FisherBroyles

May/June 2019

Corporate Law Update

The Broad Reach of The Federal Securities Laws

The applicability of the federal securities laws can be surprisingly broad. The Securities Act of 1933 defines a “security” to include stock, bonds, notes, fractional undivided interests in oil, gas and other mineral rights, and “investment contracts,” which the Supreme Court analyzed in the Howey case to mean investments in a common enterprise with an expectation of profit solely through the efforts of a promoter or of someone other than the investors themselves. Under this interpretation, everything from cryptographic tokens to orange groves have been held to be securities, and LLC interests have also been held to be securities, often depending on the extent to which a purchaser is involved in the management of the company.

The securities laws can apply both to a public offering of securities, which involve investment bankers and SEC-filed registration statements (often hundreds of pages long), as well as to non-public offerings or private placements. Despite these vast differences, federal (and state blue sky) securities laws apply to both public offerings and private placements, even where a private placement involves only a few purchasers and a relatively small amount of money. As a result, a seemingly simple, routine transaction intended to raise (or sometimes borrow) capital, to start a business, to compensate employees with equity, or to issue cryptographic tokens, is generally governed by the federal securities laws. Ignoring such laws can lead to civil claims for damages and/or rescission rights (reversal of the sale), criminal action, injunctive prohibitions on future involvement with securities transactions, and major reputational damage.

Below are some high-level points that a company issuing securities should consider:

- **Name is not everything.** The name of the interest being conveyed is unimportant to its characterization; calling something a token or interest in a physical asset or promissory note will not prevent the application of federal securities law. The issuer should conduct an analysis of whether the interest being conveyed meets the definition of an "investment contract" under Howey.

• **Exemptions.** The transaction or the security itself must satisfy a specific statutory exemption under the federal securities laws if the securities transaction will not be registered or qualified.

• **Safe Harbors.** Several exemptions – known as safe harbors – from the requirements to register an offering, including Regulation D, Regulation A, and Regulation CF are the most commonly used, and procedures exist to facilitate compliance with applicable exemptions. These Regulations may, among other things, prescribe the scope of disclosure, the ability to engage in advertising and general solicitations, the number of permitted purchasers, the maximum amount that can be raised, and the applicability of blue sky laws.

• **Exemptions are less expensive.** Compliance with the safe harbors is almost always much less burdensome and expensive than a public offering.

• **Disclosure.** Where applicable, issuers should create written disclosures that are readable, accurate, and non-misleading, and should include (i) all relevant risks, (ii) an issuer's business plan and financial condition, and (iii) management's background and conflicts of interest, even when not explicitly required. The scope of disclosure may vary based on the sophistication of the offerees, the dollar value of the securities being sold, and other attributes of the offering.

• **General Solicitations.** While for many years using the means of general solicitation to reach potential investors through advertising were strictly off limits for private placements, in recent years the SEC has relaxed these prohibitions, allowing issuers to take advantage of the Internet to communicate with potential investors, subject to compliance with the applicable regulation.

• **Sale Restrictions.** Raising capital under Regulation D, Regulation A, or Regulation CF involves qualifying purchasers to ensure that potential purchasers possess the requisite financial capacity and expertise to reasonably understand and assume the risks of an offering. Sales to individual accredited investors as defined in the rules under the Securities Act of 1933 means selling only to individuals with a net worth (excluding the primary residence) of at least $1,000,000 or annual gross income of at least $200,000 (or $300,000 with a spouse).

• **Employee Exemptions.** Issuances of securities to vendors, employees, or contractors in return for their goods or services are subject to securities laws. Rule 701 is typically relied on as an exemption.

• **Cryptocurrencies and Tokens Can Be Securities.** Recent SEC pronouncements and lawsuits regarding the applicability of the federal securities laws to cryptocurrency transactions have implications for other cases as well. Our firm's view regarding application of the SEC's recent crypto pronouncement is important guidance for both crypto and general capital raising activity.

• **Do Not Ignore State Securities Laws.** In addition to federal law, securities transactions must not run afoul of applicable state laws. State blue sky laws can vary substantially by state and by transaction. Sometimes the state exemptions are self-executing (meaning no documentation needs to be filed or fee paid), but other times both documentary filings and fee payments are required. State regulators' communications should never be ignored.

• **Transfer Restrictions.** Securities acquired absent a public offering cannot be freely transferred but can only be transferred by complying with the rules regarding resales of restricted securities.

Contacts

If you would like additional information, please contact any of the following FisherBroyles partners:

Atlanta
Carl Johnston
carl.johnston@fisherbroyles.com
(404) 330-8179

New York
Michael Pierson
michael.pierson@fisherbroyles.com
(202) 445-3779

Chicago
Marty Robins
martin.robins@fisherbroyles.com
(847) 277-2580

Los Ageles
Marc Boiron
marc.boiron@fisherbroyles.com
(973) 723-8588

Steve Papkin
steven.papkin@fisherbroyles.com
(310) 415-6254

About FisherBroyles, LLP

Founded in 2002, FisherBroyles, LLP is the first and world's largest distributed law firm partnership. It has grown to over 240 attorneys in 22 offices nationwide. The FisherBroyles' efficient and cost-effective Law Firm 2.0® model leverages talent and technology instead of unnecessary overhead that does not add value to our clients, all without sacrificing BigLaw quality. Visit our website at www.fisherbroyles.com to learn more about our firm's unique approach and how we can best meet your legal needs.