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WHAT IS THE DIFFERENCE BETWEEN SECTION 4(A)(2) AND REGULATION D?

Section 5 of the Securities Act of 1933, as amended, requires all offers and sales of securities to be registered with the SEC unless there is an available registration exemption. Failure to comply with these requirements grants the purchaser a right to sue to rescind the purchase or seek damages against the issuer. The two most common exemptions provided for in the Securities Act are Section 4(a)(2) and Regulation D. Despite their common use, there is often confusion regarding the difference between these two key exemptions.

Section 4(a)(2)

Section 4(a)(2) exempts from registration offers and sales by the issuer that do not involve a public offering or distribution. These smaller, private offerings are often referred to as private placements. The exemption of Section 4(a)(2) only applies to that particular offering and does not exempt the private placement securities from potential registration in the future, including in the event of resale. An issuer is defined as any person who issues, or proposes to issue, a security. The Securities Act does not define the term public offering but relevant case law and SEC rulings have introduced a number of factors that help determine if an offering should be considered public:

- Whether the investors are suitable for the offering.
    - If the investors are sophisticated or knowledgeable about the investment, it is less likely to be a public offering.
- The number of investors.
    - The fewer number of investors in an offering makes it less likely to be a public offering.
- Whether there is general solicitation and advertising.
    - If the offering is advertised to the public, it is more likely to be considered a public offering.
- The information provided to investors.
    - Although Section 4(a)(2) does not require particular information to be provided to investors, the more information provided makes it less likely to be a public offering.
- The existence of transfer restrictions on purchased securities.

    - The fact that securities are subject to restrictions provides further evidence that this is less likely to be a public offering.

- Investor intent with regard to purchased securities.

    - Evidence that investors intend to quickly sell purchased securities make it more likely that the sale of securities is a public offering.

- Integration with other offerings.

    - Issuers conducting a series of offerings suggests that the sale of securities are more likely to be a public offering.

Although these factors are helpful, they do not provide certainty to business owners that their offer and sale of securities will be considered a private placement exempt from registration. Issuers who believe they qualify for the Section 4(a)(2) exemption are not required to file anything with the SEC and receive no confirmation of their exemption. Additionally, Section 4(a)(2) only provides a federal exemption to registration—state blue sky laws may still require registration with state agencies even where Section 4(a)(2) applies. To provide a safe harbor mechanism to reassure business owners that their offer and sale of securities is exempt from SEC registration, the SEC adopted Regulation D in 1982.

Regulation D

Regulation D provides several separate safe harbor exemptions from the Securities Act registration requirements under Rules 504, 506(b), or 506(c). Each of these rules comes with its own different qualification requirements and restrictions with respect to the offer and sale by the issuer. Regulation D as a safe harbor mechanism is non-exclusive, so failure under Regulation D does not mean that the offering is not exempt under another exemption, including Section 4(a)(2). Similar to Section 4(a)(2), securities sold under Regulation D are considered restricted securities and cannot be resold without registration with the SEC or qualification under another exemption. As a result of the National Securities Markets Improvement Act of 1996, exemptions provided under Rule 506 of Regulation D also provide the additional blanket exemption from registration requirements under state-level blue sky laws. This exemption from state blue sky laws does not apply to Section 4(a)(2) exemptions or to exemptions under Rule 504 of Regulation D. Unlike Section 4(a)(2), Regulation D allows for a filing with the SEC of Form D no later than 15 days after the first sale of securities made under Regulation D. The filing of Form D is not a condition to the availability of Rules 504, 506(b), or 506(c), however the SEC does incentivize filing and some state regulators view the filing of Form D as a requirement for a valid Rule 506 exemption for the security for the purposes of preemption from state blue sky laws.

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JAH Can Help

The attorneys at **JAH** are available to counsel you under Section 4(a)(2) or Regulation D so you can protect your business from potential liability under the **Securities Act**. Our **corporate attorneys** will navigate these complicated rules so that you don't have to. Click **here** to contact a member of our **Corporate Group** if you are in need of assistance.

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