Raising Capital Under the New SEC Rule 506 (c)

By Gisella Rivera

Effective September 23, 2013, issuers can use general solicitation and advertising in an offering of its securities provided that each and every purchaser is an accredited investor ("Rule 506(c)"). To satisfy its obligation to verify an investor's accredited investor status, an issuer can:

- if accreditation is based on income, request copies of IRS forms such as Form W2, Form 1099 and/or Schedule K-1 showing annual compensation for the two most recent years, and a written representation that the investor reasonably expects to earn the same level of compensation for the current year; or
- if accreditation is based on net-worth, request copies of bank statements, brokerage statements and other statements of securities holdings, certificates of deposits, tax assessments and appraisal reports issued by independent third parties to verify an investor's assets, a copy of a consumer report from either Expedia, Equifax or Transunion to verify an investor's liabilities, and a written representation that the investor has disclosed all liabilities (all documents should be dated no later than three months before the date of purchase of the offered securities);
- request written confirmation of the investor's accredited investor status from a registered broker-dealer, registered investment adviser, an attorney or a certified public accountant, each of whom has verified such investor's status no later than three months before the date of purchase of the offered securities; or
- for investors who had previously purchased the issuer's privately placed securities, a certification that such investors remain eligible as accredited investors.

If a purchaser of the offered securities subsequently turns out not to be an accredited investor, the offering will not lose its exemption from registration if the issuer can prove that it has taken reasonable steps to verify accreditation (such as the safe harbor steps described above) and did not know, at the time of the purchase, that the investor is not an accredited investor. To determine whether the steps taken to verify an investor's accredited investor status are reasonable, issuers should analyze the facts and circumstances of the purchaser and the transaction on a case-by-case basis…

Networking Opportunity for Chief Financial Officers

By Ira R. Halperin

Success is built on identifying a need and then meeting it. That is pretty much how the current CFO and

Financial Executive Committee got its genesis. “When we started the current committee about four years ago, you couldn’t really call it a committee,” says co-Chair Ira Halperin, “It was more of a forum.” Halperin, an attorney and CPA at Meltzer, Lippe, Goldstein & Breitstone LLP in Mineola explains that one day he and his good friend and client Manny Cafiero, CFO and General Manager of Scales Industrial Technologies, were discussing the issues Chief Financial Officers encounter on a day-to-day basis and their relative isolation from others who share similar job responsibilities.

A decision was made to reinvent the CFO and Financial Executive Committee as a round-table discussion. The Committee started small with some handpicked participants, but over four years has grown to more than 30 members. The meetings, which include a light breakfast, are free of charge and held monthly at Meltzer Lippe’s Mineola office. Around 15 members attend each gathering, including a core group of eight or so who rarely miss a meeting…

Directors Beware: It Could Happen to You!

By Ira R. Halperin

A recent decision of Delaware Chancery Court (the “Court”) has left many corporations and directors wondering whether their current bylaws are sufficient and clear enough to address certain indemnification and advancement issues. Generally, directors are protected to a great extent under a corporation’s bylaws, especially with regard to indemnification. Section 145 of the Delaware General Corporation Law (the “DGCL”) grants corporations vast power to indemnify directors, officers, employees and others against threatened, pending or completed legal actions; provided that the person being indemnified acted in good faith and in a manner reasonably believed by the person to be in the best interests of the corporation. Additionally, Section 145 of the DGCL allows corporations to advance payment of expenses to directors in defense of legal actions so long as the directors agree to repay the advancement if it is ultimately determined that they are not entitled to indemnification. Typically, corporations draft their bylaws to provide advancement rights to both current and former directors. It was this particular fact that led to the issues and important ruling in Schoon v. Troy Corp. (“Schoon”)…

Major Changes to Rule 144 - Small Businesses Rejoice

By Ira R. Halperin

On November 15, 2007, the Securities and Exchange Commission (SEC) voted unanimously to adopt several rule amendments designed primarily to enable smaller companies to raise capital more effectively and ease some of the historically burdensome reporting and disclosure requirements. In particular, the SEC adopted certain amendments to Rule 144 under the Securities Act of 1933, as amended (the Securities Act), most significantly the shortening of the minimum holding period from one year to six months for resales of "restricted securities" (securities acquired in unregistered, private sales from the issuer or an affiliate of the issuer, which is a person or entity who is controlling, controlled by or under common control with the issuer) of "reporting companies" (issuers subject to the reporting requirements of Section 13 or 15(d) of the Securities Act of 1934, as amended (the Exchange Act)).

Section 5 of the Securities Act generally requires that stock and other securities be registered with the SEC prior to their offer or sale, unless the transaction or the securities themselves are exempt from registration. Rule 144, originally adopted by the SEC in 1972, provides a safe-harbor setting forth when, and under what conditions, restricted securities may be resold into the public marketplace without registration under the
Securities Act…

Internal Control Guidance For Small Companies

By Ira R. Halperin

On July 30, 2002, President Bush signed into law the Sarbanes Oxley Act of 2002 ("SOX"). Rule 404 of SOX requires public companies to annually provide investors with an assessment of the quality of their internal control over financial reporting. Accelerated filers, typically large public companies, were required to comply with the requirements of Rule 404 for its first fiscal year ending on or after November 15, 2004. Smaller public companies, as non-accelerated filers, are required to comply with the requirements in their first fiscal year ending on or after July 15, 2007.

Much has been written about the tremendous cost, both in out-of-pocket expenses and the diversion of management's time and energies, which large companies have incurred in complying with these requirements. This has created much concern about the ability of smaller companies, which typically have significantly less financial and management resources, to comply, and the resulting impact on their businesses. In this regard, the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") has recently taken a step to aid these filers in meeting their obligations in complying with Rule 404.

In 1992, COSO published *Internal Control – Integrated Framework (the "Framework"),* a multi-volume report establishing a common definition of internal control. The *Framework* provides a means for organizations to assess and improve their control systems. The *Framework* has been widely accepted as the internal control standard for public companies and auditors trying to comply with SOX. However, after a flood of complaints that the *Framework* was not well suited for smaller companies, in January

2005 COSO initiated a project designed to provide guidance for implementation by these organizations(1)

In late October 2005, COSO released its exposure draft. In it COSO indicated that while there are some differences in approach, many of the techniques and concepts of good control are the same whether dealing with a large company or a small company. The exposure draft is intended to explain how smaller companies can achieve effective internal controls in a more efficient manner.

The exposure draft is not a checklist and does not suggest that the same set of controls must be implemented in every company or even would work for every company. However, the draft proposes twenty-six fundamental principles, derived from the five sections of the Framework (control environment, risk assessment, control activities, information and communication, and monitoring) that smaller companies should address in enacting an effective internal control system over financial reporting. The guidance includes examples of approaches that other companies have taken to incorporate the principles. COSO suggests that company management review the various approaches and consider the cost effectiveness of each to their organization.

COSO emphasizes that each individual company should determine the most appropriate and feasible methods for accomplishing each of the twenty-six fundamental principles. When a certain principle is not being met it should be discussed with top management and the company's board of directors to decide if the internal control implemented is effective. Achievement of these principles demonstrates that controls are in place throughout the company.

While the COSO report will not alleviate the Rule 404 compliance burden on small companies, it will at least provide guidance and a better understanding of the various approaches that these companies may consider. COSO is seeking comments on the exposure draft through the end of the year and hopes to issue final guidance during the first quarter of 2006.

The basic principles are:
Section 1 – CONTROL ENVIRONMENT

1. Integrity and Ethical Values;
2. Importance of Board of Directors;
3. Management's Philosophy and Operating Style;
4. Organizational Structure;
5. Commitment to Financial Reporting Competencies;
6. Authority and Responsibility;
7. Human Resources;

Section 2 – RISK ASSESSMENT

1. Importance of Financial Reporting Objectives;
2. Identification and Analysis of Financial Reporting Risks;
3. Assessment of Fraud Risk;

Section 3 – CONTROL ACTIVITIES

1. Elements of Control Activity;
2. Control Activities Linked to Risk Assessment;
3. Selection and Development of Control Activities;
4. Information Technology;

Section 4 – INFORMATION AND COMMUNICATION

1. Information Needs;
2. Information Control;
3. Management Communication;
4. Upstream Communication;
5. Board Communication;
6. Communication with Outside Parties;

Section 5 – MONITORING

1. Ongoing Monitoring;
2. Separate Evaluations;
3. Reporting Deficiencies;

Three additional principles have been identified by COSO relating to the roles that different parties play in the internal control. The roles and responsibilities are directly taken from the 1992 guidance.**Section 6 – ROLES AND RESPONSIBILITIES**

1. Management Roles;
2. Board and Audit Committee Roles;
3. Other Personnel.

1. PricewaterhouseCoopers was engaged by COSO to conduct the project. In addition, because of similar initiatives at the SEC and PCAOB, those organizations each provided observers to the project to ensure coordination.

Accredited Investor Today Not Tomorrow

By Gisella Rivera

Beginning July 21, 2010, who can buy and to whom companies can sell privately placed securities changed when President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Individual investors can no longer include the value of their primary residence when calculating their net worth for purposes of determining whether they are eligible, as "accredited investors," to purchase unregistered and unlisted securities issued by companies in private placements.

Under the U.S. Securities Act of 1933 (the "Securities Act"), an individual investor qualifies as an accredited investor when, at the time of purchase, he has a net worth (or a joint net worth with his spouse) that is at least $1,000,0002 or an income of $200,000 (or a joint income with his spouse of $300,000) in each of the two most recent years and has a reasonable expectation of reaching the same income level in the year of investment

This change is meant to address concerns by U.S. regulators that an increasing number of individual investors qualified as accredited investors primarily due to inflation and rising real estate prices. Regulators were apprehensive that individual investors to whom offers of privately placed securities were made did not have, at the time of purchase, the requisite sophistication and financial knowledge necessary to fully understand the risks underlying such investments…
