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Rest in Peace, Rule 505

By Wendy Gerwick Couture*

After 37 years in existence,¹ the Rule 505 exemption from registration has been repealed, effective May 22, 2017. This essay reviews the evolution of Rule 505 over its lifetime; examines Rule 505's role within Regulation D and analyzes why that role eventually became obsolete; and argues that Rule 505 leaves behind a legacy that should continue to inform policy discussions about exemptions from registration.

I. Evolution of Rule 505

Rule 505 was a small issue offering exemption, adopted under § 3(b) of the Securities Act (now § 3(b)(1)), which authorizes the SEC to exempt a class of securities from the registration requirement “if it finds that the enforcement of this subchapter with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering.”² The SEC adopted Rule 242, the predecessor to Rule 505, on January 17, 1980.³ Two years later, the SEC adopted Regulation D (“Reg. D”), repealing Rule 242 and replacing it with Rule 505.⁴ Although the exemption was amended numerous times since 1980, its core elements remained largely unchanged: (a) a limitation on aggregate offering price; (b) a limitation on the number and nature of purchasers; (c) a mandatory disclosure requirement; (d) a prohibition on general solicitation or advertising; and (e) a bad actor disqualification.

(a) Limitation on Aggregate Offering Price

Section 3(b) caps the aggregate offering price that issuers can raise under a small issue offering exemption promulgated thereunder. In early 1980, when Rule 242 was adopted, the statutory cap was \$2 million,⁵ and Rule 242 incorporated that cap by reference.⁶ Later that year, Congress passed the Small Business Investment Incentive Act of 1980, which raised the § 3(b) cap to \$5 million.⁷ Accordingly, in 1982, when the SEC replaced Rule 242 with Rule 505, the SEC specified that the aggregate offering price “shall not exceed \$5,000,000, less the aggregate offering

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price for all securities sold within the twelve months before the start of and during the offering of securities under this section in reliance on any exemption under section 3(b) of the Act or in violation of section 5(a) of the Act.”⁸ Rule 505’s limitation on aggregate offering price remained unchanged from 1982 until its repeal in 2017.

(b) Limitation on Number and Nature of Purchasers

Rule 242 limited the number of “purchasers” to 35,⁹ and Rule 505 continued this limitation.¹⁰ Importantly, however, both Rule 242 and Rule 505 excluded certain investors from the definition of “purchaser,” including any person qualifying as “accredited.”¹¹ Although the 35-purchaser limitation remained in place from 1980 until the rule’s repeal in 2017, the definition of “accredited” investor evolved over time, most notably with respect to the inclusion of institutional investors and wealthy individuals.

The scope of institutional investors qualifying as “accredited” expanded over time. In 1980, Rule 242 defined a limited number of institutional investors as “accredited”: certain banks, insurance companies, employee benefit plans, and investment companies.¹² In 1982, when the SEC replaced Rule 242 with Rule 505, it expanded the definition to include certain private business development companies, 501(c)(3) organizations, and entities in which all of the equity owners qualified as accredited investors themselves.¹³ In 1988, the SEC expanded the scope even further to include certain savings and loan associations; credit unions; broker-dealers; and corporations, partnerships, and trusts with total assets in excess of \$5 million.¹⁴ The SEC explained that there did “not appear to be a compelling reason” to distinguish these institutional investors from those already qualifying as accredited.¹⁵ In 1989, the SEC expanded the scope again to include governmental plans, placing them “on the same footing as employee plans which are subject to ERISA.”¹⁶

The scope of wealthy individuals qualifying as “accredited” likewise evolved, sometimes expanding and sometimes contracting. In 1980, Rule 242 provided only one avenue for wealthy individuals to qualify as “accredited” merely by virtue of their wealth, defining as accredited “any person who purchases \$100,000 or more of securities of the issuer” in the offering for cash, an obligation to pay within 60 days of the first issuance of the securities, or the cancellation of indebtedness owed by the issuer to the purchaser.¹⁷ As the SEC later explained, the premise “was that a person capable of investing a large amount of capital . . . in an offering ought to be considered an accredited investor.”¹⁸ In 1982, when the SEC replaced Rule 242 with Rule 505, it retained the ability of a person to qualify as accredited by virtue

of the size of the person's investment but raised the investment level from \$100,000 to \$150,000; added the caveat that the purchaser's total investment must not exceed 20% of the purchaser's net worth at the time of sale; and expanded the acceptable consideration paid by the purchaser to include securities with readily available market quotations and obligations to be paid within five years of the sale of the securities to the purchaser.¹⁹ In 1982, the SEC also added two new avenues for natural persons to qualify as accredited by virtue of their wealth: (1) having a net worth, either individually or jointly with a spouse, of \$1 million,²⁰ or (2) earning an individual income in excess of \$200,000 in each of the two most recent years and reasonably expecting an income in excess of \$200,000 in the current year.²¹ In 1988, the SEC eliminated the \$150,000 purchase test, acknowledging that it was an imprecise measure of wealth and that most purchasers qualifying under the purchase test would likewise qualify under the wealth or income tests.²² The SEC also expanded the income test to include joint income with one's spouse in excess of \$300,000 in each of the two most recent years and a reasonable expectation of reaching the same income level in the current year.²³ Finally, in 2011, in response to a mandate in the Dodd-Frank Wall State Reform and Consumer Protection Act ("Dodd-Frank Act"),²⁴ the SEC excluded the equity in an investor's principal residence from the net worth calculation.²⁵

(c) Mandatory Disclosures

From its inception, Rule 505 (and its predecessor Rule 242) imposed mandatory disclosure requirements if an issuer sold securities to non-accredited investors; if issuers were selling only to accredited investors, Rule 505 did not mandate any disclosures.²⁶ From 1980 to 1989, if an issuer made sales to both accredited and non-accredited investors, the issuer was required to provide the mandated disclosures to both sets of investors.²⁷ In 1989, consistent with the general rationale that accredited investors are able to fend for themselves, the SEC omitted this requirement and mandated disclosures only to non-accredited investors.²⁸

The content of the mandatory disclosures to non-accredited investors became more graduated over time. In 1980, Rule 242 (which imposed an aggregate offering price limit of \$2 million) mandated a certain level of disclosure to non-accredited investors, regardless of the size of the offering.²⁹ In 1982, when the SEC replaced Rule 242 with Rule 505 and raised the aggregate offering price limit to \$5 million, the SEC retained a singular disclosure requirement for offerings up to \$5 million.³⁰ In 1988, the SEC introduced a more graduated disclosure requirement, relaxing the disclosures required by issuers raising up to \$2 million.³¹ The SEC explained: "[I]t appears that there would be

some benefit to another level of disclosure under the regulation as long as investor protection is not being compromised.”³² This graduated disclosure regime, which differentiated between offerings raising up to \$2 million and those raising more money, remained in effect for Rule 505 offerings until the rule’s repeal.

(d) Prohibition on General Solicitation or Advertising

From the outset, Rule 505 (and its predecessor Rule 242) prohibited general solicitation or advertising.³³ This prohibition was consistent with the SEC’s explanation when adopting another § 3(b) exemption that, absent this prohibition, “an exemption cannot be justified on the basis of the ‘limited character’ of the offering.”³⁴

(e) Bad Actor Disqualification

From the beginning, Rule 505 (and its predecessor Rule 242) disqualified certain so-called “bad actors” from relying on the exemption, incorporating Regulation A’s bad actor prohibition.³⁵ In 1980, when adopting Rule 242, the SEC explained that “it believes that this safeguard is necessary in light of the experimental nature of Rule 242.”³⁶ The SEC retained this bad actor disqualification when adopting Rule 505 as part of Reg. D, despite the absence of comparable provisions in the other Reg. D exemptions at that time.³⁷

II. Role of Rule 505

From the outset, Rule 505 (and its predecessor Rule 242) worked in concert with Rule 504 (and its predecessor Rule 240) and Rule 506 (and its predecessor Rule 146). Rule 242, which was adopted in 1980, was the last of this trio to be adopted.³⁸ Rule 146 was adopted in 1974 as a safe harbor under § 4(2) (now § 4(a)(2)),³⁹ and Rule 240 was adopted in 1975 pursuant to § 3(b) (now § 3(b)(1)).⁴⁰ When the SEC adopted Reg. D in 1982, it replaced Rules 240, 242, and 146 with Rules 504, 505, and 506, respectively.⁴¹ By combining these three exemptions within Reg. D, the SEC sought “to simplify existing rules and regulations, to eliminate any unnecessary restrictions that those rules and regulations place on issuers, particularly small businesses, and to achieve uniformity between state and federal exemptions in order to facilitate capital formation consistent with the protection of investors.”⁴² The eventual obsolescence of Rule 505 is a result of the changing relationship among the three Reg. D exemptions.

(a) Relationship Among Rules 504, 505, and 506

When adopting Rule 242 (the predecessor of Rule 505), the SEC sought to fill a gap left by Rule 240 (the predecessor of Rule 504) and Rule 146 (the predecessor of Rule 506). In particular,

commentators had criticized Rule 240 as being “of limited utility because it is available only for offerings of \$100,000 or less in 12 months by an issuer whose securities are owned beneficially by not more than 100 persons.”⁴³ Likewise, commentators had criticized Rule 146 because it “requires the issuer to make a subjective determination as to the sophistication of each offeree and each purchaser.”⁴⁴ Rule 242 addressed both of these criticisms by allowing issuers to raise more funds than permitted by Rule 240⁴⁵ and by omitting any requirement that the issuer make a subjective determination about the sophistication of offerees or purchasers.⁴⁶

When the SEC replaced Rules 240, 242, and 146 with Rules 504, 505, and 506, respectively, and compiled them in Reg. D, the three Reg. D exemptions were meant to operate as a stair-step, increasing investor protections as the size of offerings increased, with Rule 505 in the middle.⁴⁷ Rutheford B. Campbell, Jr. explained Reg. D’s stair-step approach as follows: “[I]nvestor protection devices—disclosure and sophistication requirements—generate significant transaction costs for issuers, and since relative rather than absolute transaction costs choke off capital formation, a sensible balance between capital formation and investor protection leads to the imposition of additional investor protection requirements as deals get larger.”⁴⁸

A key assumption of Reg. D’s stair-step approach was that Reg. D would operate as “a basic framework of limited offering exemptions that can apply uniformly at the federal and state levels.”⁴⁹ The SEC envisioned that Rule 504 offerings would be registered at the state level: “Because of the small amount of the offering and the likelihood that sales will occur in a limited geographic area, the Commission and NASAA [the North American Securities Administrators Association] believe that greater reliance on state securities laws is appropriate.”⁵⁰ By contrast, the SEC envisioned that Rule 505 and Rule 506 offerings would operate as “uniform federal-state exemptions.”⁵¹

Even at the time of Reg. D’s adoption, however, the gap to be filled by Rule 505 was narrowed, undercutting the intended stair-step approach. Rule 504 was less restrictive than its predecessor Rule 240 in several respects, lessening the incentives for issuers to select Rule 505 rather than Rule 504. First, Rule 504’s aggregate offering price limit was raised to \$500,000,⁵² as opposed to \$100,000 under Rule 240.⁵³ Second, Rule 504 provided a pathway for issuers to engage in general solicitation or advertising,⁵⁴ unlike Rule 240’s flat prohibition on general solicitation or advertising.⁵⁵ Third, unlike Rule 240,⁵⁶ Rule 504 did not impose a limit on the number of beneficial owners.⁵⁷ Finally, Rule 504 eliminated Rule 240’s prohibition on the payment of

commissions.⁵⁸

Likewise, Rule 506 was less restrictive than its predecessor Rule 146 in two key ways, strengthening the incentive for issuers to choose Rule 506 rather than Rule 505. First, Rule 146 had required issuers to reasonably believe that all *offerees* either (1) had such knowledge and experience in financial and business matters that they were capable of evaluating the merits and risks of the investment; or (2) were able to “bear the economic risk of the investment.”⁵⁹ Rule 506 eliminated any requirement for issuers to assess their offerees’ knowledge, experience, or ability to bear economic risk.⁶⁰ Second, Rule 146 had required issuers to reasonably believe that all *purchasers* either (1) had such knowledge and experience in financial and business matters that they were capable of evaluating the merits and risks of the investment; or (2) together with their representatives had such knowledge and experience and were able to bear the economic risk of the investment.⁶¹ With respect to accredited purchasers, Rule 506 eliminated the requirement for issuers to assess their knowledge or sophistication.⁶² With respect to non-accredited purchasers, Rule 506 eliminated the economic risk test, retaining only the requirement that issuers reasonably believe that the purchasers either alone or with a representative have the requisite knowledge and experience in financial or business matters that they are capable of evaluating the merits and risks of the prospective investment.⁶³

Indeed, data compiled by the SEC from the first year of Reg. D’s existence demonstrates that issuers, even at that time, preferred Rules 506 and 504 to Rule 505. From April 15, 1982, to April 14, 1983, 49% of Reg. D offerings proceeded under Rule 506; 25% proceeded under Rule 504; 13% proceeded under Rule 505; and 13% claimed more than one exemption.⁶⁴ In addition, the SEC noted that over 90% of Rule 506 offerings were for less than \$5 million and commented that “[f]or many of these offerings it seems a Rule 505 exemption could have been claimed.”⁶⁵

Over time, as Rules 504 and 506 became even more issuer-friendly, Rule 505 was effectively squeezed out. First, efforts to harmonize state regulation of Rules 505 and 506 fell short, and Congress preempted state regulation of offerings under Rule 506 but not under Rule 505.⁶⁶ This made Rule 506 even more attractive than Rule 505 in most contexts. Second, the SEC gradually raised Rule 504’s aggregate offering price limit, further lessening the attractiveness of Rule 505 as an alternative to Rule 504.⁶⁷

(b) Preemption of State Regulation of Rule 506 Offerings

The first disruption of Reg. D’s stair-step approach was the

preemption of state regulation of Rule 506 offerings but not Rule 505 offerings. As discussed above, the SEC intended Rules 505 and 506 to operate as “uniform federal-state exemptions.”⁶⁸ The SEC, together with the NASAA, planned to accomplish this via a Uniform Limited Offering Exemption (“ULOE”), which would serve as a companion state-level exemption to Rules 505 and 506.⁶⁹ The quest to implement uniform federal-state exemptions proved elusive, however.

In 1983, NASAA promulgated the ULOE as planned, but it did not perfectly mirror Rules 505 and 506. Most importantly with respect to Rule 505, the ULOE imposed an additional requirement for sales to non-accredited investors.⁷⁰ Under the ULOE, issuers had to reasonably believe either (1) that the “investment is suitable for the purchaser upon the basis of the facts, if any, disclosed by the purchaser as to his other security holding and as to his financial situation and needs”; or (2) that the purchaser alone or with his representative has such knowledge and experience in financial and business matters that he or she is “capable of evaluating the merits and risks of the prospective investment.”⁷¹

Moreover, although by 1996 the vast majority of states had adopted some form of the ULOE,⁷² it was far from uniform, as “[b]attles won or lost at the NASAA level could be refought at the individual state level.”⁷³ States, “because of fundamental differences in philosophy concerning securities regulation,”⁷⁴ varied with respect to “filing and notice requirements, application of ‘bad actor’ disqualification provisions, suitability standards, filing deadlines, and required disclosure.”⁷⁵ In short, issuers seeking to rely on Rule 505 or Rule 506 in multi-state offerings were required to survey, and comply with, myriad differing blue sky provisions.

In light of the failure of Rules 505 and 506 to operate as uniform federal-state exemptions, pressure grew on Congress to intervene. In 1995, Representative Jack Fields introduced a bill that would have “preempted all pre-sale state regulation of securities offerings other than intrastate transactions.”⁷⁶ As explained by Jennifer J. Johnson, the bill was so radically deregulatory, however, that Wall Street ultimately opposed it out of fear that “it could have sparked a backlash leading to tougher regulation,” and the bill was not reported out of committee.⁷⁷ The following year, however, Representative Fields reintroduced an amended bill as the National Securities Markets Improvements Act (“NSMIA”).⁷⁸ As enacted, NSMIA preempted state regulation of offerings under Rule 506 but not under Rule 505.⁷⁹ The stated rationale for preempting Rule 506 offerings was their purported national scope.⁸⁰

The preemption of state regulation of offerings under Rule 506 but not Rule 505 substantially disrupted Reg. D's stair-step approach. Even local and smaller offerings, which might otherwise have proceeded under Rule 505, were channeled into Rule 506 and its "regulatory abyss."⁸¹ Indeed, in light of this disruption, critics attacked NSMIA from both sides, with some scholars arguing that preemption should extend to Rule 505⁸² and others arguing that preemption should be removed from at least some Rule 506 offerings.⁸³

(c) Increase in Aggregate Offering Price Under Rule 504

The second disruption of Reg. D's stair-step approach was the increase in aggregate offering price under Rule 504. In 1980, when Rule 242 (the predecessor of Rule 505) was adopted, Rule 242 had an aggregate offering price limit of \$2 million,⁸⁴ while Rule 240 (the predecessor of Rule 504) was limited to \$100,000.⁸⁵ In 1982, when these rules were consolidated into Reg. D, the Rule 505 limit was raised to \$5 million,⁸⁶ and the Rule 504 limit was raised to \$500,000.⁸⁷ In 1988, the SEC raised the Rule 504 limit to \$1 million, on the condition that "no more than \$500,000 of such aggregate offering price is attributable to offers and sales of securities without registration under a state's securities laws."⁸⁸ In 1992, the SEC removed the state registration condition, instituting a flat \$1 million aggregate offering price limit.⁸⁹ Finally, in 2016, the SEC adopted an amendment, effective on January 20, 2017, raising the Rule 504 limit to \$5 million.⁹⁰

This 2016 amendment was the final nail in the coffin of Rule 505. As recognized by the SEC, the elimination of any difference in aggregate offering price limit between Rule 504 and Rule 505 "will significantly diminish the utility of Rule 505 and we are therefore repealing that rule."⁹¹

(d) Obsolescence of Rule 505

These disruptions to Reg. D's stair-step approach operated together to render Rule 505 obsolete. Anecdotally, one state securities regulator recently told this author: "If someone calls and tells me that they're planning a 505 offering, I know that they don't know what they're doing." Indeed, the only reason to select Rule 505 over Rule 506 was to avoid the requirement to assess the financial sophistication of the (up to 35) non-accredited investors. This reason, not very compelling in and of itself,⁹² was further eroded by the possibility that state-level suitability requirements would apply to an offering under Rule 505.

The data bears this out. From 2009 to 2014, 87.8% of offerings under Reg. D proceeded under Rule 506; 10.7% proceeded under Rule 504; and only 1.5% proceeded under Rule 505.⁹³

The SEC's proposal to eliminate Rule 505 elicited only three comment letters.⁹⁴ Commenters agreed that Rule 505 merited modernization, with suggestions such as raising the aggregate offering price limit, reviewing the information requirements, and revising the rule to focus on debt-based financing.⁹⁵ After considering these comments, the SEC declined the invitation to modernize Rule 505, repealing it instead.⁹⁶

III. Legacy of Rule 505

Despite the ultimate obsolescence and repeal of Rule 505, its legacy should continue to inform policy discussions about exemptions from registration. Rule 505 made lasting impacts to two components of other oft-used exemptions: the disqualification of bad actors and the substitution of wealth for mandatory disclosure. Finally, and perhaps most of all, the story of Rule 505's evolving role within Reg. D demonstrates the importance of considering the utility of exemptions in context.

(a) Introduction of "Bad Actor" Disqualification into Regulation D

Of the three rules that were replaced by Reg. D, Rule 242 (the predecessor of Rule 505) was the only one with a provision disqualifying bad actors.⁹⁷ When the SEC adopted Reg. D, it retained this distinction, with only Rule 505 including a bad actor disqualification.⁹⁸

Commentators criticized the incongruity, in light of Reg. D's stair-step approach, of disqualifying bad actors from relying on Rule 505 but not Rule 506.⁹⁹ NSMIA, which insulated Rule 506 offerings, but not Rule 505 offerings, from state-level bad actor disqualifications, exacerbated this incongruity.

In 1988, at the urging of the NASAA, the SEC solicited comments about whether to add a bad actor disqualification to Rule 506.¹⁰⁰ The NASAA argued that such a provision might convince more states to adopt the ULOE.¹⁰¹ Commenters were almost unanimously opposed to the idea, and the SEC decided not to add the provision because it was "not clear to the Commission that the adoption of this proposal would encourage a significant number of additional states to adopt ULOE."¹⁰²

In 2010, however, Congress intervened. The Dodd-Frank Act directed the SEC to add a bad actor disqualification to Rule 506,¹⁰³ and the SEC adopted the provision in 2013.¹⁰⁴ Therefore, bad actor disqualification, which Rule 505 introduced to Reg. D, will continue to be a part of Reg. D after Rule 505's demise.

(b) Substitution of Wealth for Mandatory Disclosure

Rule 242 (the predecessor of Rule 505) was the first exemption to substitute an individual investor's wealth for mandatory

disclosure.¹⁰⁵ As explained by Howard M. Friedman, “[f]or the first time, wealth alone, unaccompanied by sophistication or, at least a requirement that the purchaser obtain sophisticated investment advice, was sufficient to permit one to be targeted to buy securities without mandatory disclosure of information.”¹⁰⁶

Rule 242 accomplished this substitution of wealth for mandatory disclosure in two steps. First, Rule 242 introduced a new term—“accredited person”—and defined it to include certain wealthy investors.¹⁰⁷ Second, Rule 242 removed the mandatory disclosure requirement for issuances only to accredited investors.¹⁰⁸

Neither Rule 240 (the predecessor of Rule 504) nor Rule 146 (the predecessor of Rule 506) substituted wealth for mandatory disclosure. Rule 240 did not mandate any particular disclosure to investors, relying on state-level regulation.¹⁰⁹ Rule 146 mandated that issuers provide access to, or furnish, specified information to all offerees, regardless of their wealth.¹¹⁰

When the SEC adopted Reg. D, it retained the substitution of wealth for mandatory disclosure in Rule 505 and expanded it to Rule 506. Like Rule 242, Reg. D defined certain wealthy investors as “accredited,”¹¹¹ and both Rule 505 and Rule 506 removed the mandatory disclosure requirement for issuances only to accredited investors.¹¹² Later, in 1989, the SEC expanded this substitution so that, even if an issuer sold to both accredited and non-accredited investors, the issuer was only required to provide disclosure to the non-accredited investors.¹¹³

The rationale for substituting wealth for mandatory disclosure encompassed two subsidiary assumptions: (1) that the wealthy are financially sophisticated (or at least sophisticated enough to retain a financial representative);¹¹⁴ and (2) that the financially sophisticated possess both the savviness and the bargaining power to negotiate for adequate disclosure, undercutting the need to mandate it.¹¹⁵ The first of these assumptions, in particular, has been heavily criticized. As summarized in a 2015 report by SEC staff, some commentators have “expressed the view that the accredited investor definition is both over- and under-inclusive because certain financially sophisticated individuals may not qualify, while wealthy, financially unsophisticated individuals may.”¹¹⁶ In light of these critiques, Congress included a provision in the Dodd-Frank Act directing the SEC to review, every four years, the accredited investor definition as it applies to natural persons to “determine whether the requirements of the definition should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy.”¹¹⁷ Therefore, Rule 505’s legacy—albeit a controversial one—will continue to influence policy discussions going forward.

(c) Essentiality of Considering the Utility of Exemptions in Context

Finally, perhaps Rule 505's most enduring legacy is the story of its demise, which starkly demonstrates that the utility of every exemption must be assessed in comparison to available alternatives. For example, absent revision, the new federal crowdfunding exemption is at risk of following Rule 505's path to obsolescence.¹¹⁸ In light of the federal crowdfunding exemption's relatively low aggregate offering price limit,¹¹⁹ relatively burdensome initial disclosure requirement,¹²⁰ and ongoing annual reporting requirement,¹²¹ issuers may flock to less-burdensome alternatives.¹²² Those alternatives include the newly modernized Rule 147 and the new Rule 147A,¹²³ which correlate with state intrastate crowdfunding exemptions; Rule 504,¹²⁴ especially in light of its new aggregate offering price limit of \$5 million; and the recently added Rule 506(c), which permits issuers to engage in general solicitation and advertising (including on the internet) to raise an unlimited amount of money from accredited investors.¹²⁵

Rest in peace, Rule 505; your legacy lives on.

NOTES:

¹Rule 242, the predecessor to Rule 505, was adopted in 1980. Rule 505 replaced Rule 242 in 1982.

²15 U.S.C.A. § 77c(b).

³Exemption of Limited Offers and Sales by Qualified Issuers, S.E.C. Release No. 33-6180, (Jan. 17, 1980).

⁴Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, S.E.C. Release No. 33-6389 (Mar. 16, 1982).

⁵15 U.S.C.A. § 77c(b) (as amended Nov. 6, 1978).

⁶17 C.F.R. § 230.242(c) (effective Feb. 25, 1980) (rescinded June 30, 1982).

⁷Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, § 301, 94 Stat. 2275 (1980).

⁸17 C.F.R. § 230.505(b)(2)(i) (effective Apr. 15, 1982).

⁹17 C.F.R. § 230.242(e) (effective Feb. 25, 1980) (rescinded June 30, 1982).

¹⁰17 C.F.R. § 230.505(b)(2)(ii) (effective Apr. 15, 1982).

¹¹17 C.F.R. § 230.242(e)(2) (effective Feb. 25, 1980) (rescinded June 30, 1982); 17 C.F.R. § 230.501(e) (effective Apr. 15, 1982).

¹²17 C.F.R. § 230.242(a)(1) (effective Feb. 25, 1980) (rescinded June 30, 1982).

¹³17 C.F.R. § 230.501(a) (effective Apr. 15, 1982).

¹⁴17 C.F.R. § 230.501(a) (effective Apr. 11, 1988).

¹⁵Regulation D Revisions, S.E.C. Release No. 33-6758 (Mar. 10, 1988).

¹⁶Regulation D; Accredited Investor and Filing Requirements, S.E.C. Release No. 33-6825 (Mar. 20, 1989).

¹⁷17 C.F.R. § 230.242(a)(1)(ii) (effective Feb. 25, 1980) (rescinded June 30, 1982).

¹⁸Revision of Certain Exemptions from Registration for Transactions Offering Limited Offers and Sales, S.E.C. Release No. 33-6389 (Mar. 16, 1982).

¹⁹17 C.F.R. § 230.501(a)(5) (effective Apr. 15, 1982).

²⁰17 C.F.R. § 230.501(a)(6) (effective Apr. 15, 1982).

²¹17 C.F.R. § 230.501(a)(7) (effective Apr. 15, 1982).

²²Regulation D Revisions, S.E.C. Release No. 33-6758 (Mar. 10, 1988).

²³17 C.F.R. § 230.501(a)(1)(6) (effective Apr. 11, 1988).

²⁴Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 413(a), 124 Stat. 1376 (July 21, 2010).

²⁵Net Worth Standard for Accredited Investors, S.E.C. Release No. 33-9287 (Dec. 21, 2011).

²⁶17 C.F.R. § 230.242(f) (effective Feb. 25, 1980) (rescinded June 30, 1982); 17 C.F.R. § 230.502(b)(1) (effective Apr. 15, 1982).

²⁷17 C.F.R. § 230.242(f)(1) (effective Feb. 25, 1980) (rescinded June 30, 1982); 17 C.F.R. § 230.502(b)(1) (effective Apr. 15, 1982).

²⁸Regulation D; Accredited Investor and Filing Requirements, S.E.C. Release No. 33-6825 (Mar. 20, 1989).

²⁹17 C.F.R. § 230.242(f) (effective Feb. 25, 1980) (rescinded June 30, 1982).

³⁰17 C.F.R. § 230.502(b)(2)(A) (effective Apr. 15, 1982).

³¹Regulation D Revisions, S.E.C. Release No. 33-6758 (Mar. 10, 1988).

³²*Id.*

³³17 C.F.R. § 230.242(d) (effective Feb. 25, 1980) (rescinded June 30, 1982); 17 C.F.R. § 230.502(c) (effective Apr. 15, 1982).

³⁴Notice of Adoption of Rule 240 Under The Securities Act of 1933—“Exemption of Certain Limited Offers And Sales By Closely Held Issuers,” S.E.C. Release No. 33-5560 (Jan. 24, 1975).

³⁵17 C.F.R. § 230.242(a)(5)(v) (effective Feb. 25, 1980) (rescinded June 30, 1982); 17 C.F.R. § 230.505(b)(2)(iii) (effective Apr. 15, 1982).

³⁶Exemption of Limited Offers and Sales by Qualified Issuers, S.E.C. Release No. 33-6180 (Jan. 17, 1980).

³⁷Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, S.E.C. Release No. 33-6389 (Mar. 16, 1982).

³⁸Exemption of Limited Offers and Sales by Qualified Issuers, S.E.C. Release No. 33-6180 (Jan. 17, 1980).

³⁹Notice of Adoption of Rule 146 Under The Securities Act of 1933—“Transactions By An Issuer Deemed Not To Involve Any Public Offering,” S.E.C. Release No. 33-5487 (Apr. 23, 1974).

⁴⁰Notice of Adoption of Rule 240 Under The Securities Act of 1933—“Exemption of Certain Limited Offers And Sales By Closely Held Issuers,” S.E.C. Release No. 33-5560 (Jan. 24, 1975).

⁴¹Revision of Certain Exemptions From Registration for Transactions

Involving Limited Offers and Sales, S.E.C. Release No. 33-6389 (Mar. 16, 1982).

⁴²*Id.*

⁴³Exemption of Limited Offers and Sales by Qualified Issuers, S.E.C. Release No. 33-6180 (Jan. 17, 1980).

⁴⁴*Id.*

⁴⁵As discussed in Part I, Rule 242 incorporated the aggregate offering price limit in § 3(b). At the time of Rule 242's adoption, that limit was \$2 million. Shortly thereafter, Congress raised the § 3(b) limit to \$5 million.

⁴⁶As discussed above in Part I, Rule 242 merely required issuers to classify their investors as accredited or non-accredited and rejected any additional determination regarding the sophistication of those investors.

⁴⁷Campbell, Jr., *The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions*, 7 *Ohio St. Entrepreneurial Bus. L.J.* 287, 289 (2012) ("Regulation D, therefore, offered issuers a stair-step approach through its three exemptions—Rule 504, Rule 505 and Rule 506—requiring more investor protections as the size of the offering increased.").

⁴⁸*Id.*

⁴⁹Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, S.E.C. Release No. 33-6389 (Mar. 16, 1982).

⁵⁰*Id.*

⁵¹*Id.*

⁵²17 C.F.R. § 230.504(b)(2) (effective Apr. 15, 1982).

⁵³17 C.F.R. § 230.240(e) (effective Mar. 15, 1975) (rescinded June 30, 1982).

⁵⁴17 C.F.R. § 230.504(b)(1) (effective June 30, 1982) (removing the prohibition on general solicitation and advertising if issuers offered and sold the securities exclusively in states that provided for registration and required the delivery of a disclosure document before sale and if issuers complied with those state provisions).

⁵⁵17 C.F.R. § 230.240(c) (effective Mar. 15, 1975) (rescinded June 30, 1982).

⁵⁶17 C.F.R. § 230.240(f) (effective Mar. 15, 1975) (rescinded June 30, 1982).

⁵⁷17 C.F.R. § 230.504 (effective Apr. 15, 1982).

⁵⁸17 C.F.R. § 230.242(d) (effective Mar. 15, 1975) (rescinded June 30, 1982); 17 C.F.R. § 230.504 (effective Apr. 15, 1982).

⁵⁹17 C.F.R. § 230.146(d)(1) (effective June 10, 1974) (rescinded June 30, 1982).

⁶⁰17 C.F.R. § 230.506 (effective Apr. 15, 1982).

⁶¹17 C.F.R. § 230.146(d)(1) (effective June 10, 1974) (rescinded June 30, 1982).

⁶²17 C.F.R. § 230.506 (effective Apr. 15, 1982).

⁶³17 C.F.R. § 230.506(b)(2)(ii) (effective Apr. 15, 1982).

⁶⁴Securities and Exchange Commission, *Analysis of Regulation D*, Federal Securities Law Reports ¶ 83,631 (June 6, 1984).

⁶⁵*Id.*

⁶⁶*See, infra*, Part II.B.

⁶⁷*See, infra*, Part II.C.

⁶⁸Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, S.E.C. Release No. 33-6389 (Mar. 16, 1982).

⁶⁹*Id.*

⁷⁰Maynard, The Uniform Limited Offering Exemption: How “Uniform” is “Uniform”?—An Evaluation and Critique of the ULOE, 36 Emory L.J. 357, 448 (1987) (“The suitability requirement contained in section 1(D) of the ULOE applies to all Rule 505 offerings. By contrast, Rule 505 contains no suitability requirement for nonaccredited purchasers (of which there may be as many as thirty-five), even though they are not experienced in investment matters.”).

⁷¹NASAA, Uniform Limited Offering Exemption, § 1(D) (1983).

⁷²Johnson, Private Placements: A Regulatory Black Hole, 35 Del. J. Corp. L. 151, 171–72 (2010) (citing authority).

⁷³Sargent, The New Regulation D: Deregulation, Federalism and the Dynamics of Regulatory Reform, 68 Wash. U. L.Q. 225, 248 (1990).

⁷⁴Maynard, The Uniform Limited Offering Exemption: How “Uniform” is “Uniform”?—An Evaluation and Critique of the ULOE, 36 Emory L.J. 357, 363 (1987).

⁷⁵Johnson, Private Placements: A Regulatory Black Hole, 35 Del. J. Corp. L. 151, 172 (2010) (citing authority).

⁷⁶*Id.* at 159.

⁷⁷*Id.* at 162.

⁷⁸*Id.*

⁷⁹15 U.S.C.A. § 77r(b)(4)(E).

⁸⁰Johnson, Private Placements: A Regulatory Black Hole, 35 Del. J. Corp. L. 151, 166 (2010).

⁸¹*Id.* at 151.

⁸²*E.g.*, Campbell, Jr., The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC’s Crown Jewel Exemptions, 7 Ohio St. Entrepreneurial Bus. L.J. 287, 312 (2012) (“The solution to the Regulation D dilemma is simple to articulate. In order to restore Regulation D to its appropriate place in the governance of small business capital formation, state authority over all Regulation D offerings must be eliminated.”).

⁸³*E.g.*, Johnson, Private Placements: A Regulatory Black Hole, 35 Del. J. Corp. L. 151, 190 (2010) (“[T]his article advocates federal preemption only for private placements by issuers, or to purchasers, that are defined as accredited institutional investors in Rule 501(a)(1) and (2) of Regulation D, or entities subject to federal disclosure regulation under the 1934 Act. Other private placements should be, once again, subject to pre-sale review.”).

⁸⁴17 C.F.R. § 230.242(c) (effective Feb. 25, 1980) (rescinded June 30, 1982).

⁸⁵17 C.F.R. § 230.240(e) (effective Mar. 15, 1975) (rescinded June 30, 1982).

⁸⁶17 C.F.R. § 230.505(b)(2) (effective Apr. 15, 1982).

⁸⁷17 C.F.R. § 230.504(b)(2) (effective Apr. 15, 1982).

⁸⁸Regulation D Revisions, S.E.C. Release No. 33-6758 (Mar. 10, 1988).

⁸⁹Small Business Initiatives, S.E.C. Release No. 33-6949 (July 30, 1992).

⁹⁰Exemptions to Facilitate Intrastate and Regional Securities Offerings, S.E.C. Release No. 33-10238 (Oct. 26, 2016).

⁹¹*Id.*

⁹²Warren III, A Review of Regulation D: The Present Exemption Regimen for Limited Offerings Under the Securities Act of 1933, 33 Am. U. L. Rev. 355, 380 (1984) (“An issuer’s decision to conduct an offering under rule 505 rather than under rule 506 should not be predicated on a desire to avoid the responsibility of making suitability determinations.”).

⁹³Scott Baugess, Rachita Gullapalli & Vladimir Ivanov, S.E.C. Division of Economic and Risk Analysis, Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014 (Oct. 2015).

⁹⁴Exemptions to Facilitate Intrastate and Regional Securities Offerings, S.E.C. Release No. 33-10238 (Oct. 26, 2016).

⁹⁵Letter from David Lynn in Response to S.E.C. Proposing Release No. 33-9973, Chair of the Federal Regulation of Securities Committee, ABA Business Law Section (Apr. 8, 2016) (“Rule 505 is unnecessary unless the Commission raises the authorized dollar threshold of the amount that may be raised in a twelve-month period.”); Letter from Judith M. Shaw in Response to S.E.C. Proposing Release No. 33-9973, NASAA President (Jan. 11, 2016) (“NASAA would support a review by the Commission of Rule 505 to consider whether modifications and/or should be made to modernize the exemption; for example, reviewing the aggregate offering amount or information requirements.”); Letter from Brian Knight and Stacy Warden in Response to S.E.C. Proposing Release No. 33-9973, Milken Institute Center for Financial Markets (“[T]he Commission should consider whether Rule 505 could be remade to better suit the needs of small business, for example by focusing on debt-based financing.”) (Jan. 11, 2016).

⁹⁶Exemptions to Facilitate Intrastate and Regional Securities Offerings, S.E.C. Release No. 33-10238 (Oct. 26, 2016).

⁹⁷Exemption of Limited Offers and Sales by Qualified Issuers, S.E.C. Release No. 33-6180 (Jan. 17, 1980); Notice of Adoption of Rule 240 Under The Securities Act of 1933—“Exemption of Certain Limited Offers And Sales By Closely Held Issuers,” S.E.C. Release No. 33-5560 (Jan. 24, 1975); Notice of Adoption of Rule 146 Under The Securities Act of 1933—“Transactions By An Issuer Deemed Not To Involve Any Public Offering,” S.E.C. Release No. 33-5487 (Apr. 23, 1974).

⁹⁸Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, S.E.C. Release No. 33-6389 (Mar. 16, 1982).

⁹⁹Warren III, The Role of the States in the Regulation of Private Placements, 102 Ky. L.J. 971, 990 (2013–2014) (“Regulation D has been marred since promulgation with a major and somewhat inexplicably regulatory incongruity. When promulgated, Regulation D prohibited issuers from relying on the Rule 505 exemption if they had certain adverse regulatory histories but allowed issuers relying on the Rule 506 exemption to proceed without regard to those adverse regulatory histories.”).

¹⁰⁰Regulation D Revisions, S.E.C. Release No. 33-6758 (Mar. 10, 1988).

¹⁰¹*Id.*

¹⁰²*Id.*

¹⁰³Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 926, 124 Stat. 1376 (July 21, 2010).

¹⁰⁴Disqualification of Felons and Other “Bad Actors” From Rule 506 Offerings, SEC Release No. 33-9414 (July 10, 2013).

¹⁰⁵See Exemption of Limited Offers and Sales by Qualified Issuers, S.E.C. Release No. 33-6180 (Jan. 17, 1980); Parnall, Kohl and Huff, Private and Limited Offerings After A Decade of Experimentation: The Evolution of Regulation D, 12 N.M. L. Rev. 633, 664 (1982) (explaining that Rule 242 “provid[ed] for a dual standard of disclosure which depended upon the nature or sophistication of the purchaser, in effect clearly linking the sophistication with the information element”).

¹⁰⁶Friedman, On Being Rich, Accredited, and Undiversified: The Lacunae in Contemporary Securities Regulation, 47 Okla. L. Rev. 291, 304 (1994).

¹⁰⁷17 C.F.R. § 230.242(a)(1) (effective Feb. 25, 1980) (rescinded June 30, 1982).

¹⁰⁸17 C.F.R. § 230.242(f)(1) (effective Feb. 25, 1980) (rescinded June 30, 1982).

¹⁰⁹17 C.F.R. § 230.240 (effective Mar. 15, 1975) (rescinded June 30, 1982).

¹¹⁰17 C.F.R. § 230.146(e) (effective June 10, 1974) (rescinded June 30, 1982).

¹¹¹17 C.F.R. § 230.501(a) (effective Apr. 15, 1982).

¹¹²17 C.F.R. § 230.502(b)(1) (effective Apr. 15, 1982).

¹¹³Regulation D; Accredited Investor and Filing Requirements, S.E.C. Release No. 33-6825 (Mar. 20, 1989).

¹¹⁴Regulation D Revisions, S.E.C. Proposing Release No. 33-6683 (Jan. 16, 1987) (“This [accredited investor] concept is intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act’s registration process unnecessary.”).

¹¹⁵Consideration of the Impact of the Small Business Investment Incentive Act of 1980 on Certain Exemptions From the Registration Provisions of the Securities Act of 1933, S.E.C. Release No. 33-6274 (Dec. 23, 1980) (“In addition, if only accredited investors are involved in an offering there is no specific requirement to furnish them with information. This is based on the assumption that accredited investors are in a position to ask for and obtain whatever information they believe is relevant.”).

¹¹⁶SEC Staff, Report on the Review of the Definition of “Accredited Investor” (Dec. 18, 2015).

¹¹⁷Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 413(b)(2)(A), 124 Stat. 1376 (July 21, 2010).

¹¹⁸See Bradford, The New Federal Crowdfunding Exemption: Promise Unfulfilled, SEC Reg. L.J., Vol. 40, No. 3 (Fall 2012).

¹¹⁹17 C.F.R. § 227.100(a)(1).

¹²⁰17 C.F.R. § 227.201.

¹²¹17 C.F.R. § 227.202.

¹²²See, e.g., Couture, Five Options for Idaho Businesses to Raise Capital Online, 59 Adv. 28 (2016).

¹²³Exemptions to Facilitate Intrastate and Regional Securities Offerings, S.E.C. Release No. 33-10238 (Oct. 26, 2016).

¹²⁴17 C.F.R. § 230.504.

¹²⁵17 C.F.R. § 230.506(c).