

LEGAL UPDATES

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STEVEN R. BARRETT
CHATTANOOGA:
423.757.5905
STEVE.BARRETT@
HUSCHBLACKWELL.COM

DAVID E. GARDELS
OMAHA:
402.964.5027
DAVID.GARDELS@
HUSCHBLACKWELL.COM

MARY ANNE O'CONNELL
ST. LOUIS:
314.480.1715
MARYANNE.OCONNELL@
HUSCHBLACKWELL.COM

SEC Publishes Guidance on Regulation D - Accredited Investors

On January 26, 2009, the SEC released Compliance and Disclosure Interpretations on a number of issues under the Securities Act of 1933. Many of these SEC positions were available in the past (through no-action letters or in other formats). The SEC release compiled information on a number of key issues in one place, and clarified some open items.

Today's e-blast focuses on the SEC's guidance on "accredited investors" under Regulation D. The status of potential investors as "accredited" is crucial to an offering's exemption from registration. Any client considering a private placement will want to be familiar with the concept of accredited investors.

Director/Executive Officer

Director and executive officers of the issuing company are generally accredited investors, but the SEC offered additional guidance on interpreting that rule:

You determine accredited status at the time of investment. A director at the time of purchase who resigns two weeks later due to sudden illness is an accredited investor. Of course, any resignation that is part of an effort to evade Reg D voids the exemption.

Service as a director or executive officer of a subsidiary or parent of the issuing company does not confer accredited investor status.

Trusts

Trusts with total assets of less than \$5,000,000 are not accredited, even if the trustees and beneficiaries are accredited. The SEC confirmed the following methods for accrediting those smaller trusts:

A trust is accredited if a bank, acting in its fiduciary capacity, is the trustee and makes all investment decisions on behalf of the trust.

There are other situations where a revocable trust or an irrevocable trust may be accredited, if the trust meets a number of detailed requirements that the issuing company should review carefully.

Individuals

Under Regulation D, an individual investor may be accredited based on net worth or income (either alone or with a spouse). The SEC clarified a number of issues on calculating net worth/income:

An investor may include a spouse's assets to determine net worth even if they do not own the assets jointly and do not purchase the securities jointly.

An investor may include the value of a principal residence and vested employee stock options in determining net worth.

An investor may include vested contributions by an employer to a profit-sharing or pension plan in determining income, but may not include unrealized capital appreciation in such accounts.

An investor relying on the income test to qualify as an accredited investor must meet either the married couple income test or the single income test for all three years (and can't "mix and match" unless the couple was married only during a portion of the three year period).

An individual retirement account is accredited if the participant is an accredited investor.

Entities

Corporations, partnerships, and most other entities with total assets over \$5,000,000 are accredited, and the SEC has offered guidance on determining whether an entity meets that test:

A limited liability company with assets over \$5,000,000 is accredited (although Reg D does not specifically mention LLCs).

An entity may include assets of subsidiaries or affiliates in determining total assets only if those assets would be included in its financial statements under generally accepted accounting principles.

If **all** owners of an entity (even an individual holding only one share) are accredited, the entity is considered accredited, but you must "look through" to the natural person owners (past any entity that owns an interest) to confirm that those individuals are accredited.

The SEC's rules on determining accredited investor status can be complex, and the right answer is often not intuitive. If you are considering a private placement, please contact one of the following Securities attorneys:

HUSCH BLACKWELL

St. Louis office - Mary Anne O'Connell - 314.480.1715

Chattanooga office - Steve Barrett - 423.757.5905

Omaha office - David Gardels - 402.964.5027

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