

FREQUENTLY ASKED QUESTIONS REGARDING ADVERTISING PRIVATE OFFERINGS

As of September 23, 2013, companies and their agents can offer their stock, membership interests, promissory notes and other securities using mailings, print advertising, billboards, television, the Internet, social media and other forms of general solicitation and advertising with registering those securities under the Securities Act of 1933 (the “Act”) as long as they comply with the requirements of newly added Rule 506(c) of Regulation D under the Act.

The following Frequently Asked Questions (“FAQs”) cover several basic questions you may have about how to capitalize on new Rule 506(c) to raise money for your company. These FAQs are not legal advice, however, and you should be sure to obtain legal advice tailored to your company’s specific facts and circumstances before beginning any offering of your securities. Our team of corporate attorneys stands ready to assist!

Please note that new requirements for Rule 506 offerings generally and for Rule 506(c) specifically have been proposed but have not yet been adopted and there is no assurance that the proposed requirements will be adopted. We make no undertaking to update these FAQs for any legal changes or developments, including any adoption of the proposed new requirements.

What are the basic requirements applicable to any Rule 506 offering?

The same definitions, limitations on resale and potential for integration applicable to companies relying on the traditional Rule 506 exemption prior to September 23, 2013 (renumbered as Rule 506(b)) will continue to apply to all offerings under Rule 506, as will the new “bad actor” disqualifications and disclosure requirements in newly added Rule 506(d).

We can help you determine if any of the disqualifications apply to you.

What additional requirements apply in a Rule 506(c) offering?

While you can talk with anyone about selling your company’s securities in a Rule 506(c) offering, you can only actually sell to purchasers that you have verified qualify as “accredited investors.”

What are “accredited investors”?

The term “accredited investor” is defined in Rule 501 under the Act.

Individual accredited investors are those with (i) net worth (individually or jointly with the person’s spouse) exceeding \$1,000,000, (excluding primary residence) (the “net worth standard”); or (ii) (a) individual income exceeding \$200,000 in each of the two most recent years or (b) joint income with the person’s spouse exceeding \$300,000 in each of those years, and in either (ii) (a) or (b) a reasonable expectation of reaching the same income level in the year of investment (the “income standard”).

Common entity accredited investors are (i) entities with total assets of over \$5,000,000; and (ii) entities other than irrevocable trusts whose equity owners are all accredited investors, although entities may also be accredited investors under many other standards.

How can I verify accredited investor status?

You must take reasonable steps beyond merely requesting that purchasers check a box in a questionnaire or sign a form to determine whether or not purchasers of your company's securities are accredited investors.

Each of the following steps is deemed reasonable, regardless of transaction, as long as you do not have knowledge that the purchaser is not an accredited investor at the time of purchase:

- For your current individual security holders who purchased their current securities in a Rule 506(b) offering (i.e., a traditional Rule 506 offering prior to September 23, 2013): obtaining a certification from such purchaser at the time of the new purchase that he or she qualifies as an accredited investor.
- For accredited investors under the net worth standard:
 - Reviewing one or more of the following types of documents dated within three months of investment:
 - For assets: bank statements, brokerage statements, and other statements of securities holdings, certificates of deposit, tax assessments, and appraisal reports issued by independent third parties;
 - For liabilities: a consumer report from at least one of the nationwide consumer reporting agencies; **and**
 - Obtaining a written representation from the purchaser that all liabilities necessary to determine net worth have been disclosed.
- For accredited investors under the income standard:
 - Reviewing any IRS form that reports the purchaser's income for the two most recent years (e.g., Form W-2, Form 1099, Schedule K-1 to Form 1065; Form 1040); **and**
 - Obtaining a written representation from the purchaser that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the year of investment.
- For any accredited investor: Obtaining written confirmation from one or more of the following persons or entities that such person or entity has taken reasonable steps within the prior three months to verify that the purchaser is an accredited investor: a registered broker-dealer; an SEC registered investment adviser; an attorney in good standing in all jurisdictions where he or she is admitted to practice law; or a CPA in good standing in the place of his or her residence or principal office.

Where an individual purchaser and his or her spouse are jointly qualifying for accredited investor status, any documents required above are required with respect to both the purchaser and his or her spouse.

Please note that the steps listed above are deemed reasonable, they are not meant to prevent you from devising other reasonable means of verifying accredited investor status. While we recommend using

the above methods where practical, we can also help you with reasonably verifying accredited investor status in other ways depending on the transaction and the type of investor.

What if purchasers do not want to give the above information due to privacy concerns?

Copies of the above information with purchasers' social security numbers and other personally identifiable information redacted suffice so long as all information needed to identify that the information provided is with respect to the purchaser and all information relevant to the appropriate standard (e.g., net worth, income) are given.

Are those the only ways I can reasonably verify accredited investor status?

No. The steps listed above are the only steps deemed to be reasonable but are not exclusive.

It is best to rely on the above steps when possible. If you intend to use other steps, you need to consider the following factors:

- The nature of purchaser and the type of accredited investor the purchaser purports to be;
- The amount and type of information you have about purchaser; and
- The nature and terms of the offering.

If a purchaser claims accredited investor status due to income, for example, you might review pay stubs for the two most recent years and the current year, or look at information about average compensation earned at his or her workplace at his or her seniority level, if publicly available. For example, the specific yearly compensation for certain individual executives at public companies may be disclosed in those companies' public filings.

If a purchaser claims accredited investor status due to license status (e.g., a business development company, an investment company, or a broker-dealer firm), you might look at public records re: licenses.

You can also rely on the verification of accredited investor status by third parties other than those listed above where the third party takes reasonable steps to determine accredited investor status and you have a reasonable basis to rely on that determination.

Should I keep adequate records on how I am verifying accredited investor status?

Yes, particularly if you are not relying on one of the deemed reasonable steps.

Can I still do a traditional Rule 506 offering?

Yes. If you are confident that you can raise the money you need without a general solicitation or advertisement (e.g., through friends and family, or through a registered broker-dealer firm) you can raise money under Rule 506(b). Please remember, though, that you can only accept 35 investors who are not accredited investors under Rule 506(b).

If I am currently doing a traditional Rule 506 offering, can I switch it to a Rule 506(c) offering?

Yes. You can choose to (i) continue your offering under Rule 506(b); or (ii) switch to Rule 506(c). General solicitations after switching to a Rule 506(c) offering will not jeopardize sales under the traditional offering occurring prior to the switch to Rule 506(c).

If I am using general solicitation and want to sell to non-accredited investors, can I switch from a Rule 506(c) offering to a Rule 506(b) offering?

No, since Rule 506(b) prohibits general solicitation and a Rule 506(b) offering would likely be integrated with any concurrent or immediately preceding Rule 506(c) offering, resulting in the loss of the 506(b) exemption and the potential loss of the 506(c) exemption to the extent that non-accredited investors were accepted.

Will I lose the ability to conduct a concurrent Regulation S offering (for sale to non-U.S. persons outside the United States) if I use general solicitations in a Rule 506(c) offering?

No. Concurrent Regulation S offerings will not be integrated with Rule 506(c) offerings.

Can I use Rule 506(c) if I am a private fund exempt from Investor Company Act (“ICA”) registration under Sections 3(c)(1) or (7) of the ICA?

Yes, private funds may use Rule 506(c) without losing either the ICA Section 3(c)(1) or (7) exemptions.

Am I free to pay finders fees for unregistered persons to find purchasers under Rule 506(c)?

No. General solicitation is allowed, but the rules on unlicensed finders remains the same. Anyone who receives compensation for finding potential purchasers in your Rule 506(c) offering still needs to be registered as a broker-dealer under the Act (and any applicable state laws) or comply with an exemption from registration.

For more information, contact Lynne Bolduc at (949) 788-8900 or lpb@oswald-yap.com.

This webpage relates to general summary information only and does not constitute legal advice. Facts and circumstances vary, and specific legal advice should be obtained in relation to any issues involving Rule 506 Offerings. We make no undertaking to advise recipients of any legal changes or developments.