PUBLICATION UPDATE

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Federal Securities Act of 1933

and related publications
Federal Securities Exchange Act of 1934
Securities Primary Law Sourcebook

Publication 627 Release 129 November 2017

HIGHLIGHTS

Federal Securities Act of 1933

- Chapter 4, *Exempt Transactions under Section 4 of the Securities Act*
- Chapter 11, *Criminal Enforcement of the Securities Act of 1933*

Federal Securities Exchange Act of 1934

- Chapter 3, *Regulation of Brokers and Dealers*

Securities Primary Law Sourcebook

- Volumes A, B, D, and E have been revised and updated.

Federal Securities Act of 1933. Chapter 4, *Exempt Transactions under Section 4 of the Securities Act*—In this Release, Chapter 4—"Exempt Transactions under Section 4 of the Securities Act—has been revised and updated to reflect changes in the regulatory structure and new developments. Section 4 of the Securities Act contains an array of transaction exemptions from the registration requirements in Section 5 of the Act based on the notion that the protections afforded by Section 5 registration and regulation in the public offering or "distribution" process are not needed in some circumstances, or are achieved by other less burdensome means as, for example, offerings by an issuer solely to "accredited investors." Each transaction exemption is considered in Chapter 4 in this light.

Section 4(a)(1) of the Securities Act, which exempts from Section 5 transactions by any person other than an "issuer, underwriter, or dealer," has always received, and continues to receive, much attention because it broadly covers secondary market or "trading" transactions by public investors in whose hands securities have come to rest through an offering process. Resales of securities purchased by these investors are covered by Section 4(a)(1), but only if the

seller is not deemed to be a statutory "underwriter" in making the resales, in which case Section 5 compliance would be required. Determining "underwriter" status for purposes of the Section 4(a)(1) transaction exemption is a critical concern, given the fact that every offer and sale of a security is subject to Section 5 compliance unless an exemption is available. Chapter 4 closely examines the statutory and rule construct in the application of Section 4(a)(1). Updated case law is included, and the chapter is revised particularly to highlight for practitioners the key considerations in determining whether an investor reselling securities will run afoul of Section 5 registration requirements by reason of being deemed to be an underwriter.

Along the same line, updated and revised Chapter 4 addresses other avenues and exemptions for private resales of "restricted" securities by persons who, in particular circumstances, are considered "affiliates" or "control" persons of the issuer, and face the dilemma of statutory underwriter status either for themselves or their purchasers. Chapter 4 not only introduces SEC Rule 144, an important safe harbor for relying on the Section 4(a)(1) exemption by these persons, but also separately addresses the so-called "Section 4(a)(1)(1/2)" exemption for private resales generally, and the new statutory exemption in Section 4(a)(7) of the Securities Act specifically adopted for resales of "restricted and control securities." Although as discussed in updated Chapter 4, Section 4(a)(7) codifies a good deal of the "Section 4(a)(1)" exemption as it evolved, the new statutory exemption has its own significant limitations, and Chapter 4 deals with the continued availability of the "Section 4(a)(1)(1/2)" exemption alternative.

For issuers, exempt private securities offerings represent a key aspect of capital formation. Revised and updated Chapter 4 updates and expands considerations in the application of "Regulation D" under the Securities Act, with specific attention on Rules 504 and 506 in light of the recent repeal of Rule 505 of Regulation D. Rule 506, the "safe harbor" for private offerings in reliance of the Securities Act Section 4(a)(2) exemption is a prominent element of Chapter 4, and key pieces are newly highlighted. There continues as well to be attention paid to the conduct of private offerings under Section 4(a)(2) outside the Regulation D Rule 506 safe harbor.

With the recent SEC repeal of Rule 505 of Regulation D, which had provided for a limited offering up to $5 million, the SEC amended Rule 504 to increase the maximum offering amount from $1 million to $5 million. The increase was made with the hope of broadening its appeal for start-ups and small businesses. Updated Chapter 4 includes heightened attention to Rule 504, and recent case law affecting its availability. Attention to recent case law is also included in an updated consideration of Rule 508 of Regulation D, which establishes circumstances in which an issuer's failure to comply with all the requirements of Regulation D will not result in a loss of the exemption, and also the scope, and impact, of Rule 508 as to both private actions and SEC enforcement actions.

Chapter 11—*Criminal Enforcement of the Securities Act of 1933*. The updated chapter includes a discussion of the elements of a criminal offense under Section 24 of the Securities Act, with a particular focus on the "willful blindness" or recklessness standard that the SEC has used to prove the element of "willfulness." The updated chapter also includes a discussion of how a recent case decided in the Southern District of Florida, *SEC v. Spinosa*, 31 F. Supp. 3d 1371 (S.D. Fla. 2014), demon-

strates the SEC's broad federal jurisdiction for violations of Section 17(a). Section 17(a) says it is unlawful to engage in certain fraudulent schemes by the "use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly." 15 U.S.C. § 77q(a) (2012). In *Spinosa*, the district court held that the SEC made sufficient allegations that the Defendant used interstate commerce when he received the draft language for his misrepresentations to investors in an email. *Id.* at 1376.

Federal Securities Exchange Act of 1934. Chapter 3, *Regulation of Brokers and Dealers*—In this release, Chapter 3—*Regulation of Brokers and Dealers*—is revised and updated. The updated chapter includes additions or revisions in the following topic areas: (1) changes in the New York Stock Exchange market structure to replace specialists with designated market makers; (2) SEC no-action guidance permitting mergers and acquisition brokers to operate without registration as broker-dealers with the SEC; (3) adoption by FINRA of a new category of member—the capital acquisition broker—which is permitted to perform a limited range of activities under a simplified set or regulations; (4) adding a discussion of the concept of "material weakness" in connection with annual compliance reports required to be filed by registered broker-dealers; (5) adding a discussion of FINRA Rule 4522 regarding required security counts in addition to those required by SEC Rule 17a-13; (6) adding a discussion with respect to the restructuring by FINRA of its qualification examinations; (7) adding language regarding the SEC's increased emphasis on compliance by broker-dealers with Rule 15c3-3 under the Securities Exchange Act of 1934; (8) adding a discussion of SEC requirements with respect to lost security holders and unresponsive payees, and (9) updating information with respect to the size of the SIPC fund and the current SIPC assessment level.

Securities Primary Law Sourcebook. Statutes in Volumes A, B, D, & E are current as of Pub. Law 115-43, June 30, 2017, 131 Stat. 884. Federal regulations (CFR) in Volumes A, B, D, & E are current with changes published in the Federal Register of July 31, 2017.

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Federal Securities Act of 1933

Publication 627 Release 129 November 2017

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