment. So while these are rules that you can follow they're not a substitute for judgement about whose the right investor in your offering.

Okay, so let's move on to Slide 12 which is a subject that I guess probably a lot of you who have done any kind of private equity work are familiar with. Whether as an investor or as representing the issuer. We now understand under Reg D and under 506 and 505, the critical importance of someone being accredited versus non-accredited. Both because there are limitations on how many non-accrediteds you can sell to in your offering, that's a big reason to know if they're accredited or non-accredited because if you go over 35 of non-accredited you've blown it. But also because your information delivery requirements may be substantially less if you are selling, and we'll get to this later, only to accredited investors.

So this is really one of those key determinants that when you design your private placement, I always tell clients, If possible try to sell only to accredited because it makes your compliance life much easier. As well as it makes you less vulnerable to some person who really shouldn't be investing in speculative investments, losing their investment and being very unhappy, which can have bad implications for the company.

So if you take those as sort of warning or guidelines or the desirable objective, how do you find out about it? Well, if you've every done any kind of subscription agreement you always see the investor questionnaire which is attached, and that's referenced on Slide 12. Typically that should be prepared by your counsel, and depending upon what kind of offering you're doing, it will at least require the person offering to purchase your securities to check which of the accredited investor boxes he or she fits into. And if you're doing a 506 offering and they're not accredited that offering questionnaire also needs to elicit enough information for you and your client, your company, to make some reasonable assessment of whether this is a sophisticated investor.

I can tell you I've got a box full of investor questionnaires on the sophistication issue there's no absolute right thing to ask for, but typically you're going to want to know what their investment experience is. What kind of experience they have with private equity investments, what their own personal financial situation is, even though they're not "Accredited". What their familiarity with companies of your industry or your stage are. There could be a number of questions designed to elicit that this person is sufficiently sophisticated to make a--be able to make a reasonable judgement about the risk and the benefits, the merits and the risk of this particular private investment.

The SEC also says, you can't just rely on a questionnaire. The issuer has to have a "Reasonable belief that the target, the investor is accredited. Certainly where an investor self-certifies and says he or she is and signs that questionnaire affirming that he or she meets that status and acknowledging that the company is relying on the truth of that representation to include him in the offering is an extremely helpful fact. That I think probably shows the issuer had a reasonable belief.

However, I have had plenty of people come in my office, David has as well, to say well I don't know if Uncle Joe is accredited, but he'll sign the investor questionnaire because he really wants to get into my deal and he really trusts me. Again, if you know Uncle Joe isn't accredited and he gives you something saying he is, if this ever goes to an SEC Enforcement Action or if Uncle Joe has to rescind his offer and get his money back a year from now, the fact that you had reason to believe that he wasn't accredited will not be a helpful fact.

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So if you have some reason to doubt it either get more information or frankly don't sell to that person. It's probably not worth doing in light of the jeopardy it can place. I've done deals on both sides where a buyer, a public company buyer, is going back and literally apply our offering to confirm that all this stuff was done right and if it's not done right it can have adverse affect on the transaction or it's pricing.

The other thing I just want to say on this point is sometimes we use placement agents, finders, broker-dealers, accountants, lawyers to help us place an offering. You'll tell your outside lawyer, hey, if you can bring any investors in the deal here's some PPMs, see if you can find somebody. Well, your placement agent also has the obligation to confirm the investment status, the investor's status of a potential investor. And if that placement agent, on your behalf, does not do it right it doesn't relieve you from liability from having conducted an improper offering.

So if you use a finder a broker-dealer, they need to understand the rules of the road for your offering and you need to be satisfied that they're collecting and giving to you sufficient information for you to determine the status of your investor as accredited, non-accredited and/or sophisticated investor.

So that's sort of just the 30,000 foot analysis of the Reg D exemptions. We want to talk about some other things involving how you make the offering, what the Memorandum of Offering should look like and some other sort of gotchya's, some things to watch out for. Whether you're outside counsels managing the offering or not these are good things for you to be aware of. In my experience sometimes outside counsel doesn't know everything and it's your--presumably part of your job is to bring to bear to them, bring to their attention, things that may influence compliance, are some of the things we're about to talk about.

Let's turn to Slide 13, this is really a key issue that I think a lot of people are confused about, that's the integration of offerings. You'll remember David and I were mentioning earlier that, at least with respect to 504 and 505, and frankly Reg A and some of these other private offering exemptions, have dollar-amount limits. Remember they also have limits on accredited investors--non-accredited, excuse me, non-accredited investors.

Well what the SEC says is, we may reserve the right to integrate multiple offering. To treat one offering and another offer that you the issuer think are different, as essentially one continuation of the same offering and combine those offerings to determine, for example, how many non-accredited did you sell to? To determine, for example, how much money did you raise in your "offering." To determine whether, for example in 504, 505, whether you sold more than you were allowed to sell in that private offering. This can be deadly because Rule 502 of Reg D basically says that you have to comply with every aspect of a Reg D offering.

So if you've integrated two offerings and combined they don't meet the requirements you've blown, arguably, both offerings potentially as exempt offerings which creates lots of issues in terms of liability to the company. And makes it a lot harder in your next deal to represent, for example, to your buyer or your next investor that all your prior securities issuances were done in compliance with securities laws and Regulation D.

So the SEC has sort of said, we're going to give you what I guess we'll call a Safe Harbor, which says we typically will not integrate an offering that was more than six months prior to the current Reg D offering or an offering that occurred more than six months after your current Reg D offering. So as you can get outside those two bands of six months, while it's not guaranteed, you can have a higher assurance that you are not going to face that integration of offerings, you're offerings are combined as if they were one. You will therefore, hopefully, avoid the inadvertent combination offerings that blows your exemptions.

By the way, for some of you that have stock option plans, the good news also is that in that Safe Harbor, they don't count shares that are sold under employee benefit plans and stock option plans, generally, if those issuances were also exempt. So that's one you don't have to worry about typically in that six months before and after window.

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David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Scott, if I could just--I want it to be clear that when looking at this six-month window, it not only matters that there were no sales but also offers to make sales. So it's not like you've been trying to sell your stock for six months and nothing happens and then on the seventh month you finally sell and then you can turn around and say this is now a different offer. It really looks at--they will specifically provide that there be no offers for sale.

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

And that's a good point, David, and we started this presentation with reminding you that the Securities Act governs offers of securities, not just sales. And yes it is common, sometimes a company will have a--maybe an early-stage company or a company that's going sideways may have some difficulty closing an offering and may run it for a long period of time or may not have anybody buying and buy on the seventh month. So that's a good point, be aware of that, and hopefully as in-house counsel what you're doing is keeping a religious log of all of the offers and sales that occur in a time, place and securities sold, the terms, hopefully the underlying sales agreements because that's really your paper trail both to measure compliance and defend yourself from a claim that you've blown your exemption.

I want to make clear though, even if you're outside those six-month banns you--there's no absolute assurance that your not going to have an integration in a really extreme case, and I don't think its something typically you're going to see, and want to talk about. But if you're inside the six--the 12-months span, six months on either side of the deal therefore not qualifying for the Safe Harbor you're not necessarily automatically integrating your offerings. You still can rely on what I guess would be called the traditional integration analysis which is, and we've given you these factors to consider on Page 13 and 14, which are, are you--these are things the SEC and look at and say this is why I think your offering should be integrated or frankly why you'll argue it should not be.

Is it part of the single plan of financing? You see these companies that say, we're selling our common stock and our offering will be open for the next 12 months. Well that could arguably be a single plan of financing the company's practically admitting it is. With respect to the type of securities sold, if you're selling a common stock on month five and on month zero you're selling a Series A preferred with all the bells and whistles you've got an argument that because of the difference in the security being sold it should not be integrated.

Another example would be the closer the sales are in time, to peg a silly example, if you've got one offering on week one and six weeks later you close a second offering you're going to be more in trouble than if there were five months separating those events. The last one is, I thought, a little more obscure, for example were the sales made--the type of consideration being received. Well most companies are selling their shares for cash, but you can make an argument that if you for some reason did, for example, a merger and we'll get to minutes of mergers being securities offerings as well, and you can receive stock of a company as opposed to later you sold for cash that can be a difference to break up the integration connection.

And what you use the money for, well one was for buying out a lease and the other was for working capital, you can make those arguments. You probably don't want to be making those arguments if you can set it up so that it's in the Safe Harbor, but those are some rules to consider.

So moving along, I know we've got to fly here, I'm on Slide 15, the manner of the offering. I think we've talked a fair amount about no general advertising or solicitation. You're typically not going to be able to do an email broadcast of your offering, you're not going to be able to put an ad in the paper and these are all things you know instinctively if not by your own experience. One of the things people sometimes ask me is, well I always advertise, do I somehow have to stop advertising now just because they had a securities offering. I'm just advertising my product or my services. Obviously different rules for public companies, but in a private company, no, you can continue your normal advertising and solicitation that's unrelated to that offering.

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Let me warn you, we'll get to this in a minute, if you're using a finder, again, you have to make sure the finder is not buying your bag, making a broad dissemination of your offering proposal because that will blow your offering exemption. Because you will be engaged in general solicitation if that's what your finder or authorized broker-dealer, placement agent is doing.

There is by the way sort of a Safe Harbor--if you're using your employees and directors and affiliates, this is a bit dodgy, but to do your offering for you and they are--that's part of their job duties, they may have some latitude to get around some of the broker-dealer requirements that were going to--David's going to talk about a little bit, I'll let David do that.

Okay, lets move along to a subject that sometimes gets complicated for private companies which is, I want to use a finder to help me find investors, I don't have enough on my own or my broker-dealer has a great investor network, he loves my company, I really want to tap into his help in order to get my private placements sold. David, what are your thoughts?

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Well, I think the important thing here is just to be wary when we start using finders and brokers. And you know what's a finder, it's your lawyer-attorney, your accountant, or your friend, whomever can help you get financing. He can help you sell the securities and is that--is that illegal? No. Does there need to be some registration for it to be--to remain legal? Sometimes yes, and I don't think we want to get into the details of when registration is required as a broker-dealer for an agent or a finder who's acting on your behalf. But there's our federal guidelines, and there's also state so it's definitely something using a finder is extremely useful for a lot of companies but it's definitely something to look at, look at the state laws, look at the broker registration exactly what that broker is doing, the finder is doing can be determinant of whether that registration is necessary.

And why do you want to worry about that? Not because it blows the exemption because it will not if that broker is not registered. However you can be subject to liability under the Securities Act for those broker-dealer registrations under the various state laws you can be accused of aiding and abetting violation of broker registration. And under state law you could be required to offer a rescission to those individuals that purchase through that broker-dealer or to everybody in that state for whatever that particular state is that's coming down on--.

I think Scott mentioned some of the other stuff that you need to have and if there's still no general vilification or advertising. Here on the slide that says substantive, agrees existing relationship must exist--that's probably too strongly worded I think. But it is--it's a safeguard. It's a Safe Harbor. If that pre-existing relationship doesn't exist then you really need to--the same way if the officer or director was looking at it for investment, if a finder or a broker is out there doing the same and that relationship doesn't exist then you're on much thinner ice.

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

One of the things I do on this because it comes up time and time again with your emerging growth companies, your companies that are still actively raising equity through private sales and is want to use a finder, I really tell the company to--obviously have a written agreement with the finder or broker-dealer not just to describe what is their compensation or what's the methodology for determining their compensation whether it's layman formula or some other mechanism. But also to make it clear that they're making representations to you that they're either a registered broker-dealer or that what they're going to do on your behalf does not require registration.

And sometimes if you can you condition their ability to continue to participate in the offering and receive their fee subject compliance for that. I don't want to suggest that that gets you off the hook because you as the issuer always have the obligation to make sure that your agents are properly licensed and performing their jobs properly. But it certainly doesn't help if you ever get into a shoving match with your finder or broker-dealer who you find out was either improperly offering the--broadcasting your offering or who required registration in the state in which he or she resides and wasn't registered, it may entitle you to either get out of the contract or change the compensation terms of that intermediary. Or frankly get indemnification if it really

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goes south and an investor or the offering is impacted. And I think that's just again part of your reasonable paper trail for these types of relationships.

Okay I know we've got a really limited amount of time. We're going to fly through the rest of this. The next one, Slide 17 and 18 I really--it's hard for you to talk in the answer about what's you're going to--your Private Placement Memorandum. The area of broad provisions of the 33 Act require that you be full, fair and complete in your disclosures of material facts and not omit material facts.

But you get guidance under Reg D and the information that needs to be included in your Private Placement Memorandum by cross-references. And I see there's a cross--there's a mistake in cross-reference here. I apologize. If you look on Slide 17 the last bullet point should reference Regulation S-B. But if you go back and you pull out your Securities Reporter and cross-reference to Form S-B and Regulation S-B and Reg A, the narrative information, you'll get a decent idea of what should go in there. And, of course, your lawyer, outside lawyer if you don't do it yourself, should have examples of Private Placement Memorandums that will give you a good feel for what should be included.

You, by the way, need a controlled delivery of these PPMs. I frequently get them mailed to me on my desk. I think good practice says you should log all your Private Placement Memorandums, control who gets them and know who got them because I just think that's part of a clean and well-run offering is who gets your PPM. Also some of you may occasionally be asked to give legal opinions in connection with a private offering and I always am reluctant to do that unless I frame the issue very clearly and make certain clear assumptions of fact. Because at the end of the day a Reg D offering is a fact-driven transaction, and unless you know all the material facts are exactly what you think they are because potentially your opinion will be wrong. So just be careful on that.

David, let's talk just for a minute about something people so frequently fail to do which is filing their Form Ds.

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Yes, it's just important to remember that as part of Reg D filing, we need to file with a Form D and I'm on Slide 19 right now. And that typically would get filed 15 days after the first sale, and it's important to note that accepting amounts into escrow pending a certain per minimum investment or threshold investment is considered that first sale. Actually taking the money obviously is your first sale, but also just accepting a subscription agreement executed by the investor and you accept it and execute it and the money is going to come later, that's a sale. And so that triggers the filing requirement.

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

David, what is--? Is there any penalty or sanction if a company fails to timely file their Form D?

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Regulation D provides that and the entity is provided that it does not automatically blow up your exemption. So the recommendation hopefully is to get it in on time. Certainly it's not a very technical thing to file it on 16. You're not going do that but filing on 15 days is important not only just to comply with the federal law but also state laws which kind of brings me into number--Slide 20. These Form Ds very often need to be filed with the state laws--I'm sorry, with the state securities division and a lot of times you need to affirmatively say on your cover letter when that first sale in that state occurred.

So turning to Slide 20 very briefly the "Blue Sky" laws any time we have a Reg D offering there's going to be some corresponding state securities laws that apply. There's no uniform requirements, there's no--you'd be literally hacking out of every state that

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you are making an offering to or intend to make an offer into. Take a look at what exemption applies based on whether you can use a 504, 505, 506 and determine what's the route that you're going to do it.

In the case of 504, 505 it's extremely important to look ahead of time because there is sometimes pre-filing requirements in various states.

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

Are there pre-offering requirements or what?

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Pre-sale requirements to sign?

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

Yes.

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Pre-sale requirements.

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

So even though you haven't sold anything in that state if you want to sell in that state you have to file something. New York, for example, is very--can be very complicated and unpleasant with respect to "blue sky" compliance.

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

Yes. And some states require you to file a PPM ahead of time, and give them 15 days to basically review it, things of that nature. I want to make brief mention--limited offering exemptions. Many states have limited offering exemption for a very small number of people. Sometimes it's 10. Sometimes it's 25 so if you go into that state and you sell under only--you sell to only one individual or it's a limited offering that many of them are self-executing so you don't even need to file anything.

An example if you do a Rule 506 you may not need to file that Form D with that state because you have this self-executing limited offering exemption. And again that usually is the case if you have one individual or one state and one individual in another state things like that. It's important to note that the anti-fraud regulation and we talked before the broker-dealer regulation is still in effect regardless of whether--what kind of Reg D offering you're doing. I think it's worthy to mention the uniform limited offering exemption, which is now only used really for 505. It kind of mimics 505. It disqualify--opposite of the "bad boy" disqualification.

Here a lot of times and in any uniform limited offering exemption there's that suitability requirement that's injected again. So if you were trying to use 505 because it didn't have the 506 sophistication requirement now you have a similar type of requirement for non-accredited investors injected back in there. And also the uniform limited offerings that can provide the no commissions can be paid except to registered broker-dealers which again is talking about [inaudible].

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Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

So if you're relying on 505 and you have a finder who you're going to pay a commission to--that is a percentage of whatever he brings in, he's paid, you would no longer qualify for the united--for the limited offering exemption?

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

I'm not going to say, I mean [inaudible].

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

Okay I think it's an important fact that again a reason to think about how you use your finders.

David Fuentes - *Mintz Levin Cohn Ferris Glovsky and Popeo - Associate*

21, Slide 21 I want to talk very briefly and this is as I mentioned Rule 506 has significant advantages and that's because of the National Securities Market Improvements Act which basically preempted state regulation of Rule 506 to a certain extent. So for a 506 offering the state can file--can require you to file the Form D and most do. They can take a fee and most do. They can also have you consent or actually execute a consent as a for-service process so if you don't have a presence in that state you have to designate either a securities official or an attorney general, someone like that, that they can receive process and therefore you're subject to seat in that state. This is where the big advantage lies to 505. There's no other specific requirements that you need there's no other deliveries. There's no other--there's no pre-filing.

You should be careful some states versus--Scott mentioned New York does it have an offering pre-filing they really have an issuer pre-filing so even though it's a 506 they may maintain that you had a requirement to register as an issuer ahead of time. I mean you'll find--I know I've spoken in New York with various attorneys who disagree but it's something to be careful of. And again, this is the big advantage of 506 and why a lot of people, including myself, tend to steer people to 506 because you know that you can have your sale, do the sale, and go after the fact.

Scott Meza - *Mintz Levin Cohn Ferris Glovsky and Popeo - Member*

Okay let's go now to mergers and acquisitions, the next slide, 22. As I'm sure all of you know if you're doing a merger, a consolidation, some sort of business combination and your company is issuing its securities to the target company or a target company shareholders that is a stock issuance and it is subject to the Securities Act just as if you were selling to an outside investor for cash.

So you've got to--whenever you do an acquisition or you're being acquired you've got to do this securities analysis. And of course in some acquisitions you're going to make--it's going to be a public transaction. You're going to file a Form S-4. You're going to have your registration statement approved, and there will be that whole process just like when you register on an S-1 or S-3, a different registration form, but the process of the SEC approving your filing.

But many, many acquisitions, the majority by number anyways are done without formal registration, and you need to therefore really figure out what exemption is available for you to do your merger. One of the things--this is sort of well accepted is if you're doing--I'm just going to use the example of a merger. Let's just say our stock per stock exchange. It's actually re-org as a lot of you would be familiar with.

When you--you are deemed to have made a security offer if and when you submit that transaction to your shareholder--shareholders to approve or disapprove. At that point you're asking the shareholder to make an investment decision, and that's where the Securities Act would say show me an exemption from registration or you're going to have to go register.

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As David has pointed out in prior context, Rule 506 is the most frequently used Reg D exemption for this type of transaction partly because of its own limited size and partly because of its flexibility where there are no unaccredited investors.

And there are some--Rule 502 does specifically reference how this Reg applies to business combinations and it does require some additional disclosures. Excuse me, additional disclosures that you might not have in your normal Reg D offering to raise capital including giving your non-accredited investors a reasonable period of time to review the disclosure information you're giving to them and it asks questions of the company.

It has been my experience--excuse me, it's been my experience that one of the things a lot of companies end up regretting if they're a private company and they're building their company for acquisition or an acquisition comes to the extent you have a lot of non-accredited investors, let's say more than 35, you make it much harder to effect that transaction and usually a deal like that people are in a hurry to get it done. Maybe there's a lot of money on the table, and there you will see deals--we've done some recently where because there's too many non-accredited investors in the target you have to do--you may do some sort of share exchange with the accredited in a cash out merger to get rid of your non-accredited. But again I give you that example as an illustration of the importance of the distinction in those two terms when you're doing an M&A transaction trying to rely on a Reg D exemption to avoid registration.

You've got some of the same broker-dealer considerations we've talked about.

I think we're going to skip a PIPE. I think--we put the PIPE in here just as an example. We all have done them, and you know how complicated they can be but they are private offerings. The last sort of slides really if you look at like 25, 26, and 27 are really the cautionary slides to say, "Look, if you don't do these things right--we realize you may get--you have some risk." You may have risk for fraud. You know these anti-fraud provisions of the Securities Act. Those can result in civil sanctions, monetary damages.

The one that I see sometimes which is really very disturbing to a company is you may have a disgruntled investor who's not happy with how the company has done who wants his money back. In some cases violations of the Securities Act can give the investor a right of rescission with interest so that they can simply say, "I want my money back with interest." And if they can demonstrate a failure to follow the Reg D exemptions properly, qualify for them or they can show your disclosure statement contained materially untrue information or failed to disclose important information that should have been material to the investor's decision, you have real vulnerability. And, of course, any time you have to return a investor's money not only is that a financial burden potentially but it's a horrible precedent for the other investors in that round and a horrible precedent when you go out and try to raise money in your next round or when you're going to be acquired or when you're thinking about registering the company with an S-1 to go public.

So these are all things that--it's not brain surgery. The devil is in the details but there's lot of guidance, lots of rules well known. I find Reg D to be kind of understandable if you read it and it's interfaced with the Act. There's good guidance in SEC No-Action Letters and in case law. And practitioners in this area who have done it enough will have an instinct not just on the technical but sort of a feel for things, custom and practice as well as how close to the line should you go.

So hopefully this kind of transaction, this will give you some broader ideas about how to do things. I know we're out of time. If you've got any questions I'd be happy--David or I would be happy to answer them by email at any point after this program. Or if you want to give us a call at 703-464-4800 we'll gladly just give you some free advice if you've got a question or two about it. I hope this was helpful to everyone. I thank everybody for their patience and if we can be of any service please let us know. Thanks very much.

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