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October 29, 2012

VIA E-MAIL

Lona Nallengara, Deputy Director
Division of Corporation Finance
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Dear Lona:

I enjoyed visiting with you at the Securities Regulation Seminar on October 26, and your comments on the rule making process concerning the JOBS Act.

As we discussed, I am enclosing a memo outlining the SEC's comments on the proposed Rule 506(c), and my suggestions for issuers how to comply with the requirement to take reasonable steps to verify that each purchaser is an accredited investor, some of which may be beyond the mandate of Congress.

In any event, please feel free to publish these if you wish.

Sincerely,

PETILLON HIRAIDE & LOOMIS LLP

Lee R. Petillon

LRP:ml
Enclosure

SOME GUIDELINES FOR OFFERINGS UNDER NEW RULE 506(c)

UNDER THE STARTUP OUR BUSINESS STARTUP (JOBS ACT

By Lee R. Petillon
Petillon Hiraide & Loomis LLP
September 8, 2012

In § 201 of the JOBS Act, Congress mandated that the SEC adopt a rule permitting general solicitation and general advertising for offerings under Rule 506 of Regulation D, the primary offering exemption from registration adopted by the SEC in 1982.

Before the JOBS Act, an issuer (or a registered broker-dealer acting as placement agent) needed to have a "pre-existing personal or business relationship" with each prospective investor.

The new proposed Rule 506(c), adopted on August 29, 2012, removes that ban, and simply provides that:

- all purchasers must be accredited investors (under Rule 501(a) any person who is, or the issuer reasonably believes is, an accredited investor (individuals with a net worth that exceeds $1,000,000, excluding equity in the person's primary residence, or had in the last two years individual income exceeding $200,000 if single; $300,000 jointly with spouse); and
- (2) the issuer must take reasonable steps to verify that each investor is an accredited investor.

The SEC published the proposed rule for public comment within 30 days, and will take the comments and publish a final rule.

While the SEC didn't define any "reasonable steps" in its rule, they suggested certain guidelines in their 70 page release.

Here are some guidelines suggested in the release to ensure that the issuer takes "reasonable steps":

- Determine the nature and type of accredited investor –
    - Is she a bright successful self-made business person?
    - Is he a high school dropout who inherited $1,000,000
    - Is she a 75 year old widow who never had responsibility for family finances?
    - Is he a wealthy person with Alzeimer's Disease? Or an alcoholic? Or a drug addict?

- What is the amount of information and type of information available about the purchaser?
    - The SEC suggests that merely "checking the box" on an offeree questionnaire may not be enough. A combination offeree questionnaire and

suitability questionnaire would solicit not only their net worth and income status, but other metrics, such as time horizon, risk tolerance, investment objectives, investment experience, need for liquidity, educational level and other factors which determine whether the investment is suitable (required of registered broker-dealers under FINRA's "know your customer" rule).

- How was the purchaser solicited?
  - by a registered broker-dealer who knew his customer for many years?
  - by a widely circulated website, e-mail or advertisement? Obviously the issuer must do more careful screening in the latter case.

- What is the minimum investment amount?

  - $100 per investor? Or $50,000 per investor? The small minimum should prompt the issuer to screen more carefully.

Here are some additional investor protections issuers might consider to insure compliance with the securities laws:

- Limit each investor's investment to say, 10% of her net worth, or 5% if net worth is $1-5 million, and 10 % if net worth exceeds $5 million.
- Keep all offeree/suitability questionnaires (and other offering documents) for, say 4 years (statute of limitations for contracts).
- Make sure all advertisements, sales literature and communications clearly state that investment is limited to accredited investors.
- By questionnaire, make sure that the issuer's officers, directors and promoters and the affiliates of the placement agent (if any) are not subject to the "bad boy" disqualification provisions of SEC Rule 506(b), mandated by the Dodd-Frank Act.
- Be sure all offering materials are carefully drawn to ensure that there are no material misstatements or omissions of material facts. There are no federal or state exemptions from the anti-fraud laws (even though Rule 506 offerings are exempt from state regulation by virtue of being "covered securities" under §18 of the Securities Act of 1933.

Notes: - Issuers must file the SEC Form D with the SEC within 15 days of the first sale of securities, with a copy sent concurrently to the California Department of Corporations. The federal rules under Regulation D provide that failure to timely file doesn't vitiate the exemption, but the California Rule (25102.1) doesn't excuse late filing.

- The new rule permits hedge funds , private equity funds and venture capital funds to use general solicitation to find accredited investors, but doesn't exempt such funds from the Investment Company Act of 1940, which requires such funds to register under that act if they have more than 100 beneficial owners (§ 3(c)(1) of the '40 Act).