U.S. Private Placement Considerations for Exempt Market Dealers

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Many exempt market dealers (EMDs) find that the United States represents a potentially attractive investor base for the issuers they advise. Due to the size and scope of the U.S. capital markets, U.S. investors can form a meaningful add-on tranche to many Canadian offerings. However, EMDs cannot simply offer securities in the U.S., and not all U.S. investors may participate in private placement deals. As a result, offering securities in the United States can seem overly complex to issuers and their advisors. As the first in a series, this article will attempt to simplify some of the most common U.S. private placement issues and mechanics that may be relevant to EMDs.

When Can I Offer Securities in the U.S.?

U.S. federal securities laws is based on the principle that every security offered and sold in the U.S. must either (i) be registered with the United States Securities and Exchange Commission (SEC), or (ii) be offered and sold in a way that complies with an exemption from such registration, such as in a valid private placement. Private placement rules in the U.S. share many principles and mechanics with private placement rules in the various Canadian jurisdictions and so should seem familiar to most EMDs. So long as an issuer and its agent or underwriter complies with applicable private placement rules, securities of a Canadian issuer may generally be offered and sold at any time to U.S. purchasers. For purposes of reference, the private placement rule most often relied on in U.S. offerings is Rule 506 of Regulation D (Rule 506) under the United States Securities Act of 1933, as amended (the 1933 Act).

Who Can an EMD Offer Securities to in the U.S.?

Unlimited Number of "Accredited Investors"; No More Than 35 "Sophisticated" Investors – Under Rule 506 a company can sell securities to an unlimited number of "accredited investors", and up to 35 non-accredited investors. Because sales to even one non-accredited investor requires that prospectus-level financial and business disclosure (including U.S. GAAP reconciliations) be provided to all investors, non-accredited investors are almost never included in Rule 506 offerings, and therefore will not be discussed in this article. Please feel free to contact the author if you have any questions regarding offerings to non-accredited investors.

Accredited Investor Qualification – In order to qualify as an accredited investor for purposes of Rule 506 an investor must meet either a financial or entity test. Such tests are very similar to the accredited investor tests used in the securities legislation in the provinces and territories of Canada. The categories under which an investor might qualify as an accredited investor in the United States are set forth in the table on page 3 below.

What Must an EMD Provide to Potential Purchasers?

Where only accredited investors participate, Rule 506 does not require any specific information or disclosure; however, every offer and sale of securities remains subject to the anti-fraud provisions of the 1933 Act, which require the disclosure of material information so that an investor may make an informed investment decision regarding the issuer and its securities. In addition, all purchasers in a Rule 506 private placement must be given the opportunity to ask questions and receive answers regarding the offering. Canadian public companies will generally be able to satisfy any such disclosure requirement on the basis of publicly available information.

What Offering Mechanics Must an EMD Consider?

No General Solicitation or General Advertising Regarding the Offering – Private placements, including those conducted under Rule 506, may not be accompanied by any public promotion or advertising of the private placement which will include any advertisement, article, press release, mass mailing, notice or other communication published in a

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newspaper, magazine or similar media or broadcast over television, radio or the internet, or any seminar or meeting whose attendees have been invited by general solicitation or general advertising. This means in practice that an EMD may not solicit sales or offers to buy from an investor whom they do not know or have an introduction to. EMDs may not advertise an offering in any capacity, including advertisements seeking introductions. Advertisements can include traditional ads but also a seminar held at a club, Internet postings, or an article that discusses the offering published in print or disseminated over TV, radio, or the Internet. General solicitation or general advertising will make private placement exemptions unavailable and will cause the issuer to be engaged in an unregistered public offering in the U.S. and the EMD to be acting as an unregistered underwriter. Such a result can cause significant liability for the issuer and the participating EMD.

Broker-Dealer Registration – Persons or entities, other than an issuer, selling securities in the United States must either register as a broker-dealer under the 1933 Act and state securities laws, or have an exemption from such registration. Available exemptions from broker-dealer registration are fairly limited and will be discussed in a future article.

Transfer Restrictions – Securities sold in a Rule 506 transaction must be acquired for investment purposes only and may not be resold unless the securities are subsequently registered under the 1933 Act or an exemption for such resale is available. The issuer and its agent (e.g., an EMD) must take reasonable precautions to ensure that securities privately placed in the U.S. are not subsequently resold in a way that violates U.S. securities laws. This is typically achieved by placing a restrictive legend on the privately placed securities, which prevents transfer without confirmation that U.S. securities laws are being complied with. The two most common exemptions for resale of restricted securities issued by a Canadian issuer are provided by Rule 144 and Rule 904 under the 1933 Act. Rule 144 provides that privately placed securities may be resold by non-affiliates after 12 months, in the case of an issuer that is not publicly reporting in the United States, or six months in the case of an issuer that is publicly reporting in the United States, provided that certain other requirements are met. Rule 144 may not be available for securities issued by an entity that was ever a "shell company," unless it has subsequently become a publicly reporting company in the United States. Rule 904 permits the resale over the TSX or TSX-V of securities issued by a Canadian issuer (subject to certain limited exceptions). Upon satisfying either Rule 144 or Rule 904 restrictive legends may be removed from the securities being transferred.

Form D Filing – The issuer should file with the SEC a notice on Form D not later than 15 days after closing of a Rule 506 offering. Form D is a fairly simple information document that provides some detail on the issuer, the securities sold, and in which states such securities were sold.

Other Requirements

Each transaction is unique, and for any given transaction, other steps or documents not discussed above may be necessary or advisable. State securities laws must also be considered, although in the context of Rule 506 offerings state securities laws are typically not a substantial consideration. Also, as the state of the law in this area regularly changes, it is important that for each offering you consult with legal counsel to ensure that your activities meet the applicable federal and state securities laws requirements.

We hope the above overview is helpful. We are always available to answer any questions you may have on U.S. private placements or other related topics.

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Richard B. Raymer leads Hodgson Russ LLP's Canada/U.S. Cross-Border Practice Group. He concentrates his practice on advising U.S. and Canadian entities regarding U.S. corporate law issues, with a focus on access to Canadian and U.S. capital markets, corporate structures, and cross-border mergers and acquisitions. Prior to joining Hodgson Russ, Richard practiced securities, mergers, and acquisitions law at two prominent New York City law firms.

INSTITUTIONAL ACCREDITED INVESTORS

Category 1	A bank, as defined in Section 3(a)(2) of the 1933 Act, whether acting in its individual or fiduciary capacity; or
Category 2	A savings and loan association or other institution as defined in Section 3(a)(5)(A) of the 1933 Act, whether acting in its individual or fiduciary capacity; or
Category 3	A broker or dealer registered pursuant to Section 15 of the United States Securities Exchange Act of 1934, as amended; or
Category 4	An insurance company as defined in Section 2(13) of the 1933 Act; or
Category 5	An investment company registered under the United States Investment Company Act of 1940; or
Category 6	A business development company as defined in Section 2(a)(48) of the United States Investment Company Act of 1940; or
Category 7	A small business investment company licensed by the U.S. Small Business Administration under Section 301 (c) or (d) of the United States Small Business Investment Act of 1958; or
Category 8	A plan established and maintained by a state, its political subdivisions or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, with total assets in excess of U.S. $5,000,000; or
Category 9	An employee benefit plan within the meaning of the United States Employee Retirement Income Security Act of 1974 in which the investment decision is made by a plan fiduciary, as defined in Section 3(21) of such Act, which is either a bank, savings and loan association, insurance company or registered investment adviser, or an employee benefit plan with total assets in excess of U.S. $5,000,000 or, if a self-directed plan, with investment decisions made solely by persons who are accredited investors; or
Category 10	A private business development company as defined in Section 202(a)(22) of the United States Investment Advisers Act of 1940; or
Category 11	An organization described in Section 501(c)(3) of the United States Internal Revenue Code, a corporation, a Massachusetts or similar business trust, or a partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of U.S. $5,000,000; or

INDIVIDUAL (RETAIL) ACCREDITED INVESTORS

Category 12	Any director or executive officer of the company; or
Category 13	A natural person whose individual net worth, or joint net worth with that person's spouse, at the date hereof exceeds U.S. $1,000,000. For purposes of this calculation, if the mortgage or other indebtedness secured by the subscriber's primary residence exceeds its value and the mortgagee or other lender has recourse to the subscriber personally for any deficiency, the amount of any excess must be considered a liability and deducted from the subscriber's net worth; or
Category 14	A natural person who had an individual income in excess of U.S. $200,000 in each of the two most recent years or joint income with that person's spouse in excess of U.S. $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year; or
Category 15	A trust, with total assets in excess of U.S. $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii) under the 1933 Act; or
Category 16	Any entity in which all of the equity owners meet the requirements of at least one of the above categories.

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