Aviation Regulations (14 CFR Part 71) is to extend V-318 from Houlton, ME, to St. John, NB, Canada, via the 128°T(149°M) and the St. John 267°T(288°M) radials. Section 71.123 of Part 71 of the Federal Aviation Regulations was republished in Advisory Circular AC 70-3A dated January 3, 1983.

Under the circumstances presented, the FAA concludes that there is an immediate need for a regulation to extend V-318 in order to expedite this request by the Canadian Government to enhance their air traffic operations. Also, only 2 nautical miles of this airway are within the United States thereby having little impact on the U.S. air traffic system. Therefore, I find that notice and public procedure under 5 U.S.C. 553(b) are unnecessary and that good cause exists for making this amendment effective on the next charting date (June 9, 1983).

List of Subjects in 14 CFR Part 71

VOR Federal airway, Aviation safety.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me, § 71.123 of Part 71 of the Federal Aviation Regulations (14 CFR Part 71) is amended, effective 0901 G.m.t., June 9, 1983, as follows:

V-318 [Amended]

By deleting the words "Houlton, ME." and substituting the words "Houlton, ME, INT Houlton 128° and St John, NB, Canada, 267° radials; St John."

(Secs. 307(a) and 313(a), Federal Aviation Act of 1958 (49 U.S.C. 1348(a) and 1354(a)); Sec. 6(c), Department of Transportation Act (49 U.S.C. 1655(c)); and 14 CFR 11.69)

Note.—The FAA has determined that this regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore—(1) Is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this rule, will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Issued in Washington, D.C., on March 2, 1983.

Harold W. Becker,

Acting Manager, Airspace and Air Traffic Rules Division.

[FR Doc. 83-6069 Filed 3-9-83; 8:45 am]

BILLING CODE 4910-13-M

14 CFR Part 75

[Airspace Docket No. 82-ASO-27]

Establishment of Jet Routes and Area High Routes; Correction

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Correction to final rule.

SUMMARY: An error was noted in the description of Jet Route J-85 between Miami, FL, and Gainesville, FL, as published in the **Federal Register** on February 22, 1983 (48 FR 7437) (Airspace Docket No. 82-ASO-27). This action corrects that error.

EFFECTIVE DATE: April 14, 1983.

FOR FURTHER INFORMATION CONTACT: George Hussey, Airspace Regulations and Obstructions Branch (AAT-230), Airspace and Air Traffic Rules Division, Air Traffic Service, Federal Aviation Administration, 800 Independence Avenue, SW., Washington, D.C. 20591; telephone: (202) 426-8783.

SUPPLEMENTARY INFORMATION:

History

Federal Register Document 83-4329 (82-ASO-27), published in the **Federal Register** on February 22, 1983, realigned several jet routes in the vicinity of Miami, FL. The description of Jet Route J-85 is not correctly written and this action amends that mistake.

List of Subjects in 14 CFR Part 75

Jet routes, Aviation safety.

Adoption of the Correction

Accordingly, pursuant to the authority delegated to me, Federal Register Document 83-4329, as published in the **Federal Register** on February 22, 1983, is corrected as follows:

J-85 [Amended]

By deleting the words "From Biscayne Bay, FL, via INT Biscayne Bay 328° and Lakeland, FL, 140° radials, Lakeland," and substituting for them the words "From Miami, FL, via Gainesville, FL;"

(Secs. 307(a) and 313(a), Federal Aviation Act of 1958 (49 U.S.C. 1348(a) and 1354(a)); Sec. 6(c), Department of Transportation Act (49 U.S.C. 1655(c)); and 14 CFR 11.69)

Note.—The FAA has determined that this regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore—(1) is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this rule will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Issued in Washington, D.C., on March 3, 1983.

Harold W. Becker,

Acting Manager, Airspace-Rules and Aeronautical Information Division.

[FR Doc. 83-6070 Filed 3-9-83; 8:45 am]

BILLING CODE 4910-13-M

FEDERAL TRADE COMMISSION

16 CFR Part 436

Disclosure Requirements; Prohibitions Concerning Franchising and Business Opportunity Ventures; Grant of Franchise Rule Exemption Petition for Certain Wholesaler-Sponsored Grocery Chain Affiliation Offers

AGENCY: Federal Trade Commission.

ACTION: Petition granted for franchise rule exemption.

SUMMARY: The Federal Trade Commission has determined that certain distribution arrangements between grocery wholesalers and independent retailers should be exempt from the presale disclosure requirements of the Commission's Franchise Rule. Some of these arrangements, known as "wholesaler-sponsored voluntary chains," are technically covered by the Rule. However, voluntary chain affiliation offers do not have the potential for abuse that warranted the Rule's disclosure requirements for franchises. The exemption, which was requested by the National-American Wholesale Grocers' Association, is intended to make it clear that wholesale grocers who make voluntary chain affiliation offers have no obligation to comply with the Franchise Rule.

EFFECTIVE DATE: March 2, 1983.

ADDRESS: Federal Trade Commission, 6th & Pennsylvania Avenue, NW., Washington, D.C. 20580.

FOR FURTHER INFORMATION CONTACT: Craig Tregillus, PC-B-800, Federal Trade Commission, 6th & Pennsylvania Avenue, NW., Washington, D.C. 20580, (202) 376-2805.

SUPPLEMENTARY INFORMATION:

Before the Federal Trade Commission

Commissioners:
James C. Miller III
David A. Clanton
Michael Pertschuk
Patricia P. Bailey
George W. Douglas

In the Matter of: Petition for Exemption from Trade Regulation Rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" filed by the National-American Wholesale Grocers' Association.

Decision and Order

On October 21, 1979, the National-American Wholesale Grocer's Association (NAWGA) filed a petition on behalf of its members seeking an exemption for wholesaler-sponsored grocery chains from coverage under a Commission trade regulation rule entitled "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" (the "franchise rule").[1] NAWGA argued in its petition that an exemption is necessary to prevent unjustified coverage of these relationships, known as "voluntary chains," which enable independent grocery retailers to advertise together under common trademarks and service marks owned by their wholesale supplier.

The franchise rule, which took effect on the same day NAWGA's petition was filed, requires franchisors to provide prospective franchisees with pre-sale disclosures in writing which contain information about the franchisor, the franchised business, the terms of the franchise relationship, and substantiation for any earnings claims made. The rule is designed to assure that potential franchise purchasers have the information they need, when they need it, in order to make an informed investment decision.

Section 18(g) of the Federal Trade Commission Act authorizes the Commission to grant exemptions from its trade regulation rules where coverage is "not necessary to prevent the unfair or deceptive act[s] or practice[s] to which the rule relates."[2] Accordingly, the Commission initiated an exemption proceeding pursuant to Section 553 of the Administrative Procedure Act[3] by publishing NAWGA's submissions in the **Federal Register** for public comment.[4] Having reviewed and considered the record in this exemption proceeding, including the comments received during the 30-day comment period, the Commission has determined that the standard prescribed by Section 18(g) of the Act is met, and that an unqualified exemption from franchise rule coverage should be granted.[5]

In considering NAWGA's exemption request, the Commission's principal concern has been to determine whether the acts and practices the franchise rule was designed to prevent would be likely to occur in voluntary chain relationships if an exemption were granted. Accordingly, as in prior franchise rule exemption proceedings,[6] the Commission has examined relevant indicia of the future likelihood of such acts and practices; namely: (1) The past record of wholesaler acts and practices in making voluntary chain affiliation offers to grocery retailers; (2) comments about the need for protection by and on behalf of the grocery retailers who might benefit from franchise rule coverage; (3) the presence of conditions in the industry which could permit the abuses addressed by the franchise rule to occur; and (4) the existence of economic incentives for wholesalers to engage in any of the unfair or deceptive acts or practices to which the franchise rule relates. None of these indicia suggests that franchise rule coverage is necessary to prevent unfair or deceptive acts by wholesalers offering voluntary chain affiliations to grocery retailers.

Evidence of Abuses

We begin with the fact that there is no prior record in the grocery industry of the types of unfair or deceptive acts or practices the franchise rule was designed to prevent. The rulemaking record documenting abuses in franchise sales was devoid of evidence of any similar abuses in offers of voluntary chain affiliation by grocery wholesalers. Consequently, we were persuaded when the rule was promulgated that voluntary chains and similar relationships should be exempted from franchise rule coverage.[7]

No new evidence has since come to our attention to suggest that any of the abuses addressed by the franchise rule have occurred or are occurring in the grocery industry. The public comments received in this exemption proceeding provide a notable case in point. The comments in the record from all parties directly affected endorsed the exemption petition. Wholesale grocers and their trade association were not alone in supporting the exemption. It was also advocated by the voluntary chain affiliates who commented, as well as by two trade associations representing over 40,000 independent retail grocers, some 20,000 of whom are affiliated with voluntary chains. Thus, the very group that franchise rule coverage might benefit has failed to seek the protection the rule would provide.

The record in this proceeding provides two explanations for the apparent lack of prior problems in the grocery industry which persuade us that the likelihood of future abuses is remote: (1) The absence of the conditions that have allowed abuses to occur in franchise sales; and (2) the lack of economic incentives for grocery wholesalers to engage in unfair or deceptive practices.

Conditions Permitting Abuses

As we emphasized in the Statement of Basis and Purpose for the franchise rule, what differentiates a covered franchise from conventional distribution arrangements is the significant degree to which a franchise must rely on the franchisor's knowledge and expertise from the very outset of the relationship.[8] It is this reliance or dependence which promises to reduce the franchisee's risk of failure in a new business, but also creates the conditions which, in the absence of full disclosure as required by the rule, have allowed well-documented abuses to occur in the sale of franchises by unscrupulous promoters.

We have previously identified the factors that contribute to a prospective franchisee's dependence on the franchisor, and the consequent informational imbalance which permits abuses in the sale of franchises: (1) The frequent lack of relevant business experience and sophistication of prospective franchisees; (2) the complexity of franchise agreements and the inadequate time typically provided to review them before a binding commitment is made; and (3) the promises inherent in all franchises covered by the rule that induce reliance on the superior knowledge and expertise of the franchisor.[9] An examination of the record in this proceeding satisfies us that these factors are not characteristic of voluntary chain relationships.

The record shows that applicants seeking voluntary chain affiliation typically have extensive prior experience in the grocery industry, and thus are capable of independently evaluating the risks and benefits of affiliation. We are advised that the typical applicant, in fact, has had pertinent experience in the grocery business, with many having worked as long as five to ten years, whether as owners of an unaffiliated grocery store, managers of a chain store, or in other supervisory positions. Such prior experience is a mandatory requirement for affiliation with some voluntary groups, and the economic self-interest of the wholesalers that do not have a formal requirement makes experience a prerequisite in practice, at least when financial assistance is provided.[10]

The record also indicates that prospective voluntary chain affiliates have ample time to review and consider contractual agreements before signing them; thus, there is no place for high-pressure sales tactics in affiliation offers. The comments indicate that negotiations for affiliation typically require at least one to three months, and that many applicants consult during that time with attorneys, accountants and other business advisors. Negotiations for relationships in which the wholesaler will provide financial assistance to an affiliate are even more protracted, commonly requiring at least six months, and sometimes as long as one to three years.

Thus, the picture that emerges from the record in this proceeding is one of knowledgeable and experienced applicants with adequate time to ask pertinent questions and consult with advisors about the risks and benefits of affiliation. They stand in sharp contrast to the unsophisticated consumers the rule was primarily designed to protect, such as "mom and pop" operators of convenience stores and other franchises.

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[1] 16 C.F.R. 435 et seq. (1980).

[2] 15 U.S.C. 57a(g) (1980).

[3] 5 U.S.C. 553 (1980).

[4] 46 FR 11830 (Feb. 11, 1981).

[5] Accordingly, we need not consider the two amended petitions submitted by NAWGA on February 26 and March 27, 1980, which proposed qualified exemptions based on the prior experience and training of the grocery retailers to whom voluntary chain affiliation is offered.

[6] In re *Exemption Petitions of Automobile Importers of America, et al.*, 45 Fed. Reg. 51763 (Aug. 5, 1980); In re *Exemption Petitions of National Oil Jobbers Council et al.*, 45 FR 51765 (Aug. 5, 1980).

[7] 43 FR 59614, 59704 & n. 61 (Dec. 21, 1978).

[8] 43 FR at 59698–99.

[9] 45 FR at 51764.

[10] The franchise rule does not apply to voluntary chain affiliation offers unless the wholesaler provides some form of financial assistance to the retailer. See the discussion at p. 6, *infra*.

The pronounced differences between voluntary chain affiliations and franchise relationships are highlighted most clearly by the final factor, the lack of dependence of affiliated retailers on the wholesaler sponsoring the chain. In fact, the record shows that so little reliance on the wholesaler is induced by most affiliation offers that the prerequisites to franchise rule coverage are not even met.

Because the franchise rule targets only commercial relationships where a potential for abuse is created when an investment is induced in reliance on promises made by the franchisor, three essential elements must all be present before the rule applies: (1) An offer of the right to use the franchisor's trademark, service mark or other commercial symbol; (2) an offer of either significant assistance in operating the business or significant controls to reduce the risk of failure; and (3) required payments the franchisee must make to the franchisor to obtain the franchise, exclusive of payments made at bona fide wholesale prices for reasonable quantities of goods acquired for resale.[11]

One or more of these coverage prerequisites, which reflect the reliance and risk unique to franchise investments, is absent from almost all of the alternative business options that wholesalers typically present to their potential customers. The record indicates it is only in unique circumstances that the franchise rule ever applies to wholesaler-retailer relationships, as a brief review of the different options will demonstrate.

The first and most basic option is for establishment of an ordinary wholesale supply relationship, to which the franchise rule was never meant to apply.[12] Under this arrangement, the retailer simply contracts to purchase groceries from the wholesaler at wholesale prices, expects and receives no other services or assistance, and operates the retail business in all respects as a truly independent entrepreneur. None of the three prerequisites to franchise rule coverage is present in such a relationship.

The second option typically offered by grocery wholesalers—the opportunity to purchase not only groceries, but a variety of support services, including accounting, inventory control and payroll processing assistance [13]— is not covered either. The trademark prerequisite is not met, and there is no required payment because all the services are strictly optional, with the retailer entirely free to accept or reject each of them.[14]

For the same reason, the rule is inapplicable to the third option, the most common type of voluntary chain affiliation offer. Although the affiliation offer includes the right to operate and advertise under the wholesaler's marks and to purchase support services, the required payment prerequisite to coverage is still not met because the support services continue to be offered on a strictly optional basis.

It is only in rather limited circumstances that all three prerequisites to franchise rule coverage are technically present in voluntary chain affiliation offers. The record shows that the rule may apply when a retailer cannot affiliate unless the wholesaler invests in the business by providing some form of financial assistance. This may include, for example, an agreement to sublease store premises where the lessor demands the security of a prime lease with the wholesaler, an agreement to lease a store owned by the wholesaler, or a loan for inventory, fixtures or equipment. In each of these limited circumstances, the final prerequisite to franchise rule coverage will ordinarily be met by the required rental or loan payments the retailer must make to the wholesaler.[15] Moreover, where financial assistance is offered, required payments for such otherwise optional assistance as payroll, inventory control, accounting, site selection and store planning services may also help satisfy the final coverage prerequisite. These additional payments may be required if the wholesaler seeks to limit its risk in extending financial assistance through the control and oversight gained by providing the services, and requiring retailers who receive financing to purchase them.

We are persuaded that even though all the elements characterizing a covered franchise may technically be found when wholesalers provide financial assistance, the presence of those elements in this context reflects neither the degree of risk nor reliance likely to permit or encourage abuses. On the contrary, in providing financial assistance, the wholesaler assumes a share of the investment risk ordinarily undertaken solely by the retailer, and thus has every incentive to exercise care not to jeopardize the retailer's chances of success, through non-disclosure or otherwise. In contrast, franchisees ordinarily bear the full risk of loss in franchise investments, and franchisors do not necessarily have an incentive to promote the success of the franchise.

Furthermore, the degree of reliance of an affiliating retailer on the wholesaler is significantly less than a franchisee's reliance on a franchisor. The retailer is not induced by an affiliation offer to rely on the wholesaler's assistance, because all of the services and assistance available through affiliation are separately available from a wholesaler without affiliation. Thus, whereas a franchisee is induced to rely on a franchisor by the promise of a complete package of services and assistance not available without the franchise, no comparable reliance on a wholesaler is induced by an affiliation offer.

In addition, when the choice is made to affiliate with a voluntary chain, the retailer who needs no financial assistance is free, unlike a franchisee, to accept or reject all of the optional services offered by the wholesaler. If, on the other hand, financial assistance is sought from the wholesaler, the retailer can scarcely place any greater reliance on the wholesaler than on a bank or other commercial lender which might otherwise provide financing. The fact that the retailer may then be required to subscribe to some normally optional services can hardly be viewed as an inducement for the retailer to rely on the wholesaler to provide these services, or to obtain financial assistance from the wholesaler. If anything, such requirements might be expected to deter retailers from obtaining wholesaler financing.

With the exception of the services required when a wholesaler provides financing, the record shows that wholesalers impose no significant controls over the retailers who affiliate with voluntary chains. In marked contrast to the typical franchise, the retailer can even terminate its affiliation on relatively short notice, such as thirty days, provided its financial obligations to the wholesaler have been met. Moreover, retailers owning multiple stores are free to belong to more than one voluntary chain, and the record indicates that a number of them do, in fact, participate in chains sponsored by more than one wholesaler. By comparision, the ownership of different franchises in the same business is commonly prohibited by the non-competition clauses to be found in most franchise agreements.

Consequently, we conclude that the conditions which permit abuses in franchising are not characteristic of voluntary chain relationships between wholesale grocers and retailers. As we have noted, affiliating retailers typically have prior experience in the business, ample time to review and consider the affiliation offer, and far less exposure to the risk and reliance confronting the franchisees the rule is designed to protect. Even where franchise rule coverage would technically result from required payments that exceed the $500 threshold of the rule's minimum investment exclusion, we think our original conclusion when the franchise rule was promulgated is still valid:

> While similar in many respects to franchising, the wholesaler sponsored voluntary chains differ from franchising in that the retailers associate with the wholesalers voluntarily and with little risk.[16]

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[11] 16 CFR 436.2(a) (1) and (2); *see also* Final Interpretive Guides, 44 FR 49966, 49967 (Aug. 24, 1979).

[12] 43 FR at 59703 n.55.

[13] The record shows that wholesalers may also offer site selection, store planning and related services to retailers desiring assistance in opening a new location.

[14] Optional payments not required as a condition of obtaining a franchise do not satisfy the third coverage prerequisite. 43 FR at 59703 n.53. *See e.g.*, Informal Staff Advisory Opinion to Chrysler Corp., CCH Business Franchise Guide ¶6383 at 9553 (Aug. 10, 1979), *ratified by the Commission*, Oct. 5, 1979. Although some wholesalers charge nominal monthly affiliation and sign rental fees—typically less than $20—such fees do not exceed the $500 threshold of the minimum investment exclusion from coverage. 16 CFR 436.2(a)(3)(iii).

[15] A payment is "required as a condition of obtaining or commencing the franchise operation," 16 CFR 436.2(a)(2), if it is required by the terms of the contract offer or is "in fact necessary to begin operation." 43 FR at 59703 n. 50. All required payments made prior to and within the first six months of franchise operations count toward the $500 threshold of the minimum investment exclusion from coverage. 16 CFR 436.2(a)(3)(iii), and the record shows that even one month's rental or loan payments typically exceed that amount.

[16] 43 FR at 59704 n. 61.

Economic Incentives

Not only are the conditions which permit franchise abuses noteworthy for their absence from the grocery industry, but the structure of economic incentives actively inhibits wholesalers from committing unfair or deceptive acts and practices. Were it not for this, it would be difficult, if not impossible, to conclude that franchise rule coverage is unnecessary where financial assistance is offered.

The primary economic fact of life in the grocery business is intense price competition at the retail level. The record documents the fact that competition holds retailer profit margins at very low levels—typically one percent or less. Success and survival in the business require retailers to minimize costs and maximize sales volumes. Four consequences of this competition act as significant deterrents to wholesaler abuses in voluntary chain relationships.

First, wholesalers are unable to charge large front-end affiliation fees. Affiliating retailers cannot pass such fees on to their customers without risk of pricing themselves out of the market, and their profit margins are not sufficient to absorb them. The record confirms that initial affiliation fees are quite modest as a result—typically less than $100. Thus, there are no quick profits to be made from recruiting new affiliates; consequently, no economic incentive exists for misrepresentations to obtain them. In contrast, the incentive of substantial profits from initial franchise fees has led to well-documented sales abuses by fly-by-night franchise and business opportunity promoters.

Second, wholesalers cannot expect significant profits from continuing affiliation fees. While the record suggests that nominal monthly membership or sign rental fees are relatively common,[17] wholesalers cannot charge large on-going fees, or otherwise seek to profit at the expense of affiliated retailers, without jeopardizing the retailers' competitive position. Instead, wholesalers are constrained by retail competition to make their profit from the usual mark-up on the groceries they supply, while offering other services at cost or close to it. Thus, wholesalers stand to profit most from long-term voluntary chain affiliations, and lack the incentive franchisors can have to make short-term profits at the expense of their franchisees.

Third, unlike franchisors, wholesalers have no particular economic incentive to sell affiliation to retailers or other investors who might finance expansion of the voluntary chain. Since wholesalers profit from long-term supply relationships, rather than affiliation, they lack any significant incentive to employ unfair or deceptive practices to promote voluntary chain membership. Thus, the chain identity that affiliation offers is regarded in the industry as just another optional service provided by the wholesaler.[18] Franchisors, in contrast, typically have every incentive to expand their franchise systems as rapidly as possible, and to entice investors who can supply the necessary expansion capital to become franchisees.

Fourth, wholesalers have direct financial incentives to avoid unfairness or deception in promoting affiliation. When the rule would technically apply because a wholesaler provides financial assistance to an affiliating retailer, the record indicates that the wholesaler's losses from a store's failure can equal or exceed the retailer's. However, an even more important incentive for wholesalers to refrain from any deception that might result in financial injury to an affiliate is the wholesaler's necessary concern for preserving its good business reputation with both the affiliated and unaffiliated local retailers it serves. The loss of even one affiliate attributing a business failure to wholesaler misconduct could jeopardize a number of profitable supply relationships.

Conclusion

For these reasons, we conclude that competition in the grocery industry removes any significant incentive for wholesaler abuses in making affiliation offers. The lack of such an incentive, together with the absence of conditions that could allow abuses to occur, persuades us that there is no realistic likelihood of wholesaler misconduct in the future, just as the lack of evidence of prior abuses or requests for protection from interested parties would suggest. Thus, we conclude that franchise rule coverage of affiliation offers is not necessary to prevent the unfair or deceptive acts and practices addressed by the rule, and that an unqualified exemption from coverage should be granted since the statutory standard is met.

Our determination is unavoidably based, of course, on a forecast of the need for coverage based on the record before us of past and present conditions in the grocery industry. We recognize both that circumstances may change and that there can be no guarantee that abuses will never occur in the future. However, any isolated misconduct will be subject to scrutiny under Section 5 of the FTC Act, and the need for disclosure can be reevaluated if changed conditions ever result in widespread abuses.

Although the record in this proceeding clearly supports an exemption, there is no unanimity in the comments on the variety of proposals advanced for defining the class to whom the exemption should apply. These definitional problems can be traced to the desire of some wholesale grocers who do business as convenience store franchisors to gain an exemption for their franchise sales as well. If such an exemption is appropriate, it is not apparent on this record, which suggests, if anything, that convenience store franchises do not share the unique characteristics that minimize the potential for abuse in offers of voluntary chain affiliation.

We have determined, therefore, that the exemption we grant should apply only to voluntary chain affiliation offers, and not to convenience store franchises. Accordingly, an exemption is hereby granted from the requirements of Part 436 for:

The advertising, offering, licensing, contracting, sale or other promotion by a wholesale grocer of a voluntary chain affiliation to which Part 436 would not apply but for required payments to be made by an affiliating retailer to the wholesaler as a result of the retailer's voluntary election to obtain financial assistance from the wholesaler.

It is so ordered.

By direction of the Commission.

Benjamin I. Berman,

Acting Secretary.

[FR Doc. 83-6073 Filed 3-9-83; 8:45 am]

BILLING CODE 6750-01-M

[17] *See* note 14, *supra*, at 6.

[18] In fact, as the record reflects, wholesalers first offered the option of voluntary chain affiliation several decades ago in order to help the independent grocers they supplied to compete successfully with major grocery chains.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 211

[Release No. SAB-50]

Staff Accounting Bulletin No. 50

AGENCY: Securities and Exchange Commission.

ACTION: Publication of Staff Accounting Bulletin.

SUMMARY: This Staff Accounting Bulletin expresses the staff's views with respect to financial statement and industry guide disclosures required in a filing involving the formation of a bank holding company structure over a bank when the only substantial asset of the holding company is its investment in the bank. It also discusses requirements for subsequently filed reports on Form 10-K for such registrants.

DATE: March 3, 1983.

FOR FURTHER INFORMATION CONTACT: Howard P. Hodges, Jr. or Henry J. Velsor, Division of Corporation Finance (202-272-2553), or Marc D. Oken or Eugene W. Green, Office of the Chief Accountant (202-272-2130), Securities and Exchange Commission, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The statements in Staff Accounting Bulletins are not rules or interpretations of the Commission nor are they published as bearing the Commission's official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the Federal securities laws.

Dated: March 3, 1983.

George A. Fitzsimmons,

Secretary.

List of Subjects in 17 CFR Part 211

Accounting, Reporting requirements, Securities.

Staff Accounting Bulletin No. 50

The staff herein adds Section F to Topic 1 of the Staff Accounting Bulletin Series. This section discusses the requirements for financial statements and industry guide disclosures in filings involving the formation of a bank holding company structure over a bank and requirements for subsequent filings on Form 10–K.

Topic 1: Financial Statements

* * * * *

F. Financial Statement Requirements in Filings Involving the Formation of a One-Bank Holding Company

Facts: Holding Company A is organized for the purpose of issuing common stock to acquire all of the common stock of Bank A. Under the plan of reorganization, each share of common stock of Bank A will be exchanged for one share of common stock of the holding company. The shares of the holding company to be issued in the transaction will be registered on Form S–14. The holding company will not engage in any operations prior to consummation of the reorganization, and its only significant asset after the transaction will be its investment in the bank. The bank has been furnishing its shareholders with an annual report that includes financial statements that comply with generally accepted accounting principles.

Item 15 of Schedule 14A of the proxy rules[1] provides that financial statements generally are not necessary in proxy material relating only to changes in legal organization, (such as reorganizations involving the issuer and one or more of its totally held subsidiaries).

Question 1: Must the financial statements and the information required by Securities Act Industry Guide ("Guide 3")[2] for Bank A be included in the initial registration statement on Form S–14?

Interpretive Response: No, provided that certain conditions are met. The staff will not take exception to the omission of financial statements and Guide 3 information in the initial registration statement on Form S–14 if all of the following conditions are met:

- There are no anticipated changes in the shareholders' relative equity ownership interest in the underlying bank assets, except for redemption of no more than a nominal number of shares of unaffiliated persons who dissent;
- In the aggregate, only nominal borrowings are to be incurred for such purposes as organizing the holding company, to pay nonaffiliated persons who dissent, or to meet minimum capital requirements;
- There are no new classes of stock authorized other than those corresponding to the stock of Bank A immediately prior to the reorganization;
- There are no plans or arrangements to issue any additional shares to acquire any business other than Bank A; and,
- There has been no material adverse change in the financial condition of the bank since the latest fiscal year end included in the annual report to shareholders.

If at the time of filing the S–14, a letter is furnished to the staff stating that all of these conditions are met, it will not be necessary to request the Division of Corporation Finance to waive the financial statement or Guide 3 requirements of Form S–14.

Although the financial statements may be omitted, the filing should include a section captioned, "Financial Statements," which states either that an annual report containing financial statements for at least the latest fiscal year prepared in conformity with generally accepted accounting principles was previously furnished to shareholders or is being delivered with the prospectus. If financial statements have been previously furnished, it should be indicated that an additional copy of such report for the latest fiscal year will be furnished promptly upon request without charge to shareholders. The name and address of the person to whom the request should be made should be provided. One copy of such annual report should be furnished supplementally with the initial filing for purposes of staff review.

If any nominal amounts are to be borrowed in connection with the formation of the holding company, a statement of capitalization should be included in the filing which shows Bank A on an historical basis, the pro forma adjustments, and the holding company on a pro forma basis. A note should also explain the pro forma effect, in total and per share, which the borrowings would have had on net income for the latest fiscal year if the transaction had occurred at the beginning of the period.

Question 2: Are the financial statements of Bank A required to be audited for purposes of the initial Form S–14 or the subsequent Form 10–K report?

Interpretive Response: The staff will not insist that the financial statements in the annual report to shareholders used to satisfy the requirements of the initial Form S–14 be audited.

The consolidated financial statements of the holding company to be included in the registrant's initial report on Form 10–K should comply with the applicable financial statement requirements in Regulation S–X at the time such annual report is filed. However, the regulations also provide that the staff may allow one or more of the required statements to be unaudited where it is consistent with the protection of investors.[3] Accordingly, the policy of the Division of Corporation Finance is as follows:

- The registrant should file audited balance sheets as of the two most recent fiscal years and audited statements of income and changes in financial position for each of the three latest fiscal years, with appropriate footnotes and schedules as required by Regulation S–X unless the financial statements have not previously been audited for the periods required to be filed. In such cases, the Division will not object if the financial statements in the first annual report on Form 10–K (or the special report filed pursuant to Rule 15d–2)[4] are audited only for the two latest fiscal years.[5] This policy only applies to filings on Form 10–K, and not to any Securities Act filings made after the initial S–14 filing.

The above procedure may be followed without making a specific request of the Division of Corporation Finance for a waiver of the financial statement requirements of Form 10–K.

The information required by Guide 3 should also be provided in the Form 10–K for at least the periods for which audited financial statements are furnished. If some of the statistical information for the two most recent fiscal years for which audited financial statements are included (other than information on nonperforming loans and the summary of loan loss experience) is unavailable and cannot be obtained without unwarranted or undue burden or expense, such data may be omitted provided a brief explanation in support of such representation is included in the

[1] Item 15(c) of Schedule 14A (17 CFR Part 240).

[2] Item 801 of Regulation S–K (17 CFR Part 229).

[3] Rule 3–13 of Regulation S–X (17 CFR Part 210).

[4] Rule 15d–2 (17 CFR Part 240) would be appliable if the annual report furnished with the Form S–14 was not for the registrant's most recent fiscal year. In such a situation, Rule 15d–2 would require the registrant to file a special report within 90 days after the effective date of the Form S–14 furnishing audited financial statements for the most recent fiscal year.

[5] Unaudited statements of income and changes in financial position should be furnished for the earliest period.

report on Form 10–K. In all cases, however, information with respect to nonperforming loans and loan loss experience, or reasonably comparable data, must be furnished for at least the two latest fiscal years in the initial 10–K. Thereafter, for subsequent years in reports on Form 10–K, all of the Guide 3 information is required; Guide 3 information which had been omitted in the initial 10–K in accordance with the above procedure can be excluded in any subsequent 10–K's.

Question 3: Can organization costs incurred to register securities issued for the formation of one-bank holding companies be capitalized?

Interpretive Response: The staff will not object if organizational costs such as legal, printing and other related costs are capitalized and amortized against income over a period not to exceed 5 years. Any such organization costs should be shown in the balance sheet as an asset, and not as a reduction of shareholders' equity.

Audit fees incurred would not be deemed to be organizational costs and should be expensed.

[FR Doc. 83-6187 Filed 3-9-83; 8:45 am]
BILLING CODE 8010-01-M

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17 CFR Part 231

[Release No. 33-6455]

Interpretive Release on Regulation D

AGENCY: Securities and Exchange Commission.

ACTION: Publication of Staff Interpretations.

SUMMARY: The Commission has authorized the issuance of this release setting forth the views of its Division of Corporation Finance on various interpretive questions regarding the rules contained in Regulation D under the Securities Act of 1933. These views are being published to answer frequently raised questions with respect to the regulation.

FOR FURTHER INFORMATION, CONTACT: David B. H. Martin, Jr., Office of Chief Counsel, Division of Corporation Finance, Securities and Exchange Commission, Washington, D.C. 20549, (202) 272–2573.

SUPPLEMENTARY INFORMATION: In Release No. 33–6389 (March 8, 1982) (47 FR 11251), the Commission adopted Regulation D (17 CFR 230.501–.506) which provides three exemptions from the registration requirements of the Securities Act of 1933 (the "Securities Act" or the "Act") (15 U.S.C. 77a–77bbbb (1976 & Supp. IV 1980), as amended by the Bus Regulatory Reform Act of 1982, Pub. L. No. 97–261 section 19(d), 96 Stat. 1121 (1982)).[1] Regulation D became effective on April 15, 1982.

In the course of administering the regulation, the staff of the Division of Corporation Finance has answered numerous oral and written requests for interpretation of the new provisions. This release is intended to assist those persons who wish to make offerings in reliance on the exemptions in Regulation D by presenting the staff's views on frequently raised questions. As indicated in Preliminary Note 3 to the regulation, Regulation D is intended to be a basic element in a uniform system of federal-state exemptions. As such, aspects of Regulation D have been incorporated in many state statutes and regulations. The interpretations set forth in this release relate only to the federal provisions.

Regulation D is composed of six rules, Rules 501–506. The first three rules set forth general terms and conditions that apply in whole or in part to the exemptions. The questions arising under Rules 501–503 fall into four general categories: definitions, disclosure requirements, operational conditions, and notice of sale requirements. The exemptions of Regulation D are set forth in Rules 504–506. Questions concerning those rules usually raise issues pertaining to more than one exemption. This release, an outline of which follows, is organized so as to reflect this pattern of inquiries.

I. Definitions—Rule 501

A. Accredited Investor—Rule 501(a)

Defined in Rule 501(a), the term "accredited investor" is significant to the operation of Regulation D.[2] Under Rule 501(e), for instance, accredited investors are not included in computing the number of purchasers in offerings conducted in reliance on Rules 505 and 506. Also, if accredited investors are the only purchasers in offerings under Rules 505 and 506, Regulation D does not require delivery of specific disclosure as a condition of the exemptions. Finally, in an offering under Rule 506, the issuer's obligation to ensure the sophistication of purchasers applies to investors that are not accredited. *See* Rule 506(b)(2)(ii).

The definition sets forth eigth categories of investor that may be accredited. The following questions and answers cover certain issues under various of those categories. Given the frequency of questions regarding the application of the definition to trusts, however, there is a separate section addressing that area.

1. *General.* The definition of "accredited investor" includes any person who comes within or "who the issuer reasonably believes" comes within one of the enumerated categories "at the time of the sale of the securities to that person." What constitutes "reasonable" belief will depend on the facts of each particular case. For this reason, the staff generally will not be in

[1] Prior releases leading to the adoption of Regulation D included Release No. 33–6274 (December 23, 1980) (46 FR 2631) in which the Commission considered and requested comments on various exemptions under the Securities Act and Release No. 33–6339 (August 7, 1981) (46 FR 41791) in which the Commission published proposed Regulation D for comment.

[2] The term also is essential to the operation of section 4(6) of the Securities Act which exempts certain transactions involving sales solely to accredited investors. The definition of accredited investor for section 4(6) is found at section 2(15) of the Securities Act and Rule 215 (17 CFR 230.321). Rule 501(a) combines and repeats those provisions. As a result, interpretations regarding the definition of "accredited investor" in Regulation D also apply to the definition of that term under section 4(6).

a position to express views or otherwise endorse any one method for ascertaining whether an investor is accredited.

(1) *Question:* A director of a corporate issuer purchases securities offered under Rule 505. Two weeks after the purchase, and prior to completion of the offering, the director resigns due to a sudden illness. Is the former director an accredited investor?

Answer: Yes. The preliminary language to Rule 501(a) provides that an investor is accredited if he falls into one of the enumerated categories "at the time of the sale of securities to that person." One such category includes directors of the issuer. *See* Rule 501(a)(4). The investor in this case had that status at the time of the sale to him.[3]

2. *Certain Institutional Investors—Rules 501(a)(1)–(3).* (2) *Question:* A national bank purchases $100,000 of securities from a Regulation D issuer and distributes the securities equally among ten trust accounts for which it acts as trustee. Is the bank an accredited investor?

Answer: Yes. Rule 501(a)(1) accredits a bank acting in a fiduciary capacity.[4]

(3) *Question:* An ERISA employee benefit plan will purchase $200,000 of the securities being offered. The plan has less than $5,000,000 in total assets and its investment decisions are made by a plan trustee who is not a bank, insurance company, or registered investment adviser. Does the plan qualify as an accredited investor?

Answer: Not under Rule 501(a)(1). Rule 501(a)(1) accredits an ERISA plan that has a plan fiduciary which is a bank, insurance company, or registered investment adviser or that has total assets in excess of $5,000,000. The plan, however, may be an accredited investor under Rule 501(a)(5), which accredits certain persons who purchase at least $150,000 of the securities being offered.

(4) *Question:* A state run, not-for-profit hospital has total assets in excess of $5,000,000. Because it is a state agency, the hospital is exempt from federal income taxation. Rule 501(a)(3) accredits any organization described in section 501(c)(3) of the Internal Revenue Code that has total assets in excess of $5,000,000. Is the hospital accredited under Rule 501(a)(3)?

Answer: Yes. This category does not require that the investor has received a ruling on tax status under section 501(c)(3) of the Internal Revenue Code. Rather, Rule 501(a)(3) accredits an investor that falls within the substantive description in that section.[5]

(5) *Question:* A not-for-profit, tax exempt hospital with total assets of $3,000,000 is purchasing $100,000 of securities in a Regulation D offering. The hospital controls a subsidiary with total assets of $3,000,000. Under generally accepted accounting principles, the hospital may combine its financial statements with that of its subsidiary. Is the hospital accredited?

Answer: Yes, under Rule 501(a)(3). Where the financial statements of the subsidiary may be combined with those of the investor, the assets of the subsidiary may be added to those of the investor in computing total assets for purposes of Rule 501(a)(3).[6]

3. Insiders—Rule 501(a)(4). (6) *Question:* The executive officer of a parent of the corporate general partner of the issuer is investing in the Regulation D offering. Is that individual an accredited investor?

Answer: Rule 501(a)(4) accredits only the directors and executive officers of the general partner itself. Unless the executive officer of the parent can be deemed an executive officer of the subsidiary,[7] that individual is not an accredited investor.

4. $150,000 Purchasers—Rule 501(a)(5). This provision accredits any person [8] who satisfies two separate tests. To be accredited under Rule 501(a)(5), an investor must purchase at least $150,000 of the securities being offered, by one or a combination of four specific methods: cash, marketable securities, an unconditional obligation to pay cash or marketable securities over not more than five years, and cancellation of indebtedness. The rule also requires that "the total purchase price" may not exceed 20 percent of the purchaser's net worth. The two tests under Rule 501(a)(5) must be considered separately. Thus, for instance, in computing the "total purchase price" for the 20 percent of net worth limitation, the investor may have to include amounts that could not be included toward the $150,000 purchase test.

a. $150,000 Purchase. (7) *Question:* Two issuers, a general partner and its limited partnership, are selling their securities simultaneously as units consisting of common stock and limited partnership interests. The issues are part of a plan of financing made for the same general purpose. If an investor purchases $150,000 of these units, would it satisfy the $150,000 purchase element of Rule 501(a)(5)?

Answer: Yes. The issuers are affiliated and the simultaneous sale of their separate securities as units for a single plan of financing would be deemed one integrated offering. Rule 501(a)(5) applies to a purchase "of the securities being offered." The rule thus applies not to the securites of a particular issuer, but to the securities of a particular offering[9]

(8) *Question:* An investor will purchase securities in cash installments. Each installment payment will include amounts due on the principal as well as interest. If the total of all payments is $150,000, will the investor have purchased "at least $150,000 of the securities being offered" for purposes of Rule 501(a)(5)?

Answer: No. Under Rule 501(a)(5), any amount constituting interest due on the unpaid purchase price is not payment for the "securities being offered."

(9) *Question:* The installment payments for interests in a limited partnership that will develop commercial real estate will be conditioned upon completion of certain phases of the project. Will the obligation to make those payments be deemed "an unconditional obligation to pay" for purposes of Rule 501(a)(5)?

Answer: Yes, as long as the only conditions relate to completion of successive stages of the development project.

(10) *Question:* An investor will purchase securities in a Regulation D offering by delivering $75,000 in cash and a letter of credit for $75,000. Will such a purchase satisfy the $150,000 element of Rule 501(a)(5)?

Answer: No. Because there is no assurance that the letter of credit will ever be drawn against, the staff does not deem it to be an unconditional obligation to pay.

(11) *Question:* In connection with the sale of limited partnership interests in an oil and gas drilling program, an investor in a Regulation D offering commits to pay subsequent assessments

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[3] Preliminary Note 6 to Regulation D would support a different analysis if it could be shown that the director's appointment or resignation was "part of a plan or scheme to evade the registration provisions of the Act."

[4] Rule 501(a)(1) refers to "[a]ny bank as defined in section 3(a)(2) of the Act." Section 3(a)(2) provides that the term "bank" includes "any national bank." Section 3(a)(2) also provides that where a common or collective trust fund is involved, the term "bank" has the same meaning as in the Investment Company Act of 1940 (the "Investment Company Act") [15 U.S.C. 80a–1–80a–65 (1976 & Supp. IV 1980)]. Section 2(a)(5) of the Investment Company Act defines "bank."

[5] *See* letter re *Voluntary Hospitals of America, Inc.* dated November 30, 1982.

[6] *See* letter re *Voluntary Hospitals of America, Inc.* dated September 10, 1982.

[7] *See* Question 37.

[8] Section 2(2) of the Securities Act includes corporations and partnerships within the definition of "person."

[9] *See* letter re *Intuit Telecom Inc.* dated March 24, 1982.

that are mandatory, non-contingent, and for which the investor will be personally liable. Will the commitment to pay the assessments constitute an "unconditional obligation to pay" under Rule 501(a)(5)?

Answer: Yes. The assessments are essentially installment payments for which the investor makes the investment decision at the time the limited partnership interest originally is purchased.[10]

(12) *Question:* If the assessments in Question 11 are voluntary, contingent and non-recourse, can they be included in determining whether or not the investor has purchased $150,000 of the securities being offered?

Answer: No. Voluntary assessments of this nature are not deemed to constitute an unconditional obligation to pay.[11]

(13) *Question:* A purchaser of interests in a limited partnership makes a partial down payment and commits unconditionally to pay the balance over five years. Formation of the partnership is conditioned upon the sale of a specified number of interests. Under Rule 501(a)(5), when must the five year period for installment payments begin to run?

Answer: Rule 501(a)(5) provides that the unconditional obligation is to be discharged "within five years of the sale of the securities to the purchaser." For ease in the administration of an offering that is conditioned on a certain minimum level of sales, the staff believes it is reasonable to compute the length of installment obligations from the same date for the investors involved in reaching that minimum. Therefore, without any bearing on when the sale of the security actually occurs, the five-year time period of the investor's obligation may be measured from the date such minimum level of sales has been reached.[12]

b. 20 Percent of Net Worth Limitation

(14) *Question:* Where an investor makes installment payments composed of principal and interest, must the interest payments be included in computing the "total purchase price" for purposes of meeting the 20 percent of net worth limitation?

Answer: No. The interest is not part of the total purchase price but rather is an expense associated with financing the total purchase price.

(15) *Question:* A corporate investor will purchase $200,000 of the securities being offered for cash. Additionally, the investor will deliver an irrevocable letter of credit for $50,000 which the issuer will use as collateral in connection with a line of credit it will establish with a lending institution. Must the issuer include the $50,000 letter of credit when determining whether or not the purchaser's total purchase price exceeds 20 percent of its net worth under Rule 501(a)(5)?

Answer: Yes. Since the investor has committed to pay the $50,000 at the election of the issuer, that amount must be included with other forms of consideration in order to measure what percentage of the investor's net worth has been committed in the investment.[13]

(16) *Question:* As part of the purchase of an interest in a sale and lease-back program, the purchaser will deliver "non-recourse" debt where the source of payment for the debt is limited exclusively to the income generated by the security being purchased or the assets of the entity in which the security is being purchased. Must the non-recourse debt be included in the total purchase price for purposes of the 20 percent of net worth limitation under Rule 501(a)(5)?

Answer: No. Because the investor has no personal liability for the non-recourse debt, and because no part of the investor's assets at the time of purchase is available as a source of payment for the debt, the debt should not be included as part of the purchase price.[14]

(17) *Question:* Where the purchaser is a natural person, Rule 501(a)(5) provides that the total purchase price may be measured against the purchaser's net worth combined with that of a spouse. Would property held solely by one spouse be available for calculating the net worth of the other spouse who is making the $150,000 investment?

Answer: Yes.

(18) *Question:* An investment general partnership is purchasing securities in a Regulation D offering. The partnership was not formed for the specific purpose of acquiring the securities being offered. May the issuer consider the aggregate net worth of the general partners in calculating the net worth of the partnership?

Answer: Yes. An investment general partnership is functionally a vehicle in which profits and losses are passed through to general partners and in which the net worths of the general partners are exposed to the risk of partnership investments.[15]

(19) *Question:* A totally held subsidiary[16] makes a cash investment of $200,000 in a Regulation D offering. May that subsidiary use the consolidated net worth of its parent in determining whether or not its total purchase price exceeds 20 percent of its net worth?

Answer: Yes.[17]

5. *Natural Persons—Rules 501(a) (6)–(7).* Rules 501(a) (6) and (7) apply only to natural persons. Paragraph (6) accredits any natural person with a net worth at the time of purchase in excess of $1,000,000. If the investor is married, the rule permits the use of joint net worth of the couple. Paragraph (7) accredits any natural person whose income has exceeded $200,000 in each of the two most recent years and is reasonably expected to exceed $200,000 in the year of the investment.

(20) *Question:* A corporation with a net worth of $2,000,000 purchases securities in a Regulation D offering. Is the corporation an accredited investor under Rule 501(a)(6)?

Answer: No. Rule 501(a)(6) is limited to "natural" persons.

(21) *Question:* In calculating net worth for purposes of Rule 501(a)(6), may the investor include the estimated fair market value of his principal residence as an asset?

Answer: Yes. Rule 501(a)(6) does not exclude any of the purchaser's assets from the net worth needed to qualify as an accredited investor.

(22) *Question:* May a purchaser take into account income of a spouse in determining possible accreditation under Rule 501(a)(7)?

Answer: No. Rule 501(a)(7) requires "individual income" over $200,000 in order to qualify as an accredited investor.

(23) *Question:* May a purchaser include unrealized capital appreciation in calculating income for purposes of Rule 501(a)(7)?

Answer: Generally, no.

6. Entities Owned by Accredited Investors—Rule 501(a)(8). Any entity in which each equity owner is an accredited investor under any of the qualifying categories, except that of the $150,000 purchaser, is accredited under Rule 501(a)(8).

(24) *Question:* All but one of the shareholders of a corporation are

[10] *See* letter to *Kim R. Clark, Esq.* dated November 8, 1982.

[11] *See* letter to *Kim R. Clark, Esq.* dated November 8, 1982.

[12] *See* letter re *Winthrop Financial Co., Inc.* dated May 25, 1982.

[13] Note that this $50,000 is not deemed to be "an unconditional obligation to pay" and cannot be included in calculating whether or not the investor meets the $150,000 purchase test of Rule 501(a)(5). *See* Question 10.

[14] *See* letter to *Lola M. Hale, Esq.* dated July 1, 1982.

[15] *See* letter re *Smith Barney, Harris Upham & Co.* dated July 14, 1982.

[16] *See* CFR 230.405 for the difinition of "totally held subsidiary."

[17] *See* letter re *Federated Financial Corporation* dated May 13, 1982.

accredited investors by virtue of net worth or income. The unaccredited shareholder is a director who bought one share of stock in order to comply with a requirement that all directors be shareholders of the corporation. Is the corporation an accredited investor under Rule 501(a)(8)?

Answer: No. Rule 501(a)(8) requires "all of the equity owners" to be accredited investors. The director is an equity owner and is not accredited. Note that the director cannot be accredited under Rule 501(a)(4). That provision extends accreditation to a director of the issuer, not of the investor.

(25) *Question:* Who are the equity owners of a limited partnership?

Answer: The limited partners.

7. Trusts as Accredited Investors.

(26) *Question:* May a trust qualify as an accredited investor under Rule 501(a)(1)?

Answer: Only in directly. Although a trust standing alone cannot be accredited under Rule 501(a)(1), if a bank is its trustee and makes the investment on behalf of the trust, the trust will in effect be accredited by virtue of the provision in Rule 501(a)(1) that accredits a bank acting in a fiduciary capacity.

(27) *Question:* May a trust qualify as an accredited investor under Rule 501(a)(5)?

Answer: Yes. The Division interprets "person" in Rule 501(a)(5) to include any trust.[18]

(28) *Question:* In qualifying a trust as an accredited investor under Rule 501(a)(5), whose net worth should be considered in determining whether the total purchase price meets the 20 percent of net worth limitation test?

Answer: The net worth of the trust.

(29) *Question:* A trustee of a trust has a net worth of $1,500,000. Is the trustee's purchase of securities for the trust that of an accredited investor under Rule 501(a)(6)?

Answer: No. Except where a bank is a trustee, the trust is deemed the purchaser, not the trustee. The trust is not a "natural" person.

(30) *Question:* May a trust be accredited under Rule 501(a)(8) if all of its beneficiaries are accredited investors?

Answer: Generally, no. Rule 501(a)(8) accredits any entity if all of its "equity owners" are accredited investors. The staff does not interpret this provision to apply to the beneficiaries of a conventional trust. The result may be different, however, in the case of certain non-conventional trusts where, as a result of powers retained by the grantors, a trust as a legal entity would be deemed not to exist.[19] Thus, where the grantors of a revocable trust are accredited investors under Rule 501(a)(6) (*i.e.* net worth exceeds $1,000,000) and the trust may be amended or revoked at any time by the grantors, the trust is accredited because the grantors will be deemed the equity owners of the trust's assets.[20] Similarly, where the purchase of Regulation D securities is made by an Individual Retirement Account and the participant is an accredited investor, the account would be accredited under Rule 501(a)(8).

B. Aggregate Offering Price—Rule 501(c)

The "aggregate offering price," defined in Rule 501(c), is the sum of all proceeds received by the issuer for issuance of its securities. The term is important to the operation of Rules 504 and 505, both of which impose a limitation on the aggregate offering price as a specific condition to the availability of the exemption.[21]

(31) *Question:* The sole general partner of a real estate limited partnership contributes property to the program. Must that property be valued and included in the overall proceeds of the offering as part of the aggregate offering price?

Answer: No, assuming the property is contributed in exchange for a general partnership interest.

(32) *Question:* An owner of a mining or oil and gas property is selling interests in the property to investors for cash. The owner will retain a royalty interest in the property. Must any subsequent royalty payments be included in the aggregate offering price of the property interests?

Answer: No. Royalty payments to the seller of the property are treated as operating expenses, rather than capitalized costs for the property. As such, the royalty payments are not part of the consideration received by the issuer for issuance of the securities.

(33) *Question:* Where the investors pay for their securities in installments and these payments include an interest component, must the issuer include interest payments in the "aggregate offering price?"

Answer: No. The interest payments are not deemed to be consideration for the issuance of the securities.[22]

(34) *Question:* An offering of interests in an oil and gas limited partnership provides for additional voluntary assessments. These assessments, undermined at the time of the offering, may be called at the general partner's discretion for developmental drilling activities. Must the assessments be included in the aggregate offering price, and if so, in what amount?

Answer: Because it is unclear that the assessments will ever be called, and because if they are called, it is unclear at what level, the issuer is not required to include the assessments in the aggregate offering price. In fact, the assessments will be consideration received for the issuance of additional securities in the limited partnership. This issuance will need to be considered along with the original issuance for possible integration, or, if not integrated, must find its own exemption from registration.

(35) *Question:* In purchasing interests in an oil and gas partnership, investors agree to pay mandatory assessments. The assessments, essentially installment payments, are non-contingent and investors will be personally liable for their payment. Must the issuer include the assessments in the aggregate offering price?

Answer: Yes.[23]

(36) *Question:* As part of their purchase of securities, investors deliver irrevocable letters of credit. Must the letters of credit be included in the aggregate offering price?

Answer: If these letters of credit were drawn against, the amounts involved would be considered part of the aggregate offering price. For this reason, in planning the transaction, the issuer should consider the full amount of the letters of credit in calculating the aggregate offering price.

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[18] Section 2(2) of the Securities Act includes "a trust" within the definition of "person" but limits that inclusion to "a trust where the interest or interests of the beneficiary or beneficiaries are evidenced by a security." The Division does not view that limitation as being necessary in the context of a trust as a purchaser of securities under Rule 501(a)(5).

[19] The result would also be different in the case of a business trust, a real estate investment trust, or other similar entities.

[20] *See* letter re *Rule 501(a)(8) of Regulation D* dated July 16, 1982.

[21] The basis for a limitation on the aggregate offering price derives from section 3(b) of the Securities Act. Section 3(b) accords authority to the Commission to adopt rules exempting any class of securities as long as no issue of securities is exempted "where the aggregate amount at which such issue is offered to the public exceeds $5,000,000." *See also* section 4(6) which exempts a transaction involving offers and sales solely to one or more accredited investors "if the aggregate offering price of an issue" does not exceed the amount allowed under section 3(b).

[22] This presumes that the payments are in fact for interest. *See* Preliminary Note 6 to Regulation D.

[23] *See* letter to *Kim R. Clark, Esq.* dated November 8, 1982.

C. Executive Officer—Rule 501(f)

The definition of executive officer in Rule 501(f) is the same as that in Rule 405 of Regulation C (17 CFR 230.405).

(37) *Question:* The executive officer of the parent of the Regulation D issuer performs a policy making function for its subsidiary. May that individual be deemed an "executive officer" of the subsidiary?

Answer: Yes.

D. Purchaser Representative—Rule 501(h)

A purchaser representative is any person who satisfies, or who the issuer reasonably believes statisfies, four conditions enumerated in Rule 501(h). Beyond the obligations imposed by that rule, any person acting as a purchaser representative must consider whether or not he is required to register as a broker-dealer under section 15 of the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. 78a-78kk (1976 & Supp. IV 1980)) or as an investment adviser under section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-1–80b-21 (1976 & Supp. IV 1980)).[24]

(38) *Question:* May the officer of a corporate general partner of the issuer qualify as a purchaser representative under Rule 501(h)?

Answer: Rule 501(h) provides that "an affiliate, director, officer or other employee of the issuer" may not be a purchaser representative unless the purchaser has one of three enumerated relationships with the representative. The staff is of the view that an officer or director of a corporate general partner comes within the scope of "affiliate, director, officer or other employee of the issuer."

(39) *Question:* May the issuer in a Regulation D offering pay the fees of the purchaser representative?

Answer: Yes. Nothing in Regulation D prohibits the payment by the issuer of the purchaser representative's fees. Rule 501(h)(4), however, requires disclosure of this fact.[25]

II. Disclosure Requirements—Rule 502(b)

A. When Required

Rule 502(b)(1) sets forth the circumstances when disclosure of the kind specified in the regulation must be delivered to investors. The regulation requires the delivery of certain information "during the course of the offering and prior to sale" if the offering is conducted in reliance on Rule 505 or 506 and if there are unaccredited investors. If the offering is conducted in compliance with Rule 504 or if securities are sold only to accredited investors, Regulation D does not specify the information that must be disclosed to investors.[26]

(40) *Question:* An issuer furnishes potential investors a short form offering memorandum in anticipation of actual selling activities and the delivery of an expanded disclosure document. Does Regulation D permit the delivery of disclosure in two installments?

Answer: So long as all the information is delivered prior to sale, the use of a fair and adequate summary followed by a complete disclosure document is not prohibited under Regulation D. Disclosure in such a manner, however, should not obscure material information.

(41) *Question:* An issuer commences an offering in reliance on Rule 505 in which the issuer intends to make sales only to accredited investors. The issuer delivers those investors an abbreviated disclosure document. Before the completion of the offering, the issuer changes its intentions and proposes to make sales to non-accredited investors. Would the requirement that the issuer deliver the specified information to all purchasers prior to sale if any sales are made to non-accredited investors preclude application of Rule 505 to the earlier sales to the accredited investors?

Answer: No. If the issuer delivers a complete disclosure document to the accredited investors and agrees to return their funds promptly unless they should elect to remain in the program, the issuer would not be precluded from relying on Rule 505.

B. What Required

Regulation D divides disclosure into two categories: that to be furnished by non-reporting companies and that required for reporting companies. In either case, the specified disclosure is required to the extent material to an understanding of the issuer, its business and the securities being offered.

1. Non-Reporting Issuers—Rule 502(b)(2)(i). If the issuer is not subject to the reporting requirements of section 13 or 15(d) of the Exchange Act,[27] it must furnish the specified information "to the extent material to an understanding of the issuer, its business and the securities being offered." For offerings up to $5,000,000, the issuer should furnish the "same kind of information" as would be contained in Part I of Form S-18,[28] except that only the most recent year's financial statements need be certified. For offerings over $5,000,000, the issuer should furnish "the same kind of information" as would be required in Part I of an available registration statement.[29]

(42) *Question:* When an issuer is required to deliver specific disclosure, must that disclosure be in written form?

Answer: Yes.

(43) *Question:* Form S-18 requires the issuer's audited balance sheet as of the end of its most recently completed fiscal year or within 135 days if the issuer has been in existence for a shorter time. With a limited partnership that has been formed with minimal capitalization immediately prior to a Regulation D offering, must the Regulation D disclosure document contain an audited balance sheet for the issuer?

Answer: In analyzing this or any other disclosure question under Regulation D, the issuer starts with the general rule that it is obligated to furnish the specified information "to the extent material to an understanding of the issuer, its business, and the securities being offered." Thus, in this particular case, if an audited balance sheet is not material to the investor's understanding,

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[24] *See* letters to *Winstead, McGuire, Sechrest & Trimble* dated February 21 and 25, 1975 and re *Kenisa Oil Company* dated April 6, 1982. Questions regarding registration as a broker-dealer should be directed to the Office of Chief Counsel, Divison of Market Regulation, (202) 272-2844. Questions regarding registration as an investment adviser should be directed to the Office of Chief Counsel, Division of Investment Management, (202) 272-2030.

[25] Note 3 to Rule 501(h) points out that disclosure of a material relationship between the purchaser representative and the issuer will not relieve the purchaser representative of the obligation to act in the interest of the purchaser.

[26] As noted in Preliminary Note 1, Regulation D transactions are exempt from the registration requirements of the Securities Act, not the antifraud provisions. Thus, nothing in Regulation D states that an issuer need not give disclosure to an investor. Rather, the regulation provides that in certain instances the exemptions from registration will not be conditioned on a particular content, format or method of disclosure.

[27] An issuer is subject to section 13 reporting obligations if it has a class of securities registered under section 12 of the Exchange Act. An issuer is subject to section 15(d) reporting obligations if it has had a Securities Act registration statement go effective, or if in any year after the year of effectiveness, it has at least 300 holders of the class of securities to which the registration statement applied. In the latter instance, however, even if the issuer has 300 or more shareholders, it may not be subject to section 15(d) reporting obligations if it has had less than 500 shareholders and less than $3,000,000 in assets during the last three years. *See* Rule 15d-6 (17 CFR 240.15d-6) under the Exchange Act.

[28] *See* 17 CFR 239.28. Form S-18 is an abbreviated registration form for certain offerings not exceeding $5,000,000. The form is not available to issuers that report under the Exchange Act.

[29] Rules 502(b)(2)(i)(C) and 502(b)(2)(ii)(D) contain special provisions for foreign issuers recently adopted by the Commission. *See* Release No. 33-6437 (November 19, 1982) (47 FR 54764).

then the issuer may elect to present an alternative to its audited balance sheet.

(44) *Question:* Is Securities Act Industry Guide 5 [30] applicable in a $4,000,000 Regulation D offering of interests in a real estate limited partnership?

Answer: Rule 502(b)(2)(i)(A) requires the issuer to provide the same kind of information as that required in Part I of Form S–18.[31]

Form S–18 directs the issuer's attention to the Industry Guides noting that such guides "represent Division practices with respect to the disclosure to be provided by the affected industries in registration statements." In preparing its Regulation D offering material, therefore, an issuer of interests in a real estate limited partnership should consider Guide 5 in determining the disclosure that will be material to the investor's understanding of the issuer, its business and the securities being offered.

(45) *Question:* In a $4,000,000 Regulation D offering of interests in an oil and gas limited partnership, what are the issuer's disclosure obligations with respect to financial statements of the general partner?

Answer: Item 21(h) of Form S–18 provides that the issuer should furnish the audited balance sheet as of the end of the most recent fiscal year of any corporation or partnership that is a general partner of the issuer. For any general partner that is a natural person, in lieu of an audited balance sheet, the issuer may furnish a statement of that individual's net worth in the text of the disclosure document, where assets and liabilities are estimated at fair market value with provisions for estimated income taxes on unrealized gains.[32]

(46) *Question:* The issuer in a $3,000,000 Regulation D offering is a limited partnership that will acquire certain real estate operations with the offering proceeds. What is the appropriate consideration for disclosure of the operating history of these operations?

Answer: Item 21(g) of Form S–18, which provides special guidance for such disclosure, calls for the audited income statements of the operations, with certain exclusions, for the two most recent fiscal years. If the issuer can meet certain conditions, however, the instruction reduces that requirement to only one year of audited income statements.[33]

Under Regulation D, Rule 502(b)(2)(i)(A) provides that only the financial statements for the issuer's most recent fiscal year must be certified in an offering not in excess of $5,000,000. The staff is of the view that this provision applies to all financial statements in the disclosure document. Thus, in the Regulation D offering described, the following considerations apply. If the issuer can meet the conditions in Item 21(g) of Form S–18, it may present one year of audited income statements on the operations to be acquired. If the issuer cannot meet the conditions in Form S–18, then it should present two years of income statements, only one of which must be audited.

(47) *Question:* If the issuer in Question 46 cannot obtain the financial statements on the operations to be acquired without unreasonable effort or expense, what further considerations are applicable under Regulation D?

Answer: Rule 502(b)(2)(i)(A) provides that "[i]f the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant." The staff interprets this provision to apply to all financial statements that the issuer presents in the offering document. Thus, the issuer described above may present tax basis operating statements on the operations to be acquired.[34]

(48) *Question:* Has the Commission defined or will the staff issue interpretations on the term "unreasonable effort or expense?"

Answer: No. The meaning of "unreasonable effort or expense" depends on the particular facts and circumstances attending each case. Only the issuer will know the facts and circumstances and be able to evaluate them with respect to the requirements of the rule.

(49) *Question:* The issuer in a Regulation D offering of $7,000,000 is a corporation. That corporation is acquiring a business. The issuer is unable to obtain the financial statements for that business without unreasonable effort or expense.[35] What are the relevant considerations under Regulation D?

Answer: Rule 502(b)(2)(i)(B) provides that if the issuer is not a limited partnership and "cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited." The staff has interpreted this provision in the context of Rule 3–05 of Regulation S–X to apply to the financial statements of the business being acquired. Thus, if the business being acquired is other than a limited partnership, and if the issuer cannot obtain audited financial statements of that business without unreasonable effort or expense, then the issuer may provide the relevant financial statements for the business being acquired on and unaudited basis so long as it also provides an audited balance sheet for that business dated within 120 days of the start of the offering, or, if appropriate, as of the date of acquisition of the business.[36]

2. *Reporting Issuers—Rule 502(b)(2)(ii).* If the issuer is subject to the reporting requirements of section 13 or 15(d) of the Exchange Act, Regulation D sets forth two alternatives for disclosure: the issuer may deliver certain recent Exchange Act reports (the annual report, the definitive proxy statement, and, if requested, the Form 10–K (17 CFR 249.310)) or it may provide a document containing the same information as in the Form 10–K or Form

[30] The Commission adopted 53 Securities Act Guides in 1968 (Release No. 33–4936 (December 9, 1968) (33 FR 18617)) and 10 additional ones subsequently. The Guides served as an expression of the policies and practices of the Division of Corporation Finance. Most of those Guides have been incorporated into Regulation C (17 CFR 230.400–.494) and Regulation S–K (17 CFR 229.10–.802) (*see* Release No. 33–6383 (March 3, 1982) (47 FR 11380)) and thus were rescinded (*see* Release No. 33–6384 (March 3, 1982) (47 FR 11476)). Five of the Guides applicable to specific industries were not rescinded, however, and were redesignated. Guide 5, which was Guide 60, applies to the preparation of registration statements relating to interests in real estate limited partnerships. Guide 5 was revised in Release No. 33–6405 (June 3, 1982) (47 FR 25140).

[31] Form S–18 has been amended recently to permit its use by limited partnerships. Release No. 33–6406 (June 4, 1982) (47 FR 25126).

[32] The same general rule would be applicable to an offering in excess of $5,000,000. *See* Release No. SAB–40, Topic 6.D.3.d. (January 23, 1981).

[33] The parallel to this instruction under other forms of registration is Rule 3–14 of Regulation S–X (17 CFR 210.3–14). Rule 3–14 requires income statements for the three most recent fiscal years, unless the issuer meets certain conditions, in which case the issuer need present only one year of audited income statements.

[34] *See* letter re *Winthrop Financial Co., Inc.* dated May 25, 1982. In response to inquiries regarding the appropriateness of tax basis financial statements, issuers should refer to Statement on Auditing Standards No. 14, *Special Reports*, American Institute of Certified Public Accountants, December 1976.

[35] The issuer should refer to Rule 3–05 of Regulation S–X (17 CFR 210.3–05) for the disclosure guidelines on businesses to be acquired. If the offering were for less than $5,000,000 and the issuer were thus referring to Form S–18, Item 21(d) of that form provides a parallel rule on businesses to be acquired.

[36] *See* letter re *Walnut Valley Special Cable TV Fund* dated May 13, 1982.

10 (17 CFR 249.210) under the Exchange Act or in a registration statement under the Securities Act. In either case the rule also calls for the delivery of certain supplemental information.

(50) *Question:* Rule 502(b)(2)(ii)(B) refers to the information contained "in a registration statement on Form S–1." Does this requirement envision delivery of Parts I and II of the Form S–1?

Answer: No. Rule 502(b)(2)(ii)(B) should construed to mean Part I of Form S–1.

(51) *Question:* A reporting company with a fiscal year ending on December 31 is making a Regulation D offering in February. It does not have an annual report to shareholders, an associated definitive proxy statement, or a Form 10–K for its most recently completed fiscal year. The issuer's last registration statement was filed more than two years ago. What is the appropriate disclosure under Regulation D?

Answer: The issuer may base its disclosure on the most recently completed fiscal year for which an annual report to shareholders on Form 10–K was timely distributed or filed. The issuer should supplement the information in the report used with the information contained in any reports or documents required to be filed under sections 13(a), 14(a), 14(c) and 15(d) of the Exchange Act since the distribution or filing of that report and with a brief description of the securities being offered, the use of the proceeds from the offering, and any material changes in the issuer's affairs that are not disclosed in the documents furnished. *See* Rule 502(b)(2)(ii)(C).

C. General

Rule 502(b)(2) also contains four general provisions applicable to all classes of issuer in all offerings where specified disclosure is required. These provisions govern exhibits, disclosure of additional information to non-accredited investors, the opportunity for further investor inquiries, and disclosure of certain additional information in business combinations.

(52) *Question:* In a Rule 505 or 506 offering of interests in a limited partnership where certain purchasers are not accredited investors, must the issuer obtain an opinion of counsel regarding the legality of the securities being issued or an opinion regarding the tax consequences of an investment in the offering?

Answer: Rule 502(b)(2)(iii) provides that the issuer is not required to furnish the exhibits that would accompany the form of registration or report governing the issuer's disclosure document if the issuer identifies the contents of those exhibits and makes them available to purchasers upon written request prior to purchase.[37] Any form of registration to which the issuer refers in preparing its disclosure document under Regulation D requires that the issuer furnish the exhibits required by Item 601 of Regulation S–K. Item 601 requires that the issuer furnish, among other exhibits, an opinion of counsel as to the legality of the securities being issued. Thus, under Rule 502(b)(2)(iii), the issuer should identify the contents of this opinion of counsel and make it available to purchasers upon written request. Item 601 also sets forth certain requirements for an opinion as to tax matters. Such an opinion is required to support any representations in a prospectus as to material tax consequences. Thus, assuming the Regulation D issuer will make representations in the disclosure document as to material tax consequences of investing in a limited partnership, the issuer should identify the contents of and make available upon request an opinion supporting that discussion.[38]

III. Operational Conditions

A. Integration—Rule 502(a)

Rule 502(a) achieves two purposes. First, it explicitly incorporates the doctrine of integration into Regulation D. Second, it establishes an exception to the operation of that doctrine.

Integration operates to identify the scope of a particular offering by considering the relationship between multiple transactions. It is premised on the concept that the Securities Act addresses discrete offerings and on the recognition that not every offering is in fact a discrete transaction. The integration doctrine prevents an issuer from circumventing the registration requirements of the Securities Act by claiming a separate exemption for each part of a series of transactions that comprises a single offering. Because the determination of whether transactions should be integrated into one offering is so dependent on particular facts and circumstances, the staff does not issue interpretations in this area.[39] The Note to Rule 502(a), however, does set forth a number of factors that should be considered in making an integration determination.

Rule 502(a) also sets forth an exception to the integration doctrine. It provides that a Regulation D offering will not be integrated with offers or sales that occur more than six months before or after the Regulation D offering. This six month safe harbor rule only applies, however, where there have been no offers or sales (except under an employee benefit plan) of securities similar to those in the Regulation D offering within the applicable six months.[40]

(53) *Question:* An issuer conducts offering (A) under Rule 504 of Regulation D that concludes in January. Seven months later the issuer commences offering (B) under Rule 506. During that seven month period the issuer's only offers or sales of securities are under an employee benefit plan (C). Must the issuer integrate (A) and (B)?

Answer: No. Rule 502(a) specifically provides that (A) and (B) will not be integrated.[41]

B. Calculation of the Number of Purchasers—Rule 501(e)

Rule 501(e) governs the calculation of the number of purchasers in offerings that rely either on Rule 505 or 506. Both of these rules limit the number of non-accredited investors to 35. Rule 501(e) has two parts. The first excludes certain purchasers from the calculation. The second establishes basic principles for counting of corporations, partnerships, or other entities.

(54) *Question:* One purchaser in a Rule 506 offering is an accredited investor. Another is a first cousin of that investor sharing the same principal residence. Each purchaser is making his own investment decision. How must the issuer count these purchasers for purposes of meeting the 35 purchaser limitation?

Answer: The issuer is not required to count either investor. The accredited investor may be excluded under Rule 501(e)(1)(iv), and the first cousin may then be excluded under Rule 501(e)(1)(i).[42]

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[37] This provision is similar to that found in former Rule 146 at paragraph (e)(1)(ii)(c).

[38] *See* letters to *Hecker & Phillips* dated December 22, 1982 and *Hopper, Kanouff, Smith and Peryam* dated September 10, 1982.

[39] *See* Release No. 33–6253 (October 28, 1980) (45 FR 72044); letters re *Security Bancorp, Inc.* dated January 21, 1980 and *Kearney Plaza Company* dated March 8, 1979.

[40] The Note to Rule 502(a) also points out that certain foreign offerings are not integrated with domestic exempt offerings.

[41] Rule 502(a), however, does not provide a safe harbor to the possible integration of offering (C) with either offering (A) or (B). In resolving that question, the issuer should consider the factors listed in the Note to Rule 502(a).

[42] The Note to Rule 501(e) provides that the issuer must satisfy all other conditions of Regulation D with respect to purchasers that have been excluded from the count. Thus, for instance, the issuer would have to ensure the sophistication of the first cousin under Rule 506(b)(2)(ii).

(55) *Question:* An accredited investor in a Rule 506 offering will have the securities she acquires placed in her name and that of her spouse. The spouse will not make an investment decision with respect to the acquisition. How many purchasers will be involved?

Answer: The accredited investor may be excluded from the count under Rule 501(e)(1)(iv) and the spouse may be excluded under Rule 501(e)(1)(i). The issuer may also take the position, however, that the spouse should not be deemed a purchaser at all because he did not make any investment decision, and because the placement of the securities in joint name may simply be a tax or estate planning technique.

(56) *Question:* An offering is conducted in the United States under Rule 505. At the same time certain sales are made overseas. Must the foreign investors be included in calculating the number of purchasers?

Answer: Offers and sales of securities to foreign persons made outside the United States in such a way that the securities come to rest aboard generally do not need to be registered under the Act. This basis for non-registration is separate from Regulation D and offers and sales relying on this interpretation are not required to be integrated with a coincident domestic offering.[43] Thus, assuming the sales in this question rely on this interpretation, foreign investors would not be counted.

(57) *Question:* An investor in a Rule 506 offering is a general partnership that was not organized for the specific purpose of acquiring the securities offered. The partnership has ten partners, five of whom do not qualify as accredited investors. The partnership will make an investment of $100,000. How is the partnership counted and must the issuer make any findings as to the sophistication of the individual partners?

Answer: Rule 501(e)(2) provides that the partnership shall be counted as one purchaser. The issuer is not obligated to consider the sophistication of each individual partner.

(58) *Question:* If the partnership in Question 57 purchases $200,000 of the securities being offered and if that amount does not exceed 20 percent of the partnership's net worth, how should the partnership be counted?

Answer: Rule 501(e)(2), which provides that the partnership shall be counted as one purchaser, operates in tandem with Rule 501(e)(1). Thus, because the partnership is an accredited investor (in this case under Rule 501(a)(5)), the partnership may be exluded from the count under Rule 501(e)(2)(iv).

(59) *Question:* An investor in a Rule 506 offering is an investment partnership that is not accredited under Rule 501(a)(8). Although the partnership was organized two years earlier and has made investments in a number of offerings, not all the partners have participated in each investment. With each proposed investment by the partnership, individual partners have received a copy of the disclosure document and have made a decision whether or not to participate. How do the provisions of Regulation D apply to the partnership as an investor?

Answer: The partnership may not be treated as a single purchaser. Rule 501(e)(2) provides that if the partnership is organized for the specific purpose of acquiring the securities offered, then each beneficial owner of equity interests should be counted as a separate purchaser. Because the individual partners elect whether or not to particpate in each investment, the partnership is deemed to be reorganized for the specific purpose of acquiring the securities in each investment.[44] Thus, the issuer must look through the partnership to the partners participating in the investment. The issuer must satisfy the conditions of Rule 506 as to each partner.

C. Manner of Offering—Rule 502(c)

Rule 502(c) prohibits the issuer or any person acting on the issuer's behalf from offering or selling securities by any form of general solicitation or general advertising. The analysis of facts under Rule 502(c) can be divided into two separate inquiries. First, is the communication in question a general solicitation or general advertisement? Second, if it is, is it being used by the issuer or by someone on the issuer's behalf to offer or sell the securities? If either question can be answered in the negative, then the issuer will not be in violation of Rule 502(c). Questions under Rule 502(c) typically present issues of fact and circumstance that the staff is not in a position to resolve. In several instances, however, the staff has been able to address questions under the rule.

In analyzing what constitutes a general solicitation, the staff considered a solicitation by the general partner of a limited partnership to limited partners in other active programs sponsored by the same general partner. In determining that this did not constitute a general solicitation the Division underscored the existence and substance of the pre-existing business relationship between the general partner and those being solicited. The general partner represented that it believed each of the solicitees had such knowledge and experience in financial and business matters that he or she was capable of evaluating the merits and risks of the prospective investment. *See* letter re *Woodtrails-Seattle, Ltd.* dated July 8, 1982.

In analyzing whether or not an issuer was using a geneal advertisement to offer or sell securities, the staff declined to express an opinion on a proposed tombstone advertisement that would announce the completion of an offering. *See* letter re *Alma Securities Corporation* dated July 2, 1982. Because the requesting letter did not describe the proposed use of the tombstone announcement and because the announcement of the completion of one offering could be an indirect solicitation for a new offering, the staff did not express a view. In a letter re *Tax Investment Information Corporation* dated January 7, 1983, the staff considered whether the publication of a circular analyzing private placement offerings, where the publisher was independent from the issuers and the offerings being analyzed, would violate Rule 502(c). Although Regulation D does not directly prohibit such a third party publication, the staff refused to agree that such a publication would be permitted under Regulation D because of its susceptability to use by participants in an offering. Finally, in the letter re *Aspen Grove* dated November 8, 1982 the staff expressed the view that the proposed distribution of a promotional brochure to the members of the "Thoroughbred Owners and Breeders Association" and at an annual sale for horse owners and the proposed use of a magazine advertisement for an offering of interests in a limited partnership would not comply with Rule 502(c).

(60) *Question:* If a solicitation were limited to accredited investors, would it be deemed in compliance with Rule 502(c)?

Answer: The mere fact that a solicitation is directed only to accredited investors will not mean that the solicitation is in compliance with Rule 502(c). Rule 502(c) relates to the nature of the offering not the nature of the offerees.

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[43] *See* Release No. 33-4708 (July 9, 1964) (29 FR 828), Preliminary Note 7 to Regulation D and Note to Rule 502(a).

[44] *See* letter re *Madison Partners Ltd. 1982-1* dated January 18, 1982. *See also* letter re *Kenai Oil & Gas, Inc.* dated April 27, 1979.

D. Limitations on Resale—Rule 502(d)

Rule 502(d) makes it clear that Regulation D securities have limitations on transferability and requires that the issuer take certain precautions to restrict the transferability of the securities.

(61) *Question:* An investor in a Regulation D offering wishes to resell his securities within a year after the offering. The issuer has agreed to register the securites for resale. Will the proposed resale under the registration statement violate Rule 502(d)?

Answer: No. The function of Rule 502(d) is to restrict the unregistered resale of securities. Where the resale will be registered, however, such restrictions are unnecessary.

IV. Exemptions

A. Rule 504

Rule 504 is an exemption under section 3(b) of the Securities Act available to non-reporting and non-investment [45] companies for offerings not in excess of $500,000.

(62) *Question:* A foreign issuer proposes to use Rule 504. The issuer is not subject to section 15(d) and its securities are exempt from registration under Rule 12g3–2 (17 CFR 240.12g3–2). May this issuer use Rule 504?

Answer: Yes.

(63) *Question:* An issuer proposes to make an offering under Rule 504 in two states. The offering will be registered in one state and the issuer will deliver a disclosure document pursuant to the state's requirements. The offering will be made pursuant to an exemption from registration in the second state. Must the offering satisfy the limitations on the manner of offering and on resale in paragraphs (c) and (d) of Rule 502?

Answer: Yes. An offering under Rule 504 is exempted from the manner of sale and resale limitations only if it is registered in *each* state in which it is conducted and only if a disclosure document is required by state law.

(64) *Question:* The state in which the offering will take place provides for "qualification" of any offer or sale of securities. The state statute also provides that the securities commissioner may condition qualification of an offering on the delivery of a disclosure document prior to sale. Would the issuer be making its offering in a state that "provides for registration of the securities and requires the delivery of a disclosure document before sale" if its offering were qualified in this state on the condition that it deliver a disclosure document before sale to each investor?

Answer: Yes.[46]

(65) *Question:* If an issuer is registering securities at the state level, are there any specific requirements as to resales outside of that state if the issuer is attempting to come within the provision in Rule 504 that waives the limitations on the manner of offering and on resale in Rules 502 (c) and (d)?

Answer: No.[47] The issuer, however, must intend to use Rule 504 to make bona fide sales in that state and not to evade the policy of Rule 504 by using sales in one state as a conduit for sales into another state. *See* Preliminary Note 6 to Regulation D.

B. Rule 505

Rule 505 provides an exemption under section 3(b) of the Securities Act for non-investment companies for offerings not in excess of $5,000,000.

(66) *Question:* An issuer is a broker that was censured pursuant to a Commission order. Does the censure bar the issuer from using Rule 505?

Answer: No. Rule 505 is not available to any issuer who falls within the disqualifications for the use of Regulation A (17 CFR 230.251–.264). *See* Rule 505(b)(2)(iii). One such disqualification occurs when the issuer is subject to a Commission order under section 15(b) of the Exchange Act. A censure has no continuing force and thus the issuer is not subject to an order of the Commission.

C. Questions Relating to Rules 504 and 505

Both Rules 504(b)(2)(i) and 505(b)(2)(i) require that the offering not exceed a specified aggregate offering price. The allowed aggregate offering price, however, is reduced by the aggregate offering price for all securities sold within the last twelve months in reliance on section 3(b) or in violation of section 5(a) of the Securities Act.

(67) *Question:* An issuer preparing to conduct an offering of equity securities under Rule 505 raised $2,000,000 from the sale of debt instruments under Rule 505 eight months earlier. How much may the issuer raise in the proposed equity offering?

Answer: $3,000,000. A specific condition to the availability to Rule 505 for the proposed offering is that its aggregate offering price not exceed $5,000,000 less the proceeds for *all* securities sold under section 3(b) within the last 12 months.

(68) *Question:* An issuer is planning a Rule 505 offering. Ten months earlier the issuer conducted a Rule 506 offering. Must the issuer consider the previous Rule 506 offering when calculating the allowable aggregate offering price for the proposed Rule 505 offering?

Answer: No. The Commission issued Rule 506 under section 4(2), and Rule 505(b)(2)(i) requires that the aggregate offering price be reduced by previous sales under section 3(b).[48]

(69) *Question:* Seven months before a proposed Rule 504 offering the issuer conducted a rescission offer under Rule 504. The rescission offer was for securities that were sold in violation of section 5 more than 12 months before the proposed Rule 504 offering. Must the aggregate offering price for the proposed Rule 504 offering be reduced either by the amount of the rescission offer or the earlier offering in violation of section 5?

Answer: No. The offering in violation of section 5 took place more than 12 months earlier and thus is not required to be included when satisfying the limitation in Rule 504(b)(2)(i). The staff is of the view that the rescission offer relates back to the earlier offering and therefore should not be included as an adjustment to the aggregate offering price for the proposed Rule 504 offering.

(70). *Question:* Rules 504 and 505 contain examples as to the calculation of the allowed aggregate offering price for a particular offering. Do these examples contemplate integration of the offerings described?

Answer: No. The examples have been provided to demonstrate the operation of the limitation on the aggregate offering price in the absence of any integration questions.

(71) *Question:* Note 2 to Rule 504 is not restated in Rule 505. Does the principle of the note apply to Rule 505?

Answer: Yes. Note 2 to Rule 504 sets forth a general principle to the operation of the rule on limiting the aggregate offering price which is the same for both Rules 504 and 505. It provides that if, as a result of one offering, an issuer exceeds the allowed aggregate offering price in a subsequent unintegrated offering, the exemption for the first offering will not be affected.

[45] The Division is of the view that the provision in Rules 504 and 505 that bars an investment company from using the exemptions should be construed to mean an investment company as that term is defined in section 3 of the Investment Company Act.

[46] *See* letter to *Geraldine D. Green* dated November 22, 1982.

[47] *See* letter re *Freeport Resources, Inc.* dated December 9, 1982.

[48] Note that under Rule 502(a) these offerings may not have to be integrated because they are separated by six months.

D. Rule 506

(72) *Question:* May an issuer of securities with a projected aggregate offering price of $3,000,000 rely Rule 506?

Answer: Yes. The availability of Rule 506 is not dependent on the dollar size of an offering.

(73) *Question:* Rule 506 requires that the issuer shall reasonably believe that each purchaser who is not an accredited investor either alone or with a purchaser representative has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospectve investment. Former Rule 146 required the issuer to make a similar determination with respect to each offeree. Rule 506 is not an exclusive basis for satisfying the requirements of the private offering exemption in section 4(2). *See* Preliminary Note 3 to Regulation D. What is the Commission's view of the relevance of the nature of the offerees in an offering that relies exclusively on section 4(2) as its basis for exemption from registration?

Answer: Clearly, in an offering relying exclusively on section 4(2) for an exemption from registration, all offerees who purchase must possess the requisite level of sophistication. The sophistication of each of those to whom the securities are offered who do not purchase is not a fact that in and of itself should determine mechanically the availability of the exemption; the number and the nature of the offerees, however, are relevant in determining whether an issure has engaged in a general solicitation or general advertising that would preclude reliance on the exemption in section 4(2).

E. Questions Relating to Rules 504–506

(74) *Question:* If an issuer relies on one exemption, but later realizes that exemption may not have been made available, may it rely on another exemption after the fact?

Answer: Yes, assuming the offering met the conditions of the new exemption. No one exemption is exclusive of another.

(75) *Question:* May foreign issuers use Regulation D?

Answer: Yes. Recent amendments to Regulation D have clarified the disclosure requirements for foreign issuers.[49]

(76) *Question:* Is Regulation D available to an underwriter for the sale of securities acquired in a firm commitment offering?

Answer: No. As Preliminary Note 4 indicates, Regulation D is available only to the issuer of the securities and not to any affiliate of that issuer or to any other person for resales of the issuer's securities. *See also* Rule 502(d) which limits the resale of Regulation D securities.

(77) *Question:* Regulation T (12 CFR 220.1–.8) of the Federal Reserve Board imposes certain restrictions on brokers and dealers for the use of credit in the purchase of securities. Regulation T provides an exemption from those provisions for the arrangement of credit in a sale of securities that is exempt from the registration requirements of the Securities Act under section 4(2). *See* 12 CFR 220.7(g). What is the applicability of this provision to offerings conducted under Regulation D?

Answer: Regulation T is interpreted by the Federal Reserve Board which has expressed the view that the exemption from Regulation T in 12 CFR 220.7(a) is available for offerings conducted in reliance on Rules 505 and 506,[50] but not for those under 504.[51]

(78) *Question:* A corporation proposes to implement an employee stock option plan for key employees. Can the issuer rely on Regulation D for an exemption from registration for the issuance of securities under the plan?

Answer: The corporation may use Regulation D for the sale of its securities under the plan to the extent that such offering complies with Regulation D. In a typical plan, the grant of the options will not be deemed a sale of a security for purposes of the Securities Act. The issuer, therefore, will be seeking an exemption for the issuance of the stock underlying the options. The offering of this stock generally will commence when the options become exercisable and will continue until the options are exercised or otherwise terminated. Where the key employees involved are directors or executive officers, such individuals will be accredited investors under Rule 501(a)(4) if they purchase securities through the exercise of their options. Other key employees may be accredited as a result of net worth or income under Rules 501(a)(6) or (a)(7).

(79) *Question:* In an "all or none" or minimum-maximum Regulation D offering of interests in a limited partnership, the general partner proposes, if necessary, to purchase enough interests for the issuer to sell a specified level of interests by the specified expiration date of the offering. What disclosure and other considerations are relevant?

Answer: The staff is of the view that pursuant to Rule 10b–9 under the Exchange Act, the issuer must disclose the possibility that the general partner may make purchases of the limited partnership interests in order to meet the specified minimum. In addition, the issuer should disclose the maximum amount of the possible purchases. Finally, these purchases must be for investment and not resale. Questions regarding these views should be directed to the Division of Market Regulation, Office of Trading Practices, (202) 272–2874.

(80) *Question:* An issuer will conduct a Regulation D offering on an "all or none" basis within a specified time. What considerations are there for the issuer if it wishes to extend the offering beyond the specified time in order to sell the specified amount of securities?

Answer: The staff is of the view that an offering may be extended beyond the specified time without resulting in a violation of Rule 10b–9 under the Exchange Act or, in the case of an offering in which a broker-dealer is a participant, Rule 15c2–4 under the Exchange Act, under the following conditions:

a. Prior to the specified expiration date, a reconfirmation offer must be made to all subscribers that discloses the extension of the offering and any other material information necessary to update previously provided disclosure.

b. The reconfirmation offer must be structured so that the subscriber affirmatively elects to continue his investment and so that those subscribers who take no affirmative action will have their funds returned to them.

c. The reconfirmation offer must be made far enough in advance of the specified expiration date so that any subscriber who does not elect to continue his investment will have his funds returned to him promptly after the specified expiration date.

Questions regarding these views should be directed to the Division of Market Regulation, Office of Trading Practices, (202) 272–2874.

V. Notice of Sale—Form D

Rule 503 requires the issuer to file a notice of sale on Form D. The notice must be filed not later than 15 days after the first sale, every six months

[49] *See* Release No. 33–6437 (November 19, 1982) (47 FR 54764).

[50] Letters from Laura Homer, Securities Credit Officer, Board of Governors of the Federal Reserve System to Ardith Eymann, Esq., Chief Counsel, Division of Market Regulation, Securities and Exchange Commission (April 10, 1982) and to Mrs. Mary E.T. Beach, Associate Director, Securities and Exchange Commission (January 8, 1982).

[51] Letter from Laura Homer, Securities Credit Officer, Board of Governors of the Federal Reserve System to Alan G. Rosenberg, Esq. (May 20, 1982).

thereafter, and no later than 30 days after the last sale.[52]

(81) *Question:* Where can an issuer obtain copies of Form D and where must the form be filed?

Answer: Form D is available through the Public Reference Branch of the Commission's main office, 450 5th Street, NW., Washington, D.C. 20549, (202) 272-7460, or any of its regional or branch offices. The form should be filed at the Commission's main office. There is no filing fee.

(82) *Question:* In a minimum-maximum offering where subscription funds are held in escrow pending receipt of minimum subscriptions, when is the first Form D required to be filed?

Answer: In the context of Rule 503, the first sale takes place upon receipt of the first subscription agreement and the deposit of the first funds into escrow. The issuer, therefore, should file its first Form D not later than 15 days after the receipt of the first subscription agreement.

(83) *Question:* An issuer conducting a minimum-maximum offering has received subscriptions for the minimum number of interests needed to form the limited partnership. Subsequent to closing and formation of the partnership, the issuer continues to offer interests. After two months in which no sales take place, the issuer decides to terminate the offering. Because more than 30 days have elapsed since the last sale, how can the issuer comply with Rule 503 in the filing of its final Form D?

Answer: The staff is of the view that a final Form D may be filed not later than 30 days after the last sale or after the termination of the offering, whichever occurs later.

(84) *Question:* In an employee stock option plan, when would the first and last Form D be filed?

Answer: The first Form D should be filed not later than 15 days after the exercise of the first option. The final Form D would be due not later than 30 days after the exercise or expiration of the last outstanding option, whichever occurs later.

(85) *Question:* An issuer commences a Regulation D offering and files an original Form D not later than 15 days after the first sale. Subsequently, because no further sales are made, the issuer returns the money to the one investor and terminates the offering. How should the issuer reflect the unsuccessful offering on its Form D?

Answer: The issuer should file a final Form D indicating zero sales, investors, and proceeds.

(86) *Question:* If the issuer is a limited partnership, who would be considered the chief executive officer for purposes of Form D questions?

Answer: The chief executive officer of a limited partnership is that individual who fulfills the function of chief executive officer. That individual may be the chief executive officer of a corporate general partner.

(87) *Question:* What is a Standard Industrial Classification ("SIC") and where is it obtained?

Answer: The SIC is a code associated with a particular economic activity. The SIC system, developed by the Bureau of the Census under the auspices of the Office of Management and Budget, is used in classification of establishments by the type of activities in which they are engaged. An issuer's SIC can be found in the Standard Industrial Classification Manual, a publication of the U.S. Government that may be obtained from the Superintendent of Documents and is generallly available in public and university libraries.

(88) *Question:* Question 8 of Part A asks for the issuer's CUSIP number. What is a CUSIP number?

Answer: CUSIP [53] is the trademark for a system that identifies specific security issuers and their classes of securities. Under the CUSIP plan, a CUSIP number is permanently assigned to each class and will identify that class and no other. Generally, a CUSIP number will be assigned only to a class for which there is a secondary trading market. The operation of the CUSIP numbering system is controlled by the CUSIP Board of Trustees which awarded a contract to Standard & Poor's Corporation to function as the CUSIP Service Bureau, the operational arm of the system. Issuers relying on Regulation D that do not have a class of securities with a secondary trading market and thus do not have a CUSIP number should answer Question 8 in the negative.

(89) *Question:* Part B of Form D requests statistical information about the issuer. In an offering of interests in a limited partnership to be formed, how should this part be answered?

Answer: The answers to Part B should be with respect to the partnership to be formed and will be zero or "not applicable." This will reflect the statistical profile of a start-up issuer.

(90) *Question:* Question 2 to Part C requests certain information as to the number of accredited and non-accredited investors in a Rule 505 or 506 offering. Must an issuer make a finding as to accredited investors even if the issuer is not relying on the accredited investor concept in its offering?

Answer: No. Where an issuer under Rule 505 or 506 is not relying on the accredited investor concept for all or certain investors, it should treat those investors as non-accredited for purposes of this question.

(91) *Question:* Questions 5 and 6 to Part C request certain information regarding the offering expenses and the use of proceeds. May the issuer attach a separate schedule listing expenses and use of proceeds in lieu of completing these questions?

Answer: No. The Form D has been formulated for keypunching and entry of the information into an automatic data storage system. Failure to complete the questions on the form in the space provided frustrates the objectives of the form.

(92) *Question:* May the Form D be signed by the issuer's attorney?

Answer: Form D may be signed on behalf of the issuer by anyone who is duly authorized.

Text of Amendment

List of Subjects in 17 CFR Part 231

Reporting requirements, Securities.

In accordance with the foregoing, Title 17, Chapter II, of the Code of Federal Regulations is amended as follows:

PART 231—INTERPRETIVE RELEASES RELATING TO THE SECURITIES ACT OF 1933 AND GENERAL RULES AND REGULATIONS THEREUNDER.

1. Part 231 is amended by adding this Release No. 33-6455 (March 3, 1983) to the list of interpretive releases.

By the Commission.

George A. Fitzsimmons,

Secretary

March 3, 1983.

[FR Doc. 83-6220 Filed 3-9-83; 8:45 am]

BILLING CODE 8010-01-M

DEPARTMENT OF STATE

Bureau of Consular Affairs

22 CFR Part 41

[Dept. Reg. 108.829]

Issuance of Nonimmigrant Visas—Procedures

AGENCY: Department of State.

[52] A Form D is also required to be filed in connection with an offering conducted pursuant to section 4(6). *See* 17 CFR 239.500.

[53] The acronym "CUSIP" derives from the title of the American Banker's Association committee that developed the CUSIP system—Committee on Uniform Security Identification Procedures.