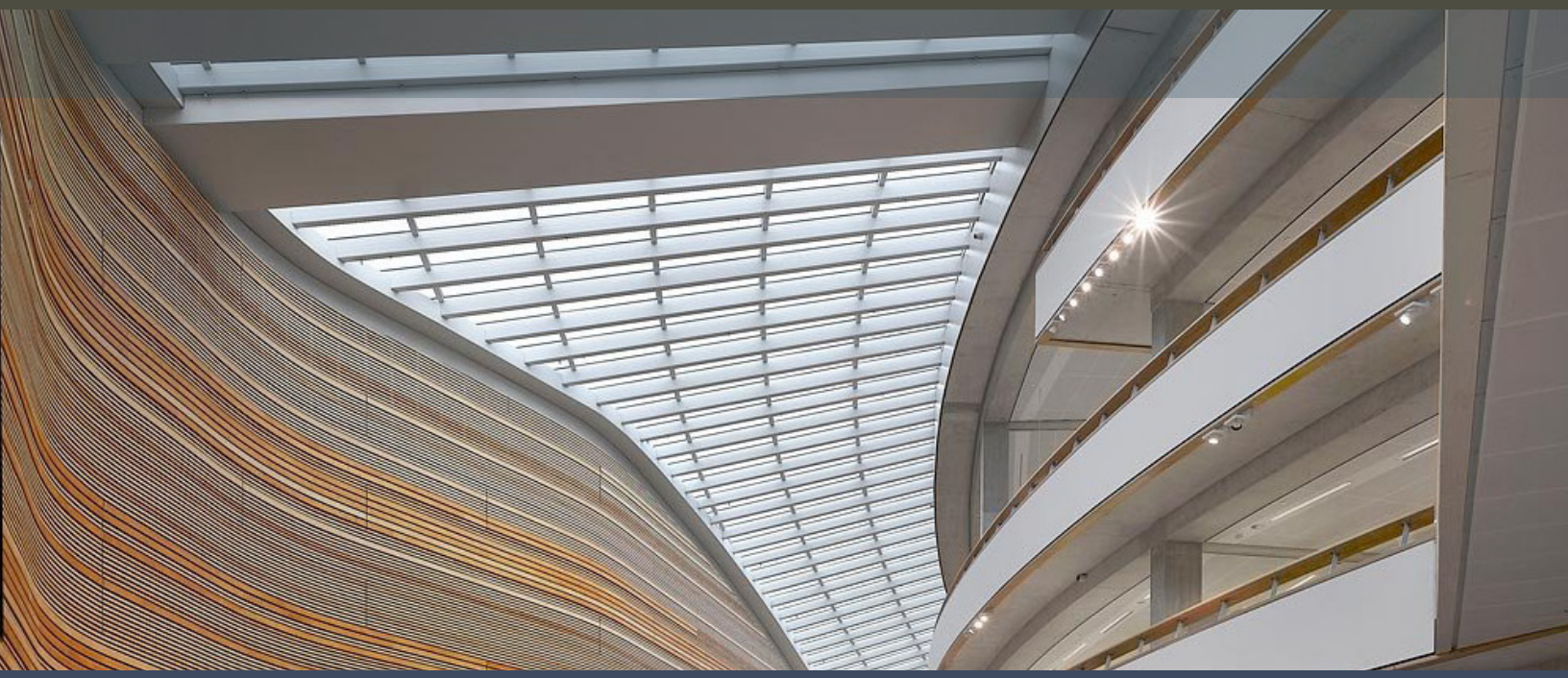
RAISING CAPITAL THROUGH A REGULATION D PRIVATE PLACEMENT

By John S. Lore, Esq.



CAPITAL FUND
LAW GROUP

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I. ABOUT THE AUTHOR

John S. Lore, Esq. is the managing partner of **Capital Fund Law Group**, a boutique securities law firm focused on Regulation D private placement offerings and investment funds. Mr. Lore advises companies throughout the United States on equity and debt private placement offerings for all market sectors, including real estate, technology, software, oil and gas, mining, investment funds, lending and finance, automotive, healthcare, manufacturing and others. Mr. Lore also advises investment fund sponsors in a variety of fund structures and strategies.

Mr. Lore's representation of a broad range of securities issuers allows him to keep abreast of emerging market trends. Prior to founding Capital Fund Law Group, Mr. Lore practiced corporate and securities law at a number of law firms, including the private securities division of Akin Gump Strauss Hauer & Feld, one of the largest international law firms in the world, in its New York City and Moscow offices.

Mr. Lore received his Juris Doctorate, *with honors*, from the University of Utah, S.J. Quinney College of Law, where he served as a senior member of the *Utah Law Review* staff.

Mr. Lore has been quoted on Regulation D securities law topics in a number of nationally recognized financial publications, including Forbes and Entrepreneur. He is the author of numerous publications, including books, white papers and articles dedicated to private placement securities law topics.

II. ABOUT CAPITAL FUND LAW

Choosing securities legal counsel is one of the most crucial decisions in conducting a private placement offering. Securities law requires careful navigation through a complex and rapidly evolving regulatory framework. Our attorneys have spent their legal careers focused on securities and investment law and provide a deep level of expertise and sophistication. Capital Fund Law Group conducts securities offerings and forms investment funds for clients throughout the United States in varied investment strategies, vehicles, jurisdictions and industry sectors.

Capital Fund Law Group's legal team has extensive experience advising securities issuers on all aspects of their business, from capital raising to implementation of their business models.

Our Services

Capital Fund Law Group offers flat-fee engagements for its services, which include structuring the offering terms, preparing the PPM (when appropriate), as well as all other ancillary documents such as the subscription agreement and investor suitability questionnaires. In addition, our firm assists with federal and state Form D filings, revising governing documents, such as operating agreements or bylaws and advising companies on legally marketing the offering to investors. The flat fee will depend on the complexity of the offering structure and the extent of disclosures required.

We encourage you to contact us to schedule a complimentary consultation with one of our securities attorneys to discuss your offering and obtain a quote for the preparation of your private placement offering.

III. INTRODUCTION

This book provides a guide through the process of raising equity and debt capital through a Regulation D private placement offering for an operating company (rather than an investment fund). The book explores the various components that are involved in preparing a private securities offering, including: structuring the offering, preparing the offering documents, complying with securities regulation requirements and marketing the private placement. Throughout the book we highlight pitfalls that a company needs to watch for and suggest best practices to safely and effectively conduct a Regulation D offering.

The book is divided into three parts, ascending in the level of complexity:

Part I

Part I provides an overview of the private placement process, including:

- how to avoid securities liability;
- what securities regulations control a private offering;
- the components of the various sections of a private placement memorandum;
- a description of ancilliary documents needed for a private placement; and
- an overview of the document preparation process.

Part II

Part II is an in-depth discussion of the marketing, structural and regulatory considerations involved in raising capital through a private placement offering, including:

- determining who can invest in the offering;
- marketing a private placement memorandum;
- selecting the appropriate debt or equity capital structure;
- setting appropriate investment terms and determining equity valuation;
- properly securing appropriate securities registra¬tion exemptions;
- filing federal Form D filings and state "blue sky" filings; and
- maintaining regulatory compliance.

Part III

Part III is a brief excerpt of a sample operating company private placement memorandum (PPM) for a fictitious company: a medical device manufacturer raising capital to conduct FDA clinical trials. The model PPM excerpt places particular emphasis on the risk factor section, which is one of the most important and most customized components of a private placement memorandum.

Glossary

The complexity of a Regulation D private placement offering requires that companies be familiar with key securities law terminology. Key definitions are defined and explained in the glossary section at the end of the book.

IV. AVOIDING POTENTIAL LIABILITY

A. Improper PPM Drafting Could Result in Fraud Violations

Improper drafting of securities disclosures often results in significant liability, even when the issuer did not overtly intend to deceive investors. The SEC and state securities commissions have developed complex systems of disclosure regulations, with which a company must comply for the securities to be deemed properly sold. In recent years, SEC regulations have undergone and continue to undergo major shifts, largely in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank) and the Jumpstart Our Business Startups Act (JOBS Act). Failure to properly navigate the complex and continually changing regulations carries significant liability, including personal civil liability and criminal penalties in some cases.

i. Liabilities for Violating Federal Anti-Fraud Provisions

Section 10(b) of the Securities Exchange of Act of 1934 ("Exchange Act"), imposes liability on a person who misrepresents or omits a material fact in connection with the sale of securities. The primary penalty imposed is a rescission of the investor's contract to purchase the security. A rescission means that the company, and in some cases an officer or director of the company, would be required to repay the purchase price of the investment made, as well as interest, attorney fees, and other costs. Payment of the liability under this section can be ordered by the court against the individual directors and officers personally.

Furthermore, if the SEC can prove that the material omissions or misstatements were willful, a court can impose fines on individuals up to five million dollars and/or imprisonment of up to 20 years.

ii. Liabilities for Violating State Anti-Fraud Provisions

Similar to the SEC, each state has its own securities laws that effectively piggyback the Exchange Act and impose civil liability on persons who misrepresent or omit material facts. They include personal liability against directors and officers. Thus, after the SEC imposes its penalties, each state in which a security was sold may then impose its own penalties against the directors and officers of the issuing company.

B. Retaining Experienced Securities Counsel

Experienced securities counsel will help

the company make the proper disclosures and protect it from unintentionally making misleading statements and material omissions. Unintentionally deviating from the disclosure requirements can result in serious consequences for the companies as well as its directors, officers, and managers.

To adequately protect private issuers, private securities offerings should include specific disclosures of present information about the company and a recitation of potential risks of the offering (known as risk factors). Risk factors vary from one offering to another and require the drafting attorney to foresee potential contingencies and assumptions that may result in unfavorable returns. The risk factors should be crafted to fit specific risks specific to the company's operations and the securities being offered.

A PPM requires specific language, drafting style, disclosures, and content. State securities divisions often request to review PPMs as part of the state's Form D notice-filing. A state's review of the PPM and marketing documents could result in liability to a company that erred in preparing the offering documents, regardless of whether there is any investor complaint. The structure should be driven by the advice of experienced counsel that has been provided with detailed information about the company and the contemplated offering.

V. PRIVATE PLACEMENT MEMORANDUM OVERVIEW

A. What is a PPM?

A private placement memorandum ("PPM") is a securities disclosure document that provides investors with material information about the offering and the company to enable an investor to make an informed investment decision. The PPM acts as the company's primary defense document against investor claims of securities fraud and federal or state regulatory action. Similar to a prospectus in a public securities offering, a private placement memorandum provides potential investors with specific information about the issuing company, which should be disclosed according to the SEC's format.

A PPM can be dispensed with for certain Regulation D offerings. If the offering involves investment by only one or two qualified investors as part of a fully negotiated transaction, such that investors are in a position to participate in setting the terms of the transaction, a PPM can be replaced with a summary of principal terms (often referred to as a "term sheet"), with appropriate risk factors and Form D filings. Even in small, closely negotiated transactions, there are circumstances that would warrant the preparation of a PPM. Companies should consult with legal counsel before determining whether a PPM is necessary for a given offering.

In addition to a PPM, the private offering documents include a number of additional documents that should be drafted in conjunction with the PPM and have legal significance of equal importance to the disclosures provided in the PPM. These include the subscription agreement, the investor suitability questionnaire, governing documents (such as bylaws, operating agreement or limited partnership agreement), the promissory note (in debt offerings) and others.

In making the securities disclosures, it is essential that the company work closely with experienced private placement securities attorneys. Legal counsel should assist with the planning and structuring of each aspect of the offering. As will be discussed in later sections, an issuing company faces many important decisions regarding how to structure the offering and select the proper exemptions. These considerations carry significant legal consequences.

B. Components of a Private Placement Memorandum

From an investor's point of view, the purpose of a PPM is to obtain needed information about the company and the security being offered, to allow investors to make an informed decision about whether to purchase the security. From the company's perspective, the purpose of a

PPM is to provide the necessary disclosures about the company and its securities to protect the company against claims of material misstatements or omissions. The following are some of the more important sections contained in any PPM. Each of the following sections is discussed in detail below:

- summary of offering terms;
- risk factors;
- estimated use of proceeds;
- description of the securities; and
- business/management section.

i. Summary of Offering Terms

The summary of the terms of the offering is (just as its name suggests) a condensed description of the offered terms. Among the summarized items are: a description of the securities (such as the class of securities, securities attributes, etc.); the calculation of the price; minimum subscription amount; investor qualification standards; placement agent commissions (if applicable) and discussion of the terms from the company's governing documents (limited partnership agreements, operating agreements, etc.).

ii. Risk Factors

Perhaps the most important component of the PPM is the risk factors. Risk factors are considerations that investors should consider that could lead to a loss of the investment.

Risk factors should be one of the first sections in a Private Placement Memorandum. This section is usually quite voluminous, often spanning dozens of pages, and covering many subcategories. A major mistake that many companies make is to fail to include detailed, customized risk factors, relying solely on risk factors of uniform applicability found in a template. The SEC has indicated the need for specific, relevant risk factors.

Risk factors must be drafted with specificity, tailored for the type of investment offered, the industry and sub-industry, offering structure, and company and management specific risks. Risk factors should be organized into sub categories according to the type of risk.

When disclosing risks, companies are often tempted to add mitigating language explaining why their business has a high probability of avoiding the disclosed risks. Such risk factor clauses are simple to identify. They often begin with "while," "though" or "however." SEC releases have given specific guidance to avoid mitigating language in risk factors. Risk factors should be limited to the identification and brief description of material risks. That is not to say disclosure of a mitigating business strategy should not be discussed in the PPM, but the language should not appear in the risk factors. The appropriate place to elaborate on risk mitigation strategies is the business and management sections of the PPM.

iii. Estimated Use Of Proceeds

A vital component of the private placement memorandum is the disclosure of how the company expects to use the proceeds of the offering. The use of proceeds section contains language describing how the offering proceeds will be deployed, and where possible, a table showing item-by-item anticipated expenditures to be allocated to each category. It can be difficult in many circumstances to determine the exact percentage of the proceeds that will be allocated to a given purpose. The "estimated" use of proceeds is a best-efforts forecast of how the proceeds will be used.

One point of caution, however, is that are some items that should not be estimated, but stated unequivocally, including the compensation or other value that any related party will receive from the proceeds. This compensation could be in the form of salary, consultant payment, purchase of a sale of an asset to the company, such as intellectual property, or any other direct or indirect compensation paid to a founder or related party from the proceeds. Note that disclosure of compensation from the proceeds of the offering is also required in the Form D filing, which is publicly available.

iv. Description of the Securities

One of the sections of the private placement memorandum requiring the greatest need for precision in drafting is the description of the securities. In this section, the company discloses the attributes of the debt or equity offering (including preferred returns, liquidation preferences, voting terms and others). In an equity offering, these attributes are contained in the governing documents of the company (operating agreement, limited partnership agreement, shareholders agreement, etc.). In a debt offering, investment attributes are set forth in the promissory note. The description of the securities section describes key terms found in the governing document or promissory note.

v. Business and Management Sections

The business section describes the investment opportunity and the business of the issuing company. The business section should provide background information concerning the company, its background, its business plans, and (when needed) the industry in which the company operates. The management section contains biographical and background information about the managers, founders, directors, key officers, etc. Legal counsel relies heavily on the company's management to provide it with the initial narrative for these sections. Business and management disclosures must be free from misleading statements and must not overstate accomplishments, opportunities or financial strength.

C. Other Offering Documents

The PPM itself is only one of a number of documents and filings needed to conduct a private placement offering. Other documents include the subscription agreement, the investor suitability questionnaire and the company's governing documents, a promissory note (with a debt offering) and others.

VI. THE PRIVATE PLACEMENT DRAFTING PROCESS

The private placement offering preparation process generally takes between three to six weeks for legal counsel and management of the company to complete. The time frame for completion of a private placement depends on the complexity of the offering and the extent of structuring and document preparation required. The determining factor is often how quickly a company is able to respond to the attorneys' requests for information and documents. Structuring and preparation of a private placement offering involves a number of important steps outlined below.

A. Review of Company Documents

The first step in preparing a private placement memorandum is a review of the company's legal documents. Among the documents that legal counsel should review include: formation documents (certificates or articles), governing documents (bylaws, operating agreements, limited partnership agreements, etc.) and other agreements to which the company is a party.

Loan documents, articles, bylaws, operating agreements, limited partnership agreements, or other legal documents must often be amended to facilitate the contemplated securities offering. If a company has not yet filed the foundational or organization documents, the securities attorneys should prepare them in connection with the offering.

B. Information Request Memorandum

As part of the structuring process, legal counsel will request in-depth information about the companies and principals, initially in the form of a detailed questionnaire or information request memorandum. This request will ask for written summaries of certain company information, as well as additional documents and records. The memorandum will ask for items such as the following:

- available financial statements;
- management bios, organizational chart, compensation structure;
- operating history, capital structure, outstanding debt;
- competitive strengths, position in the marketplace, advertising and distribution channels;
- anticipated capital expenditures, anticipated short and long term growth and dividend policies;
- risks particular to the company, including pending or threatened litigation; and
- regulatory investigations against the company or its management.

C. Structuring the Offering

The issuing company's management team should work closely with the securities attorneys to develop the structure of the offering. Competent securities counsel will be able to advise the company on the pros and cons of various offering structures, as well as provide insight into setting market-appropriate terms. Among the important decisions that the company will need to make when structuring the offering include:

- the Regulation D exemptions relied upon;
- the number of total authorized shares or membership interests;
- the class of shares or interest offered (preferred, participating, liquidation preferences, etc.);
- investor rights, including conversion and transferability rights;
- investment minimums; and
- the price of the equity or interest rate of the promissory notes.

D. Preparing the Offering Documents

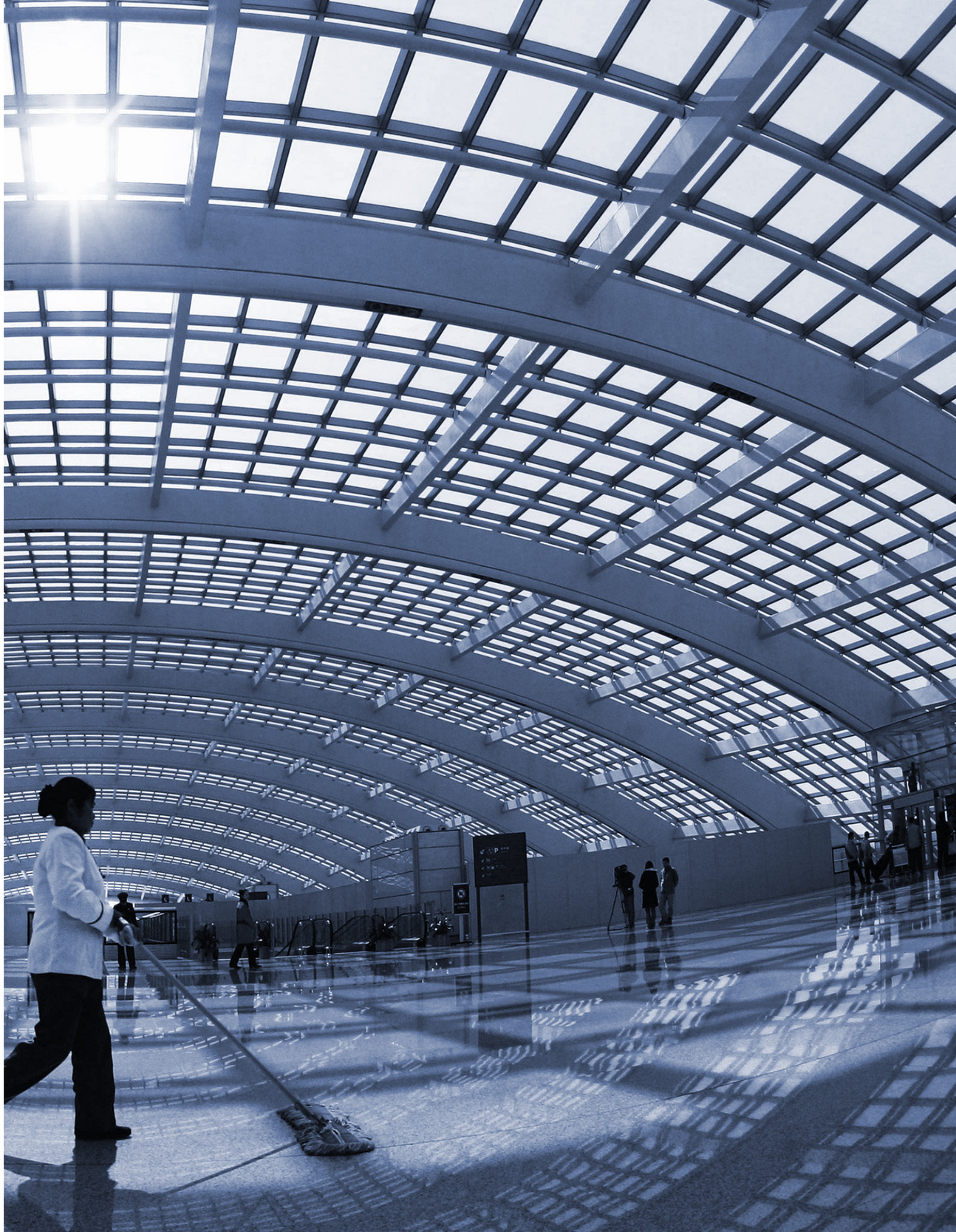
Once the company has responded to the requested information and has determined the terms, the securities attorneys will begin to draft the offering documents, which typically includes a private placement memorandum (PPM), sometimes referred to as a private offering memorandum; a subscription agreement and an investor suitability questionnaire for both individuals and entity investors. As stated previously, in heavily negotiated transactions, where the entire offering will be funded entirely by one or two investors, a term sheet with appropriate risk factors will be substituted for a PPM.

In debt offerings, the attorneys also prepare a promissory note. During this phase, it is important that your company be responsive to attorney requests for additional information to avoid delays. This phase is where the majority of the preparation time is spent.

E. Form D Notification Requirements

The last step of preparing a private placement offering is filing the appropriate SEC Form D and state notice filings. The federal Form D discloses biographical information about the offering, the company, use of proceeds, and the principals of the company. Failure to timely file the proper regulatory documents could result in adverse consequences for the company, its managers, officers or directors.

More discussion about the requisite SEC Form D and state securities documents is discussed in Part II below.



PART II
Marketing, Structure and Regulation

VII. WHO MAY INVEST?

Understanding investor eligibility is crucial to determining what exemptions the offering may use to avoid registration of the securities. The SEC has defined two categories of investors that may invest in Regulation D private placements: those that are "accredited" and those that are unaccredited, but sophisticated. Note that when the PPM involves investment funds subject to the Investment Advisers Act, the investors must often meet a higher wealth threshold, known as the "Qualified Client" standard. The SEC also excludes certain individuals based on regulatory or legal action against them.

A. Accredited Investors

An accredited investor is an investor that meets the income or net worth tests established by the SEC.

i. The Net Worth Test

For individuals, the investor must have an individual net worth or joint net worth with his or her spouse in excess of one million dollars. Net worth means the excess of total assets (excluding the positive equity of a principal residence) at fair market value minus total liabilities.

ii. The Income Test

Alternatively, an individual may also qualify as an accredited investor if he or she has an individual income in excess of $200,000 in each of the two most recent years ($300,000 when combined with spouse) and a reasonable expectation of reaching the same income level in the current year. Executive officers, directors, and general partners of the company, by their position and responsibilities, can likewise qualify as accredited investors without meeting the requisite income or net worth requirements.

In addition to individuals, accredited investors may also be entity investors (LLCs, corporations, limited partnerships, etc.) with a net worth of at least five million dollars. Entities with less than a five million dollar net worth may also be considered accredited investors if the entity is beneficially owned entirely by accredited investors.

B. Unaccredited Investors

Unaccredited investors are those that do not meet the standards discussed above. In order to invest in most Regulation D private placements, unaccredited investors must be "sophisticated." This is not a set net worth or income threshold like the accreditation criteria, but a loose standard based on the individual investor's business acumen and investment expertise. To be sophisticated, the SEC requires that investors have such knowledge, experience, and sophistication in financial and business matters that he or she is able to evaluate the merits and risks of an investment in the securities. It is often difficult to ascertain whether this standard has been met.

In addition to the sophistication requirement, certain Regulation D exemptions require additional disclosures to be made to unaccredited investors. Failure to make such disclosures could cause the company to lose its exemption for all securities sold. We recommend that when possible, unaccredited investors be excluded from a company's investor pool because they pose a substantial risk to the company on many levels.

C. Determining Investor Qualifications

Other than in a Rule 506(c) offering, which will be discussed below, federal regulations generally require only that the company have a reasonable belief that the investor is accredited and a reasonable belief that the prospective investor has sufficient knowledge and sophistication to properly evaluate the offering.

Each investor must fill out an investor suitability questionnaire as part of the subscription documents. In this document, the investor must certify, based on answering a series of questions, that the investor meets one of the definitions of an accredited investor. Except in a Rule 506(c) offering (where advertising is employed) the investor's self-certification is sufficient to protect the company from liability, should any subsequent question arise as to whether the investor actually met the accreditation standard.

As will be discussed below, Rule 506(c) allows advertising and solicitation for certain offerings and imposes upon the company additional documentation and due diligence requirements to verify the investor's accreditation status.

D. Bad Actor Disqualification

Issuers should be aware of the SEC's "bad actor" disqualification from participation in Regulation D offerings, implemented in 2013, for certain equity investors and affiliated persons of the issuer that have had certain actions taken against them. Disqualified persons include those that have been subject to certain suspension orders or expulsion from the SEC, the Financial Industry Regulatory Authority ("FINRA"), and certain self-regulating agency or individuals that have been convicted of certain crimes within a given period prior to the offering.

Legal counsel should prepare a "bad actor questionnaire" to be filled out by all investors and members of management, representing that such persons are not disqualified from participating in the offering. Note that when certain bad actor events fall outside the statutory disqualification period, such events may be subject to disclosure. Should you have any concerns that an associated person might fail one or more of the above provisions, it is strongly urged you speak with securities legal counsel before proceeding.

VIII. MARKETING TO INVESTORS

A. Advertising and Solicitation

For decades, securities regulations have contained a prohibition against using advertisement or solicitation in connection with most private placements. The prohibition has included such methods as television, radio, print, Internet advertisements, cold calling (calling individuals with which the issuer or its agents have no prior relationship), distributing brochures to potential investors, setting up booths at shows, fairs, or other events and soliciting individuals or companies with whom the agents do not have a preexisting relationship.

For most Regulation D offerings, that prohibition is still in place, and companies should insure that when raising capital, no advertising is conducted. Further, companies need insure that the company or its agent has a substantive preexisting business or personal relationship with each potential investor prior to discussing the offering. However, a recent regulatory development has allowed companies to engage in advertising, although much is still unknown about potential risks and implications of relying on the relatively new regulatory structure.

B. The JOBS Act Allows General Advertising for Certain Offerings

In September 2013 the SEC implemented provisions of the JOBS Act to lift the ban on advertising and solicitation for certain Regulation D private placement offerings. At the same time, the SEC proposed new rules that will require additional regulatory burdens if passed.

The lifting of the ban on general advertising represents one of the most fundamental shifts to securities regulation in nearly 80 years. Under the new rules, private companies seeking to raise capital are permitted to market their private placement publicly to accredited investors, via social media, print materials, email, group seminars and other means.

i. Lifting of the Advertising Ban for Private Placements–New Rule 506(c)

Under the newly adopted Rule 506(c), a company is permitted to engage in advertising and solicitation if all purchasers are accredited investors and the company takes "reasonable steps" to verify that all investors are accredited.

ii. What are Reasonable Steps?

The SEC has provided a non-exclusive list of ways to verify whether an investor is accredited (among the list, only the first will be acceptable to most companies):

- obtaining written certification from a licensed attorney, CPA or broker-dealer certifying that the professional has reviewed documentation indicating that the investor meets the accreditation standard;
- reviewing recent IRS forms, along with self certification by the investor; and
- reviewing bank and brokerage documents, together with self-certification by the investor.

iii. Proposed Rules Requiring Additional SEC Disclosures

In addition to lifting the ban on advertising and solicitation, the SEC proposed new rules that (if adopted) will place additional regulatory burdens on companies using this rule, especially for those using advertisements in written form. These changes will not go into effect until finalized and adopted.

iv. Advertising Must Not Be Misleading

State and federal law against misleading statements or material omissions are unchanged by this rule change. The standard for what constitutes a "misleading statement" in a securities offering is much stricter than the general standard for misleading advertising. Even a seemingly innocent mistake in wording could have serious consequences. A private placement attorney should review all marketing and advertising material.

C. Using Intermediaries to Raise Capital

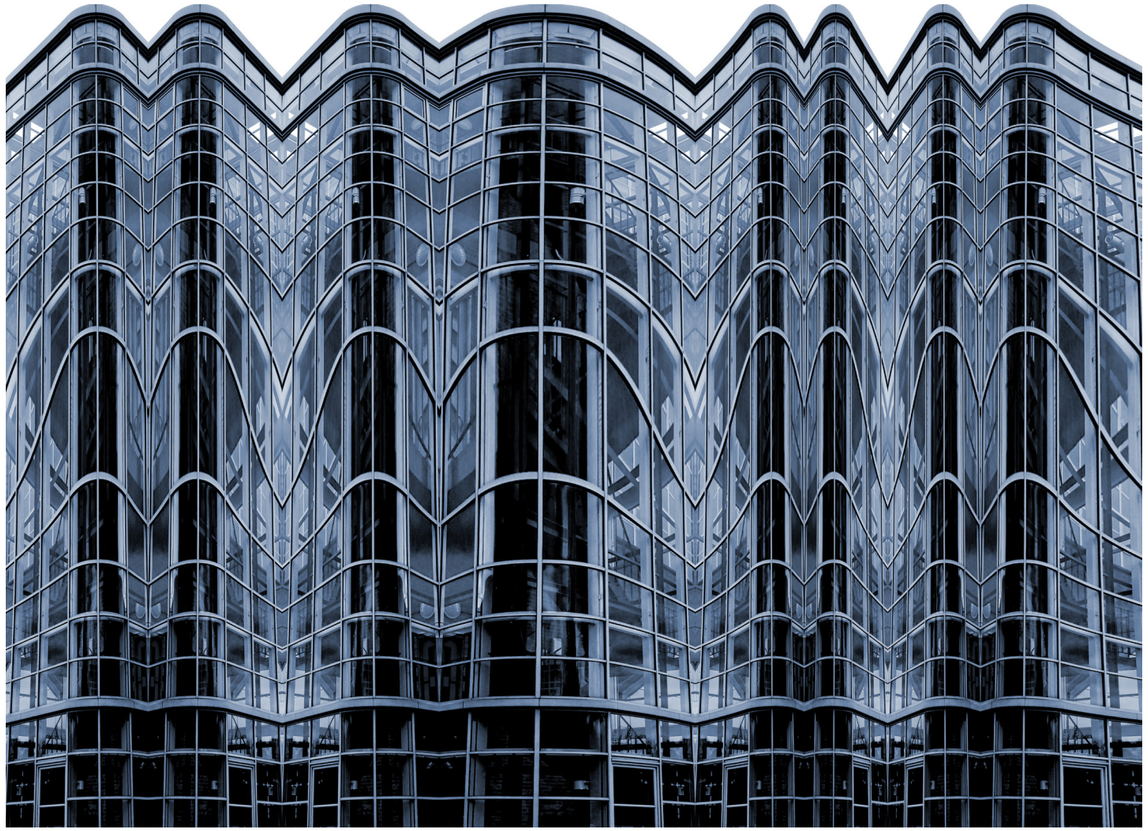
Typically, the starting point for finding investors is within the personal and professional networks of the company's directors, managers, partners, officers, or employees. These individuals can raise investments from investors with whom they have existing relationships (relying on the "issuer exemption" from broker-dealer registration.

i. Broker-Dealer Placement Agents

Only broker-dealers registered with FINRA may receive transaction-based compensation as an intermediary in a securities offering. Broker-dealers tend to be very selective in accepting engagements. Before a broker-dealer will agree to participate as a placement agent, it will perform a due diligence review of the company to establish that the private placement meets its risk profile. All private placements undertaken by a registered broker-dealer must be reviewed by FINRA.

ii. Finders

The use of individuals not registered as broker-dealers as intermediaries (so called "finders") is allowed only in an extremely narrow set of circumstances. Generally, paying transaction-based compensation to a finder for selling securities is illegal, although it remains a common practice. The SEC has recently increased its enforcement against unregistered individuals and imposed liability for failing to register as broker-dealers while engaging in activities explicitly reserved for registered broker-dealers. The SEC has also intensified its enforcement actions against issuing companies who employ finders in violation of SEC regulations. Because engaging finders can subject the company and even its management to significant unneeded liability, we strongly recommend that finders not be used. If you have specific questions on the use of finders, please call our office to discuss your specific circumstances.



IX. STRUCTURING THE OFFERING

An offering's basic structure involves debt, equity, or some combination of debt and equity. Within the basic structure, a company has numerous options, from convertible securities (debts that convert to equity upon certain events), to priority distributions and preferred returns. The offering's structure is driven in large part by investor appetite for the particular investment and the needs of the issuing company.

A. Debt

A debt structure involves the investors purchasing promissory notes of the company and receiving interest and principal payments according to the terms of the note. Interest payments can be payable in installments or as lump-sum payments, with the principal due on the maturity date. Investors become creditors of the company and typically have no voting or management rights.

This structure is usually limited to companies that have an identifiable revenue stream. Since debt offerings have limited upside potential, investors tend to be hesitant to invest in debt offerings that involve unpredictable or uncertain returns. A company that fails to make a payment will usually be deemed in immediate default and can put the entire company at risk. Startup companies in which losses are expected for the first few years can find it difficult to meet periodic debt repayment obligations when the cash would be better suited to keep operations progressing.

B. Equity

Equity structures involve more complex planning, but provide issuers with greater flexibility on distributions to investors. An equity structure involves giving investors ownership interest in the company as stock in a corporation, membership interest in a limited liability company, limited partnership interest in a limited partnership, or other form of ownership interest in an entity. Many companies are hesitant to offer equity interests because of concerns about giving up voting control. However, there are various forms of equity structures to limit investor control.

C. Valuation for an Equity Offering

Establishing an equity structure involves determining the value of the equity offered. Valuation is simply the amount that investors are willing to invest in exchange for a given percentage of the equity of the company. However, to set a price per equity interest, companies must establish a pre and post money valuation, which is a very subjective measure and encompasses many factors. These factors include the company's need for the capital,

the quality of the potential product or service and its intellectual property, the quality of the management team, the size of the market for the product or service and past and anticipated revenue.

One method of determining the value is based on a multiple of the company's projected gross revenues, earnings before interest, taxes, depreciation, or amortization (EBITDA), or net income. After calculating that estimate, the company would calculate what percentage of the company an investor would need to receive in order for the investor to receive its money back plus a certain percentage of their investment (for example 200%). For an investment fund, valuation on the fund's assets is performed by third-party appraisals or by market exchanges.

D. Governing Documents

Each type of entity has specified governing documents such as operating agreements for limited liability companies, bylaws for corporations and limited partnership agreements for limited partnerships. The governing documents are the foundational documents of a company and direct how a company will operate. They include such items as how and when distributions are to be made, the rights and responsibilities of the management and owners and allocations of income to the owners. Because the governing documents control the operations of the company, they must be tailored to conform to the terms of the offering. For example, if there are multiple classes of equity, then the governing documents must authorize each class and set forth the preferences of distributions, the voting rights of the classes and other rights of each class. The governing documents should be revised or rewritten by the private placement attorneys to correspond to the terms of the offering. Failure to do so could result in material misstatements.

X. CHOOSING SECURITIES EXEMPTIONS

A. Federal and State Exemptions

Having decided on the offering structure and categories of investors that the company will include in its offering, the company must then determine the applicable registration exemptions upon which to rely. Absent appropriate exemptions, the SEC and state securities commissions would require that the securities be registered prior to being offered. Also, since both the SEC and state securities commissions require exemptions from registration, the company must have an exemption at both the federal and state levels.

The primary exemptions used at the federal level are found in the federal legislation and SEC Regulations, the most prominent of which is Regulation D, promulgated under the Securities Act of 1933. Registration exemptions are not mutually exclusive, and an offering may often rely simultaneously on multiple exemptions. Some exemptions are self-executing while others require the company to take specific action to invoke their provisions.

B. Regulation D

Regulation D is a safe-harbor regulation that provides exemptions from federal registration to provide certainty to securities issuers. These include exemptions under Rules 504, 505, 506(b) and 506(c). Rule 506(b) and 506(c) are the most commonly relied upon exemption in private offerings (accounting for more than 90% of offerings, according to SEC statistics).

i. Rule 506(b) and Rule 506(c) Exemptions

Rule 506(b) and 506(c) are governed by Section 4(a)(2) of the Securities Act of 1933 (the "Securities Act"). Following the implementation of the federal Jumpstart Our Business Startups Act (the JOBS Act), Rule 506 was divided into two exemptions: Rule 506(c), which allows advertising and general solicitation, and Rule 506(b), which does not. Unless the context otherwise requires, Rule 506(b) and Rule 506(c) will be collectively referred to as "Rule 506."

Rule 506 permits a company to offer securities to an unlimited number of accredited investors and up to thirty-five unaccredited investors. Our firm recommends that (when possible) issuers strictly limit Rule 506 offerings to accredited investors to minimize liability. Rule 506 offers numerous advantages over other Regulation D exemptions, as will be discussed below.

a. Federal Preemption Over State Law

Rule 506 is unique among the Regulation D exemptions, in that with a properly prepared

Regulation D offering, there is no need to register at the state level or satisfy any state exemption. Through the National Securities Markets Improvement Act of 1996 ("NSMIA"), Congress has specifically preempted state authority to review securities exempted under Rule 506 or impose additional requirements. The NSMIA effectively took from the states their power to review an offering under Rule 506. States may only require that securities issuers submit a notice filing and impose filing fees.

b. Reduced Risk of Losing the Exemption

Additionally, if an offering made under Rule 506 is made only to accredited investors (as Capital Fund Law Group recommends), the company making the offering will not lose its exemption from failure to make statutorily prescribed disclosures. A private placement memorandum should be drafted carefully to protect the company from violations of the "anti-fraud" provisions under the Securities Act and the Exchange Act as well as state securities laws.

ii. Rule 504 Exemption

Rule 504 is governed by Section 3(b) of the Securities Act. This rule is a safe harbor provision for private offerings not to exceed one million dollars. There can be an unlimited number of investors and accreditation is not required. A company that follows the requirements of Rule 504 is exempt from registering its securities with the SEC, but is still subject to state registration in each state in which the company offers securities unless the company can satisfy a state registration exemption. Thus, even in offerings of less than one million dollars, we recommend that securities issuers rely on Rule 506 rather than Rule 504 when possible, to avoid being subject to state registration requirements.

Rule 504 is most commonly used when a company needs to raise capital from more than thirty-five unaccredited investors and the company is not eligible for a 506 exemption. In certain cases, Rule 504 may be used with general advertising without federal registration. However, such an offering would require registration or an exemption in every state in which it is offered.

iii. Rule 505 Exemption

Rule 505, like Rule 504, is governed by Section 3(b) of the Securities Act. It is a safe harbor provision for offerings that will not exceed five million dollars. Because of the benefits that are offered under Rule 506, Rule 505 is rarely relied upon, except as a backup exemption. Rule 505 permits the issuer to offer securities to no more than thirty-five unaccredited investors. This rule prohibits solicitation or advertising to potential investors. Rule 505 also requires that strictly prescribed information be given to the unaccredited investors.

iv. SCOR Offering

A Small Corporate Offering Registration (SCOR) offering is essentially a more complex version of a Rule 504 Offering. The SCOR offering uses a standardized disclosure format that most states currently accept and relaxes some of solicitation and advertising prohibitions that are prevalent in a Rule 504 Offering. The standardized disclosure format permits an issuer to comply with many of the state securities laws using a single registration, as opposed to preparing offering documents for each state and then filing such documents with each individual state. The standardized disclosure document is a question and answer document, which is different than a typical PPM disclosure document.

Under a SCOR Offering, an issuer is limited to raising a maximum of one million dollars in a twelve-month period. It must also provide two years of audited financial statements if the offering amount exceeds $500,000. Because of the burden of state registration, we would only recommend the SCOR offering in very limited circumstances.

v. Rule 147 Intrastate Exemption

The Intrastate exemption is available if an issuer will only be offering securities in a single state. The exemption requires that the issuing company be organized in the state in which it intends to offer its securities. It is a narrow exemption and can easily be lost if not followed exactly. There is no limit on the amount of securities that may be sold. The Intrastate exemption is quite restrictive and generally has limited usefulness to issuers, particularly when compared to Rule 506. Rule 506 offerings can typically provide the same exemptive protection, but with less chance for the company to lose its exemption. Because of the risk of losing the exemption, we generally recommend that the intrastate exemption be relied upon only as a backup to another exemption.

vi. Advantages of Rule 506

Rule 506 provides a number of advantages over other available exemptions. As discussed above, the NSMIA preempts states from denying exemption status to securities issued under a Rule 506 offering. States may request an issuing company's Form D filing information, but they may not impose their own registration requirements if the securities are offered under a Rule 506 exemption. Additionally, a Rule 506 offering does not limit the amount that may be raised under the exemption. Companies engaging in large and small offerings alike may utilize this exemption.

As discussed above, pursuant to the JOBS Act, the SEC has removed the ban against advertising and solicitation for companies that follow the requirements of Rule 506(c). Finally, companies relying on a Rule 506 exemption will not be at risk for losing their exemption for failure to include one of the many specifically prescribed disclosures required by the SEC, as would be the case when relying on other exemptions.

C. State Exemptions

In addition to the federal exemptions, state securities laws, also known as "blue sky laws," require companies to either register their securities or find an applicable exemption. As discussed above, states may not impose additional registration requirements with respect to an offering relying on Rule 506 for federal and state exemption (other than to require a state Form D notice filing).

XI. FORM D FILING

A. Federal Requirements

Form D is a federal notice of an exempt securities offering and is the only disclosure document that is required to be filed with the SEC. This document discloses biographical information about the offering, the company, use of proceeds, and the principals of the company. Form D is not subject to review or approval by the SEC, but is a required notification document, and must be filed within 15 days of the first sale to investors. If the offering is ongoing, Form D must be updated each year in which the offering is open.

The first part requires basic biographical and contact information. The company must also disclose the names and contact information of each executive officer, director, general and managing partners, and managers or managing members of limited liability companies as well as any individual who has acted as a promoter of the company within the previous five years. The second part of the Form D filing requires information about the offering itself, including exemptions on which the company relies. As discussed previously, a company may rely on multiple exemptions.

Offerings that last more than one year require a Form D to be filed each subsequent year the offering remains open. The company must signify whether the securities are debt (which includes convertible securities) or equity. The company must also provide any sales compensation that has or will be paid directly or indirectly in connection with the sale of securities and to whom they have or will be paid as well as the total amount of sales commissions that the issuer intends to pay during the offering. The issuer must describe how it will use the proceeds received from the offering, and in particular, what amount of the proceeds will be taken as direct or indirect compensation to a company affiliate. 23

B. State Requirements

In addition to the Federal Form D requirements, each state in which an investor resides requires Form D notification filings as well. Under Regulation D Rule 506 offerings (the most common offering), a state's authority to review Regulation D exempt securities is restricted. However, states have their own notice-filing requirements that must be complied with when offering securities to a resident of its state. Each state's requirements differ with respect to the information required and the due date of the required notice filing. Most states require the notice filing to be made within fifteen days after a resident of the state makes an investment; however, certain states (including New York) require that the notice filing be made prior to any offer of securities within the state. The state of Florida currently has no state Form D notice-filing requirement.

PART III

SAMPLE OPERATING COMPANY PPM EXCERPT

Name: _____[1]

Copy No.: _____[2]

XYZ Medical, LLC

A NEW YORK LIMITED LIABILITY COMPANY

CONFIDENTIAL OFFERING MEMORANDUM[3]

(AN ILLUSTRATIVE EXCERPT)

January 1, 2015 [4]

Targeting up to 8,000,000 of
Class A Units ($1.00 per offered unit)
Offering Available Exclusively to Accredited Investors

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1 Issuers must carefully track the circulation of the PPM and the other offering documents to demonstrate that no advertising or general solicitation was used in the offering (when not relying on Rule 506(c). Additionally, tracking circulation of offering documents is essential to satisfy New York's pre-offer Regulation D filing requirement and to satisfy potential SEC or state audits. Beyond the regulatory requirements, as a practical matter it is important to know which version of an offering document was given to which investor, as modifications are common.

Each PPM should bear the name of the intended offeree and a unique identifying number. The fund manager should maintain a spreadsheet showing the name and number of each PPM distributed, together with the date of offer, the version of the document, and a description of any written information provided to the investor.

2 As noted above, each memorandum should be numbered, preferably non-sequentially.

3 This document is an illustrative excerpt of a private placement memorandum for a fictitious, New York-based medical device manufacturer raising series A financing for FDA approval and initial manufacturing.

4 Generally the date of a PPM does not reflect the date that the PPM was given to an investor, but the date on which the most recent version of the PPM was finalized. When material changes occur that affect the fund or its management, such changes should be reflected in an amended PPM and the date should be modified accordingly.

IMPORTANT GENERAL CONSIDERATIONS

This Private Placement Memorandum (this "*Memorandum*") relates to the private offering by XYZ Medical, LLC, a New York limited liability company ("*we*,""*us*,""*our*," or the "*Company*"), of up to $8,000,000 of its Class A Units (the "*Class A Units*") at a price per Class A Unit of $1.00 for a total offering price of $8,000,000, which will constitute equity ownership of thirty-five percent (35.00%) of the Company. The Class A Units are being offered on a "best efforts" basis by our Company.

These securities are speculative, and an investment in them involves a high degree of risk. See "*Risk Factors*" in this Memorandum beginning on page 10 for a discussion of some of the risks that you should consider before making an investment decision. No public market exists with respect to any of our securities, and none is expected to develop in the foreseeable future. You must be prepared to bear the economic risk of any investment for an indefinite period of time and be able to withstand a total loss of your investment.

The securities described in this Memorandum have not been registered with or approved by the U.S. Securities and Exchange Commission (the "*Commission*"), nor has the Commission or any applicable state or other jurisdiction's securities commission or other regulatory authority passed upon the accuracy or adequacy of this Memorandum or endorsed the merits of this offering (this "*Offering*"). Any representation to the contrary is unlawful. None of the securities may be resold, transferred, or otherwise disposed of unless the transaction effecting such disposition is registered under the U.S. Securities Act of 1933, as amended (the "*Securities Act*"), or an exemption therefrom is available and our Company receives an opinion of counsel acceptable to it that such registration is not required pursuant to such exemption. Each investor ("*Investor*") will sign an agreement that will contain representations, warranties, and covenants consistent with the foregoing.[5]

5 This required disclosure informs investors that the notice filing of a Regulation D offering does not imply that the SEC or any state has sanctioned the offering. This seeks to clarify that the filing of a Form D notice filing does not involve government approval, as in the case of a public offering. New York requires a submittal of the offering in connection with the Form D notice filing prior to making an offering in the state but does not approve or disapprove the offering. Additionally, when a broker-dealer is used as a placement agent, the offering documents must be reviewed by FINRA.

We reserve the right to modify, amend, and/or withdraw all or any portion of this Offering, to accept subscriptions for part of the securities offered hereby and continue the Offering, to approve or disapprove each Investor, and to accept or reject any subscription in whole or in part in our sole discretion.

CONFIDENTIALITY NOTICE

This Memorandum and the materials accompanying this Memorandum contain confidential, proprietary, and nonpublic information, including without limitation, business plans, financial information, and data (collectively, the "*Information*") regarding our Company. Each recipient hereof agrees by accepting this Memorandum that the Information is of a confidential nature and that such recipient will treat the Information in a strictly confidential manner and that such recipient will not, directly or indirectly, disclose or permit such recipient's affiliates to disclose any Information to any other person or entity, or reproduce the Information, in whole or in part, without the Company's prior written consent. The recipient of this Memorandum further agrees to use the Information solely for the purpose of analyzing the desirability of a purchase of Class A Units of our Company and for no other purpose whatsoever. The recipient hereof agrees not to use the Information in any way that is harmful to or competitive with us or our affiliates. The recipient of this Memorandum agrees to return it and the related documentation if the recipient does not commit to purchase Class A Units of our Company in this Offering.

THESE ARE SPECULATIVE SECURITIES WHICH INVOLVE A HIGH DEGREE OF RISK. ONLY THOSE INVESTORS WHO CAN BEAR THE LOSS OF THEIR ENTIRE INVESTMENT SHOULD INVEST IN THESE CLASS A UNITS.

THIS OFFERING IS NOT UNDERWRITTEN. THE OFFERING PRICE HAS BEEN ARBITRARILY SET BY THE MANAGEMENT OF THE COMPANY. THERE CAN BE NO ASSURANCE THAT ANY OF THE SECURITIES WILL BE SOLD.

THE SECURITIES DESCRIBED HEREIN HAVE NOT BEEN REGISTERED PURSUANT TO THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), NOR UNDER THE SECURITIES ACTS OF NEW YORK OR OTHER STATES. THIS OFFERING IS MADE UNDER RULE 506 OF REGULATION D OF THE SECURITIES ACT AND AS ENACTED BY THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES ACT, AS WELL AS OTHER EXEMPTIONS FROM REGISTRATION REQUIREMENTS, INCLUDING SECTION 4(a)(2) OF THE SECURITIES ACT.

These materials are for the personal use of the Offeree whose name appears above and are not to be transferred or electronically forwarded to any other person.

IMPORTANT SECURITIES LAW NOTICES

THIS OFFERING IS BEING MADE IN RELIANCE UPON AN EXEMPTION FROM REGISTRATION FOR AN OFFER AND SALE OF CLASS A UNITS WHICH DOES NOT INVOLVE A PUBLIC OFFERING. EACH PURCHASER OF CLASS A UNITS OF OUR COMPANY OFFERED HEREBY, IN MAKING A PURCHASE, WILL BE DEEMED TO HAVE MADE CERTAIN ACKNOWLEDGMENTS, REPRESENTATIONS, AND AGREEMENTS AS SET FORTH HEREIN.

THE PURCHASE OF CLASS A UNITS OF OUR COMPANY OFFERED HEREBY INVOLVES A HIGH DEGREE OF RISK AND SHOULD BE CONSIDERED ONLY BY PERSONS WHO ARE ABLE TO SUSTAIN A TOTAL LOSS OF THEIR PURCHASE. PROSPECTIVE INVESTORS SHOULD CAREFULLY CONSIDER THE "RISK FACTORS" CONTAINED HEREIN.

WE HAVE THE UNCONDITIONAL RIGHT TO ACCEPT OR REJECT ANY PURCHASE, IN WHOLE OR IN PART, FOR ANY REASON OR WITHOUT A SPECIFIC REASON, IN OUR SOLE AND ABSOLUTE DISCRETION (EVEN AFTER RECEIPT AND CLEARANCE OF SUCH INVESTOR'S FUNDS).

NO PERSON HAS BEEN AUTHORIZED TO PROVIDE ANY INFORMATION WITH RESPECT TO OUR CLASS A UNITS, OUR COMPANY, OR OUR AFFILIATES EXCEPT FOR THE INFORMATION CONTAINED HEREIN. RECIPIENTS SHOULD NOT RELY ON ANY MATERIALS OTHER THAN AS SET FORTH HEREIN.[6] THE INFORMATION CONTAINS DESCRIPTIONS AND OTHER MATTERS AS OF THE DATE OF THIS MEMORANDUM. NEITHER WE NOR ANY OTHER PERSON OR ENTITY IS UNDER ANY OBLIGATION TO UPDATE OR OTHERWISE REVISE THE INFORMATION FOLLOWING ITS DISTRIBUTION, AND RECIPIENTS SHOULD NOT EXPECT ANY SUCH UPDATE OR REVISION. RECIPIENTS ARE URGED TO CONDUCT AN INDEPENDENT INVESTIGATION AND EVALUATION OF OUR COMPANY BEFORE CHOOSING TO PURCHASE CLASS A UNITS OF THE COMPANY.

THE INFORMATION CONTAINED HEREIN HAS BEEN PROVIDED BY US AND OTHER SOURCES IDENTIFIED HEREIN, BUT THERE CAN BE NO ASSURANCE AS TO THE

6 While this clause attempts to mitigate statements conflicting with the PPM by telling the investors they may not rely upon them, the effectiveness of such language in a court proceeding is uncertain. Any statement made by a representative of a hedge fund to a prospective investor concerning the offering, whether verbal or written, has the potential to be construed as a representation, warranty, or material misstatement.

Issuers need to be just as careful when crafting statements in marketing material, presentations and email as they would be when making disclosures in the PPM. Experienced legal counsel should review all marketing material prior to circulation. Marketing material should bear legends instructing investors to make investment decisions based on the PPM.

ACCURACY OR COMPLETENESS OF SUCH INFORMATION. EACH PROSPECTIVE INVESTOR OF CLASS A UNITS OF OUR COMPANY MUST COMPLY WITH ALL APPLICABLE LAWS AND REGULATIONS IN FORCE IN ANY JURISDICTION IN CONNECTION WITH THE SUBSEQUENT OFFER OR SALE OF CLASS A UNITS PURCHASED PURSUANT TO THIS MEMORANDUM. IN MAKING A PURCHASE DECISION, PROSPECTIVE INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF US AND THE TERMS OF THIS OFFERING, INCLUDING THE MERITS OF THE PURCHASE AND THE RISKS INVOLVED. THE CONTENTS OF THIS MEMORANDUM ARE NOT TO BE CONSTRUED AS LEGAL, BUSINESS, OR TAX ADVICE. EACH PROSPECTIVE INVESTOR SHOULD CONSULT AN ATTORNEY, BUSINESS ADVISOR, AND/OR TAX ADVISOR, AS APPLICABLE, AS TO LEGAL, BUSINESS, OR TAX ADVICE.

THIS MEMORANDUM CONTAINS SUMMARIES BELIEVED TO BE ACCURATE IN ALL MATERIAL RESPECTS AS TO THE TERMS OF CERTAIN DOCUMENTS DESCRIBED HEREIN, BUT REFERENCE IS HEREBY MADE TO THE ACTUAL DOCUMENTS (COPIES OF WHICH WILL BE MADE AVAILABLE TO PROSPECTIVE INVESTORS UPON REASONABLE REQUEST) FOR COMPLETE INFORMATION WITH RESPECT THERETO, AND ALL SUCH SUMMARIES ARE QUALIFIED IN THEIR ENTIRETY BY SUCH REFERENCE.

THIS OFFERING CAN BE WITHDRAWN AT ANY TIME BEFORE CLOSING AND IS SPECIFICALLY MADE SUBJECT TO THE TERMS DESCRIBED IN THIS MEMORANDUM.

THE CLASS A UNITS OF THE COMPANY OFFERED HEREBY WILL BE SOLD SUBJECT TO THE SUBSCRIPTION AGREEMENT AND OTHER PURCHASE DOCUMENTATION BEING DELIVERED WITH THIS MEMORANDUM, WHICH CONTAIN CERTAIN REPRESENTATIONS, WARRANTIES, TERMS, AND CONDITIONS. EACH INVESTOR SHOULD CAREFULLY REVIEW THE PROVISIONS OF SUCH DOCUMENTATION BEFORE PURCHASING.

THE DELIVERY OF THIS MEMORANDUM TO A POTENTIAL INVESTOR SHALL NOT UNDER ANY CIRCUMSTANCES CREATE ANY IMPLICATION THAT THERE HAS NOT BEEN ANY CHANGE IN OUR AFFAIRS SINCE THE DATE HEREOF. WE WILL MAKE AVAILABLE TO ANY PROSPECTIVE QUALIFIED INVESTOR THE OPPORTUNITY TO ASK QUESTIONS OF AND RECEIVE ANSWERS FROM US CONCERNING THE TERMS AND CONDITIONS OF THE OFFERING AND THE BUSINESS AND OPERATIONS OF OUR COMPANY.

NOTE ON FORWARD-LOOKING STATEMENTS

This Memorandum contains forward-looking statements concerning our plans, intentions, strategies, expectations and predictions concerning our future activities and results of operations and other future events or conditions. For this purpose, any statements contained in this Memorandum that are not statements of historical fact may be deemed to be forward-looking statements. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "believe," "may," "will," "could," "intend," "estimate," "might," or "continue" or the negative or other variations of these words or comparable terminology.

A variety of factors could cause actual results or activities or actual events or conditions to differ materially from those estimated or projected in the forward-looking statements. Some of these factors may be beyond our control. The plans, strategies, and intentions of management may change based upon increased experience with our business model, as well as in response to competition, general economic trends, or perceived opportunities, risks, or other developments. Important factors that could cause actual results to differ materially from our expectations are disclosed under the caption "*Risk Factors*," below.[7]

Projections concerning our future results of operations and expansion plans are based on a number of assumptions and estimates made by management. To the extent that actual events differ materially from these assumptions and estimates, actual results will differ from those projected. See "*Risk Factors*," below.

[End of section excerpt. This section has been significantly shortened for use in this sample.]

7 A key concept of a securities offering document is to include multiple references to important information or key risks. When a discussed topic can be found in greater detail elsewhere in the PPM, a cross-reference to the specific section should be included.

THE OFFERING

The following statements related to the Class A Units offered hereby are summaries, do not purport to be complete, and are subject to and qualified in their entirety by reference to all of the provisions contained elsewhere in this Memorandum or to the other documents referenced in this Memorandum.[8]

Issuer: XYZ Medical, LLC is a New York limited liability company, which is treated as a partnership for tax purposes.

Amount of Financing and Related Matters: Targeting up to 8,000,000 of Class A Units which will be approximately thirty-five percent (35.00%) of the equity in the Company. The Company anticipates that multiple closings will occur beginning on or after the date of this Memorandum and ceasing upon raising $8,000,000 or at the discretion of the Company, whichever is earlier. The Company may, in its sole discretion, determine when to cause such multiple closings for the Class A Units to occur (each of such dates, as applicable, a "*Closing Date*").

Type of Security: Class A Units.

Managers: Our Company will be managed by a Board of Managers elected by our current members ("*Managers*"), and discussed in "*Our Management*" section of the Memorandum. The Managers may be changed from time to time according to the provisions of our Operating Agreement.

Capitalization: See "*Capitalization and Indebtedness*," below.

8 The summary of terms provides highlights of the key components of the offering, the equity structure, and key investment terms. Each of these items would be dealt with in detail in the body of a typical PPM. For purposes of this excerpt, we have necessarily shortened the summary of terms to include only a few key provisions. Notably, we have not included information summarizing the fictitious investment company's management, business and technology.

Investors; Minimum Investment:

Investors must be "accredited investors" as that term is defined in Rule 501 of Regulation D of the Securities Act.

The minimum investment shall be equal to $100,000 provided that the Company may, in its sole discretion, accept commitments of lesser amounts for Class A Units.

Operating Agreement:

As a condition of purchasing Class A Units, the Company and each of its members (including Investors of the Class A Units) will sign a counterpart to the Company's Operating Agreement (our "*Operating Agreement*") that, among other things, will (i) set forth the profit and loss allocations and distributions to all members, (ii) prohibit transfers of Class A Units or withdrawals by holders of Class A Units and (iii) describe the economic rights of each class of members, unless certain requirements are met. See "***EXHIBIT A*** – Operating Agreement."[9]

Subscriptions:

Class A Units can be subscribed for by completing a Subscription Agreement and executing a counterpart signature page to our Operating Agreement. Once a Subscription Agreement is submitted to and accepted by us, such Investor will be bound by the terms of such Subscription Agreement and our Operating Agreement effective as of the next applicable closing date. Our Manager and any of their respective affiliates may purchase Class A Units in this Offering.

Fiscal Year:

Our fiscal year will end on December 31st of each year.

9 It is vital that the PPM properly reflect the underlying governing documents (in this case, the operating agreement). In performing offering document reviews from prior drafters, we often discover significant discrepancies between the summarized terms of the PPM and the actual terms of the governing documents. One reason for this is that many view the PPM as the primary offering document, to which an operating agreement may be quickly conformed.

It is important to understand the distinction between the functions of the PPM versus that of the governing documents and subscription agreement. The PPM is not a binding contractual document, but a disclosure of the terms and risks of investment in the company and a summary of the binding terms in the governing documents and subscription agreement.

Additional Capital Commitments or Contributions:

No Investor shall be required to make, or shall be subject to assessment for, any additional capital contributions to our Company. *See "Anti-Dilution Rights" below.*

Allocations and Distributions of Profits and Losses:

Allocations and Distributions from Operations. In general, Investors will be entitled to receive allocations and distributions of profits and losses in our Company as follows, and in the following order:

(i) First, to Class A Unit holders in proportion to their membership interest in the company;

(ii) Then, to common unit holders in proportion to their membership interest in the Company.

Distributions will be made based on the amount of "net available cash flow" as such amount is determined by our Managers from time to time. Allocations and distributions are more particularly described in our Operating Agreement attached as ***EXHIBIT A***.

Minimum Tax Distributions. Notwithstanding the foregoing, our Operating Agreement provides for tax distributions to our members on not less than an annual basis; *provided, however,* there is no guarantee that our Company will have sufficient net available cash flow to make such distributions. Any such tax distribution shall be considered an advance against the next distribution(s) payable to the applicable holder of membership interest units and shall reduce such distribution(s) on a dollar-for-dollar basis.

Liquidation:

Liquidation. In the event we are sold, merged, acquired, liquidated, dissolved or wound up, the holders of Class A Units will be entitled to a distribution of assets remaining after the payment of all expenses and costs to our creditors, to all holders

of Class A Units, in accordance with the holders of Units' positive capital account balances. In this regard, the capital account balances of all holders of Class A Units shall be determined after taking into consideration the allocation of all profits and losses, including profits and losses accrued or incurred during winding up, in accordance with the requirements of our articles of organization, Operating Agreement and the New York Limited Liability Company Law. This distribution of Company assets will be made prior to any liquidating distribution to the holders of Common Units.

Transfer Restrictions; No Withdrawal Rights: Transfer of our Class A Units is restricted by the terms of our Operating Agreement, and generally may not be effected except for: (i) lifetime or testamentary transfers by a member of all or any portion of his or her Class A Units to or for the benefit of his or her family or descendants (or a trust or other entity for the benefit of same); and (ii) transfers following compliance with the right of first refusal procedures set forth in our Operating Agreement in favor of the Company and the other members. Members are not permitted to withdraw from our Company without the approval of our Managers, which may be granted or denied in the sole discretion of our Managers.

The Class A Units are "restricted securities" and, therefore, may be transferred only pursuant to registration or qualification under federal and state securities laws or under an exemption from such registration or qualification requirements.

No Participation in Management or Voting Rights: Our Company is managed by our Managers; thus, holders of Class A Units will have no right to participate in the management of the Company. Our

Class A Units are voting membership interest units. Investors will receive voting rights equal to their equity interest in the Company. However, because the Class A Units being offered comprise only 35% of the total equity of the Company, Investors will not be able to change, control, or participate in the management of the Company or affairs of the business.

No Registration Rights: We will not grant any registration rights to any purchasers of the Class A Units in this Offering.

No Anti-Dilution Rights: Holders of our Class A Units will not be entitled to any preference to purchase additional Class A or other membership interest units in the Company in the event of additional equity securities offerings.

Use of Proceeds: After deducting offering expenses, we intend to use the proceeds of this Offering to acquire additional technologies, pay salaries of officers, executives, and employees and conduct clinical trials, expand research and development capabilities and for general working capital purposes. See "*Use of Proceeds*" below.

[End of section excert; this section has been significantly shortened for use in this sample.]

RISK FACTORS[10]

The purchase of the Class A Units entails certain risks that Investors should consider before making a decision to purchase the Class A Units. There can be no assurance that any rate of return or other investment objectives will be realized or that there will be any return of capital. Prospective Investors should consider the following factors among others in making their investment decision. [11]

Risks Related to Our Business

Our Company has limited operating history and was recently formed.

The Company is newly formed, and therefore, has limited operating history. There is no assurance that the Company will operate profitability or that your investment in whole or in part will be returned. The Company is subject to all the risks inherent in the establishment of a new business venture. The likelihood of success of the Company must be considered in light of the problems, expenses, difficulties, complications, uncertainties and delays frequently encountered with the formation of any new business. XYZ Medical, LLC, was established in 2015 and has been focused on raising capital and developing its medical device products to market. Because the company is new, with limited operating history, there is no assurance that XYZ Medical, LLC, will realize earnings from operations or net profits in the future.

Our products have yet to be commercialized.

Because of the novelty of the Company's medical device technology, there is no way to predict all of the risks associated with this unique venture. The Company may not generate sufficient sales proceeds to pay all of its research, development, marketing, manufacturing and operating expenses, taxes, and debt service requirements. There is no assurance that we will generate any cash flow.

Our products may not achieve broad market acceptance or be commercially successful.

We expect that sales of our devices will account for the vast majority of our revenues for at least

10 The risk factor section is one of the most valuable components of a private placement memorandum for liability mitigation. Risk factors should be one of the first sections in a private placement memorandum. This section is usually quite voluminous, often spanning dozens of pages, and covering many subcategories, with disclosures ranging from broad and generic risks to highly. In this illustrative excerpt, we have provided two of the many risk factor categories (which have been shortened considerably for this excerpt).

11 The risk factor section is one of the most valuable components of a private placement memorandum for liability mitigation. Risk factors should be one of the first sections in a private placement memorandum. This section is usually quite voluminous, often spanning dozens of pages, and covering many subcategories, with disclosures ranging from broad and generic risks to highly. In this illustrative excerpt, we have provided two of the many risk factor categories (which have been shortened considerably for this excerpt).

the next several years. The products we intend to develop may not gain broad market acceptance unless we are able to convince physicians, hospitals and patients of their benefits. Moreover, even if physicians and hospitals understand the benefits of any of our products, they still may elect not to use our products for a variety of reasons.

We have limited internal manufacturing resources, and if we are unable to provide an adequate supply of our products, our growth could be limited and our business could be harmed.

Final assembly of many of our product components is expected to occur at our manufacturing facility. If our facility experiences a disruption or if we are unable to make our lease payments, we would have no other means of assembling those components until we are able to restore the manufacturing capability at our current facility or develop the same capability at an alternative facility.

In connection with the commercialization of our products, we expect that we will need to increase, or "scale up," the production process of our components over the anticipated initial level of production. While we have taken steps in anticipation of growth, manufacturers often encounter difficulties in scaling up production, such as problems involving yields, quality control and assurance, and shortages of qualified personnel. If the scaled-up production process is not efficient or produces a product that does not meet quality and other standards, we may be unable to meet market demand and our revenues, business and financial prospects would be adversely affected.

Our reliance on single-source suppliers could harm our ability to meet demand for our products in a timely manner or within budget.[12]

Many of the components and component assemblies of our products are anticipated to be provided to us by single-source suppliers. We expect to purchase components and component assemblies through purchase orders, rather than long-term supply agreements and generally will not maintain large volumes of inventory. While we believe alternative suppliers exist and will be identified, the disruption or termination of the supply of components and component assemblies could cause a significant increase in the cost of these components, which could affect our operating results.

12 When disclosing business risks, issuers are often tempted to add mitigating language explaining why their business has a high probability of avoiding a disclosed risk. Such risk factor clauses are simple to identify: They often begin with "while," "though" or "however." SEC releases have given specific guidance to avoid mitigating language in risk factors. Risk factors should be limited to identification and brief description of material risks.

That is not to say disclosure of mitigating strategies should not be discussed in the PPM, but the language should not appear in the risk factors. The appropriate place to elaborate on risk mitigation strategies is the business and management sections.

Our anticipated dependence on a limited number of third-party suppliers and the challenges we may face in obtaining adequate supplies involve several risks, including limited control over pricing, availability, quality and delivery schedules. A disruption or termination in the supply of components could also result in our inability to meet demand for our products, which could harm our ability to generate revenues, lead to customer dissatisfaction and damage our reputation. Furthermore, if we are required to change the supplier of a key component or component assembly of our products, we may be required to verify that the new supplier maintains facilities and procedures that comply with quality standards and with all applicable regulations and guidelines. The delays associated with the verification of a new supplier could delay our ability to manufacture our products in a timely manner or within budget.

Our future success depends on our ability to obtain regulatory clearances or approvals for our products. We cannot be certain that we will be able to do so in a timely fashion, or at all.[13]

We do not have the necessary regulatory clearances or approvals to market our devices in the United States or in any foreign market. In the United States, without clearances or approvals from the Food and Drug Administration ("FDA"), we cannot market a new medical device, or a new use of, or claim for, or significant modification to, an existing product, unless an exemption applies. To obtain FDA clearance or approval, we must first receive premarket clearance under Section 510(k) of the federal Food, Drug, and Cosmetic Act.

In the 510(k) clearance process, the FDA must determine that a proposed device is "substantially equivalent" to a device legally on the market, known as a "predicate" device, with respect to intended use, technology, safety and effectiveness, in order to clear the proposed device for marketing. Clinical data is sometimes required to support substantial equivalence. The 510(k) clearance process generally takes three to twelve months from submission, but can take significantly longer.

The process of obtaining PMA approval is much more costly and uncertain than the 510(k) clearance process. The PMA approval process can be lengthy and expensive and requires an applicant to demonstrate the safety and effectiveness of the devices based, in part, on data obtained in clinical trials. The PMA process generally takes one to three years, or even longer, from the time the PMA application is submitted to the FDA until an approval is obtained.

If the third-parties on which we may need to rely to conduct any clinical trials and to assist us with pre-clinical development do not perform as contractually required or expected, we may not be able to obtain regulatory clearance or approval for our products or any additional claims that we may seek for our products.

13 Proper risk factor disclosure is at the heart of a well-drafted PPM. Risk factors should be specific, relevant to the investment strategy and management background, and thorough. Inadequate attention to risk factors (or relying on boilerplate risk factors) can be problematic.

We do not have the independent ability to conduct pre-clinical and clinical trials. To the extent that we will need to conduct such trials, we will need to rely on third parties, such as contract research organizations, medical institutions, clinical investigators and contract laboratories, to conduct such trials. If these third-parties do not successfully carry out their contractual duties or regulatory obligations or meet expected deadlines, if these third-parties need to be replaced, or if the quality or accuracy of the data they obtain is compromised due to the failure to adhere to our clinical protocols or regulatory requirements or for other reasons, our pre-clinical development activities or clinical trials may be extended, delayed, suspended or terminated, and we may not be able to obtain regulatory clearance or approval for a product candidate or additional claims we may seek for our products on a timely basis, if at all. As such, our business, operating results and prospects may be adversely affected. Furthermore, our third-party clinical trial investigators may be delayed in conducting our clinical trials for reasons outside of their control.

The results of our clinical trials may not support our product candidate claims or any additional claims we may seek for our products and may result in the discovery of adverse side effects.[14]

Even if any clinical trial that we need to undertake is completed as planned, we cannot be certain that its results will support our product candidate claims or any new indications that we may seek for our products or that the FDA or foreign authorities will agree with our conclusions regarding the results of those trials. The clinical trial process may fail to demonstrate that our products or a product candidate is safe and effective for the proposed indicated use, which could cause us to stop seeking additional clearances or approvals for our products, abandon the devices, or delay development of other product candidates. Any delay or termination of our clinical trials will delay the filing of our regulatory submissions and, ultimately, our ability to commercialize a product candidate. It is also possible that patients enrolled in clinical trials will experience adverse side effects that are not currently part of the product candidate's profile.

We could become subject to product liability claims that could be expensive, divert management's attention and harm our business.

Our business exposes us to potential product liability risks that are inherent in the development, manufacturing, marketing and sale of medical devices. We may be held liable if our products cause injury or death or are found otherwise unsuitable or defective during usage. Our products incorporate mechanical and electrical parts, complex computer software and other sophisticated components, any of which can have defective or inferior parts or contain defects, errors or failures. Complex computer software is particularly vulnerable to errors and failures, especially when first introduced.

14 Proper risk factor disclosure is at the heart of a well-drafted PPM. Risk factors should be specific, relevant to the investment strategy and management background, and thorough. Inadequate attention to risk factors (or relying on boilerplate risk factors) can be problematic.

The medical device industry has historically been subject to extensive litigation over product liability claims. A product liability claim, regardless of its merit or eventual outcome, could result in significant legal defense costs. Although we intend to maintain product liability insurance, the coverage is subject to deductibles and limitations, and may not be adequate to cover future claims. Additionally, we may be unable to maintain our existing product liability insurance in the future at satisfactory rates or in adequate amounts. A product liability claim, regardless of its merit or eventual outcome could result in: decreased demand for our products; injury to our reputation;

We may not be able to operate if there are certain changed events.

Unexpected negative events concerning either the intellectual property, product to be developed, or the economy in general could alter investment conditions to the extent that dilution of existing investors is required in order to raise necessary capital. While the officers have the right to loan additional capital to the Company, the officers may not be in a position to do so. In such event, there can be no assurance that the current management team would remain in place or that the Company's business plan would not materially change as a result of a shift in control.

Any adverse change in general economic conditions, significant price increases, or adverse occurrences affecting our industry, could have a material adverse effect on us and the results of our operations.

Our Managers may allocate their time to other businesses thereby causing conflicts of interest in its determination as to how much time to devote to the Company's affairs.

The Managers may be engaged in other business endeavors and are not obligated to contribute any specific number of hours per week to the Company's affairs. If the other business affairs of our Managers require them to devote more substantial amounts of time to such affairs, it could limit their ability to devote time to the affairs of the Company, which could have a negative impact on our ability to operate efficiently.

Risks Related to our Intellectual Property

If we, or the third-parties from whom we license intellectual property, are unable to secure and maintain patent or other intellectual property protection for the intellectual property covering our marketed products or our product candidates, our ability to compete will be harmed.

Our commercial success depends, in part, on obtaining and maintaining patent and other intellectual property protection for the technologies contained in our marketed products and product candidates. The patent positions of medical device companies, including ours, can be highly uncertain and involve complex and evolving legal and factual questions. Our patent position

is uncertain and complex, in part, because of our dependence on intellectual property that we license from others. If we, or the third-parties from whom we license intellectual property, fail to obtain adequate patent or other intellectual property protection for intellectual property covering our marketed products or product candidates, or if any protection is reduced or eliminated, others could use the intellectual property covering our marketed products or product candidates, resulting in harm to our competitive business position. In addition, patent and other intellectual property protection may not provide us with a competitive advantage against competitors that devise ways of making competitive products without infringing any patents that we own or have rights to.

United States patents and patent applications may be subject to interference proceedings and United States patents may be subject to reissue and reexamination proceedings in the United States Patent and Trademark Office. Any of these proceedings could result in either loss of the patent or denial of the patent application, or loss or reduction in the scope of one or more of the claims of the patent or patent application. Changes in either patent laws or in interpretations of patent laws may also diminish the value of our intellectual property or narrow the scope of our protection. Interference, reexamination and opposition proceedings may be costly and time consuming, and we, or the third-parties from whom we license intellectual property, may be unsuccessful in such proceedings. Thus, any patents that we license may provide limited or no protection against competitors. In addition, our pending patent applications and those we may file in the future may not result in patents being issued or may have claims that do not cover our products or product candidates. Even if any of our pending or future patent applications are issued, they may not provide us with adequate protection or any competitive advantages. Our ability to develop additional patentable technology is also uncertain.

Non-payment or delay in payment of patent fees or annuities, whether intentional or unintentional, may also result in the loss of patents or patent rights important to our business. In addition, many countries limit the enforceability of patents against third-parties, including government agencies or government contractors. In these countries, the patent owner may have limited remedies, which could materially diminish the value of the patent. In addition, the laws of some foreign countries do not protect intellectual property rights to the same extent as do the laws of the United States, particularly in the field of medical devices and procedures.

We may face claims that we are violating the intellectual property rights of others.

Although we are not aware of any potential violations of others' intellectual property rights, we may face claims, including from direct competitors, other companies, scientists or research universities, asserting that our technology or the commercial use of such technology infringes or otherwise violates the intellectual property rights of others.

We cannot be certain that our technologies and processes do not violate the intellectual property rights of others. If we are successful in developing technologies that allow us to earn revenues and our market profile grows we could become increasingly subject to such claims.

We may also face infringement claims from the employees, consultants, agents and outside organizations we have engaged to develop our technology. While we have sought to protect ourselves against such claims through contractual means, we cannot provide any assurance that such contractual provisions are adequate, and any of these parties might claim full or partial ownership of the intellectual property in the technology that they were engaged to develop.

If we were found to be infringing or otherwise violating the intellectual property rights of others, we could face significant costs to implement work-around methods, and we cannot provide any assurance that any such work-around would be available or technically equivalent to our potential technology. In such cases, we might need to license a third-party's intellectual property, although any required license might not be available on acceptable terms, or at all. If we are unable to work around such infringement or obtain a license on acceptable terms, we might face substantial monetary judgments against us or an injunction against continuing to use or license such technology, which might cause us to cease operations.

In addition, even if we are not infringing or otherwise violating the intellectual property rights of others, we could nonetheless incur substantial costs in defending ourselves in suits brought against us for alleged infringement. Also, if we are to enter into a license agreement in the future and it provides that we will defend and indemnify our customer licensees for claims against them relating to any alleged infringement of the intellectual property rights of third-parties in connection with such customer licensees' use of such technologies, we may incur substantial costs defending and indemnifying any customer licensees to the extent they are subject to these types of claims. Such suits, even if without merit, would likely require our management team to dedicate substantial time to addressing the issues presented. Any party bringing claims might have greater resources than we do, which could potentially lead to us settling claims against which we might otherwise prevail on the merits.

Any claims brought against us or any customer licensees alleging that we have violated the intellectual property of others could have negative consequences for our financial condition, results of operations and business, each of which could be materially adversely affected as a result.

Protecting and enforcing our intellectual property rights could consume monetary funds needed for other company objectives.

Protecting and enforcing our intellectual property rights and combating unlicensed copying and use of our intellectual property can be difficult and expensive. Litigation filed by or against the Company and excessive legal costs could result in insufficient cash available to continue our business objective. Similarly, reductions in the legal protection for our intellectual property rights could adversely affect revenue.

[End of illustrative excerpt; this section has been significantly shortened for use in this sample.]

GLOSSARY OF TERMS

Accredited Investor

An accredited investor is an investor that meets certain income or net worth requirements set by the Securities and Exchange Commission under Rule 501 of Regulation D. For individuals, the income requirement is $200,000 annual income or $300,000 when combined with a spouse. The net worth requirement is $1,000,000 exclusive of the positive equity in the investors' primary residence.

Anti-Fraud Provisions

Anti-Fraud Provisions refer to Section 17(a) of the Securities Act of 1933 and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 that require issuers to make certain required disclosures to investors when offering and selling securities. Additionally, each state has its own securities fraud provisions.

The anti-fraud provisions prohibit the making of a misstatement or omission of a material fact in connection with an offering of securities. The company and its officers and directors can be held liable for violations. One of the key purposes of a private placement memorandum is to make full and adequate disclosure of the terms of a private offering to avoid violating the anti-fraud provisions, including carefully drafted risk factors.

Blue Sky Laws

Blue sky laws are state laws governing the issuance and registration of securities within that state. Blue sky laws contain registration requirements and anti-fraud provisions. Investment funds and most other private placement issuers rely on exemptions from the registration requirements of state law, most often Regulation D Rule 506. Even with the registration exemption, Regulation D issuers must still file a Form D notice filing and pay a state statutory fee in each state where investors have subscribed. This notice filing is often referred to as a "blue sky" filing.

In most states, issuers have fifteen days from the date of first subscription by an investor in a given state to make a blue sky filing. In New York, a company must pre-submit its blue sky filings before offering the securities in the state. New York's Form D filing process is more onerous than other states, requiring a full submission of the Private Placement Memorandum and other offering documents.

Broker-Dealer

A Broker-dealer is an individual or firm that purchases or sells securities for itself or on behalf of others, often acting as a placement agent. Broker-dealers must be registered with FINRA and are subject to extensive regulation. Only registered broker-dealers are permitted to accept commissions or other transaction-based compensation for making capital introductions. So-called "finders" or unregistered placement agents that make capital introductions are not permitted to accept any form of transaction-based compensation for capital raising efforts.

Hedge funds and other investment funds and private issuers often rely on broker-dealers as placement agents to find capital. Due to increasing FINRA regulations, broker-dealers have heavy due diligence standards when offering private placements, which require them to scrutinize the risks of the offering.

Accordingly, most broker-dealers are unwilling to sell private placements and it is very difficult for a start-up fund manager or a new company to find broker-dealers that are comfortable placing their securities. When a broker-dealer does agree to act as a placement agent for an issuer, the private placement memorandum must be submitted in advance to FINRA.

Capital Accounts (as used in LPs and LLCs)

Capital account is an account on the company's books that shows the owner's net investment in the company. It is calculated by taking the capital contribution of the owner, adding the owner's share of company profits, and then subtracting the owner's share of company losses in addition to the distributions or returns of capital. Capital accounts are used in limited partnerships, LLCs and other flow-through, partnership-based entities.

Dodd-Frank Act

The Dodd-Frank Act is the Dodd-Frank Wall Street Reform and Consumer Protection Act, a federal law enacted in July 2010. The Dodd-Frank Act brought sweeping changes to financial regulation affecting almost every component of the financial services industry.

Regulations resulting from Dodd-Frank also made changes to the definition of investor suitability standards of an "accredited investor."

Drag-Along Rights

Drag-Along Rights are rights that enable a majority equity holder to force a minority equity holder to accept a sale of its equity interests to a third-party purchaser for the price negotiated by the majority equity holder.

Equity Offering

An equity offering is an offering of securities that gives investors an ownership interest in the company. Examples of equity offerings include stock (common or preferred), limited partnership interests, or membership interests/ units in a limited liability company.

Finder

A finder is an individual who is not registered with FINRA as a broker-dealer, but who locates potential investors on behalf of an issuer and then facilitates the introduction between the investor and the company. A finder may not receive transaction-based compensation. Only registered broker-dealers may receive transaction-based compensation.

(FINRA) Financial Industry Regulatory Authority

Financial Industry Regulatory Authority (FINRA) is a regulatory agency that assists the SEC in regulating financial markets. Specifically, FINRA handles all the registrations of broker-dealers eligible to solicit investments to investors.

Additionally, all state and federal investment advisor registrations are processed through FINRA's Investment Advisor Registration Depository (IARD) system. FINRA administers the various licensing examinations for the securities financial markets.

Form D

Form D is an SEC form used to file a notice of an exempt offering of securities under Regulation D. Privately held companies that raise capital are required to file a Form D with the SEC.

Forward-Looking Statements

Forward-looking statements are statements made in a private placement memorandum (or public securities disclosure) that are predictive of events to occur, but which have not actually occurred. They are predicated on certain assumptions. Should the statements fail to come to fruition, actual results, performances or goals could be materially different than those proposed. The use of forward-looking statements requires extreme care, and must be accompanied by appropriate explanatory language.

Intermediary

An intermediary is a person or organization that acts a middleman between investors and companies raising funds. Intermediaries can include broker-dealers, regulated by FINRA, as well as unregistered finders. Care must be taken when entering into any transaction with a finder, since transaction-based compensation for capital introduction may only be paid to a registered broker-dealer.

Intrastate Exemption–Rule 147

The intrastate exemption is available if an issuer will only be offering securities in a single state. The exemption requires that the issuer be organized in the state it intends to offer its securities. It is a narrow exemption and can easily be lost if not followed exactly. There is no limit on the amount of securities that may be sold. The Intrastate exemption is quite restrictive and generally has limited usefulness to issuers, particularly when compared to Rule 506 offerings, which can typically provide the same exemptions, but with less chance for the issuer to lose its exemption. Because of the risk of losing the exemption, we generally recommend that the intrastate exemption be relied upon only as a backup to another exemption.

Investor Suitability Questionnaire

An investor suitability questionnaire is a document filled out by an investor seeking to purchase securities in a private offering. The questionnaire will ask for the investor's contact information and ask the investor to attest that it meets the appropriate investor qualification standards required by the SEC.

(JOBS Act) Jumpstart Our Business Startups Act

The JOBS Act is the Jumpstart Our Business Startups Act, a federal law that was enacted on April 5, 2012. This act loosened the restrictions on capital raising for small businesses, including requiring the SEC to lift the ban on advertising and solicitation on certain Regulation D and Rule 144A offerings.

Material Omissions

Material omissions are misstatements, willful or unintentional, or omissions of material facts in association with an offering of securities.

National Securities Markets Improvement Act of 1996

The National Securities Markets Improvement Act of 1996 (NSMIA) was passed by Congress to amend and simplify former security acts to create one standard code for all companies and regulators. Because of NSMIA, offerings made in reliance of Rule 506 (either 506(b) or 506(c)) preempts state securities registration regulation.

Operating Agreement

An operating agreement is the legal governing document for an LLC (similar to bylaws for a corporation or a limited partnership agreement for a limited partnership). This document specifies how ownership of the company is divided among the principals, voting issues, tax treatment, capital distribution and other important internal governance.

Placement Agent

A placement agent assists the alternative investment community or private companies seeking to raise capital through private placement. Placement agents should be registered broker-dealers to accept transaction-based compensation.

Private Placement Memorandum

A private placement memorandum ("PPM"), also known as a private offering document and confidential offering memorandum, is a securities disclosure document used in a private offering of securities. From an investor's point of view, the purpose of a PPM is to obtain needed information about the security and the company, both good and bad, to allow investors to make an informed decision about whether to purchase the security. From the company's perspective, the purpose of a PPM is to provide the necessary disclosures about the company and its securities to protect the company against claims of misstatements or omissions.

Regulation D

Regulation D is the safe harbor SEC regulation promulgated under the Securities Act, which governs private placement securities exemptions, allowing issuers the ability to sell securities without registering with the SEC. Investment funds that have US investors almost always rely on Regulation D, specifically, Regulation D Rule 506(b) or Rule 506(c).

Regulation D Rule 504

Regulation D Rule 504 is governed by Section 3(b) of the Securities Act. This rule is a safe harbor provision for private offerings that will not exceed one million dollars, from an unlimited number of investors. A company that follows the requirements of Rule 504 is exempt from registering its securities with the SEC, but is still subject to state registration in each state in which the company offers securities, unless the company finds a state registration exemption. Thus, even in offerings of less than one million dollars, we recommend that when possible, issuers rely on Rule 506 rather than Rule 504, to avoid being subject to state registration requirements.

Rule 504 is most commonly used when the company needs to raise capital from more than thirty-five unaccredited investors and the company is not eligible for a 506 exemption. In certain cases, Rule 504 may be used with general advertising without federal registration. However, such offerings would require registration or an appropriate exemption in every state in which it is offered.

Regulation D Rule 505

Regulation D Rule 505, like Rule 504, is governed by Section 3(b) of the Securities Act. It is a safe harbor provision for offerings made to accredited investors and up to thirty-five unaccredited investors that will not exceed five million dollars. Because of the benefits that are offered under Rule 506, this exemption is almost never relied upon, except as a backup exemption. Rule 505 permits the issuer to offer securities to no more than thirty-five unaccredited investors. This rule prohibits general solicitation or advertising to potential investors. Rule 505 requires that strictly prescribed information be given to the unaccredited investors, including audited financial statements.

Rule 10b-5

Rule 10b-5 is an SEC regulation under the Securities and Exchange Act of 1934, which prohibits the use of false statements, omission of information and other deceptive practices in transactions involving stocks and securities. The company and its officers and directors can be held liable for violations.

SCOR Offering

A Small Corporate Offering Registration (SCOR) offering is essentially a more complex version of a Rule 504 Offering. The SCOR offering uses a standardized disclosure format that 43 of the 50 states currently accept and relaxes some of the solicitation and advertising prohibitions that are prevalent in a Rule 504 Offering. The standardized disclosure format permits an issuer to comply with many of the state securities laws using one document and registering once, as opposed to preparing offering documents for each state and then filing such documents with each individual state. The standardized disclosure document is a question and answer document which is different than a typical PPM disclosure document.

Under a SCOR Offering, an issuer is limited to raising a maximum of one million dollars in a 12 month period. It must also provide two years of audited financial statements if the offering amount exceeds $500,000. Because of the burden of state registration, we would only recommend the SCOR offering in very limited circumstances and when other exemptions are unavailable.

Securities

Securities are financial or investment instruments that represent ownership positions in a company, a creditor relationship with the company, or some derivative of either ownership or evidenced debt. Securities include a broad array of financial instruments, contracts and compensation schemes.

The legal test for establishing the existence of a "security" is found in the landmark case: SEC v. Howey (known as the Howey Test). Under the Howey Test, a financial relationship

represents a security if there is:

i. an investment in a common enterprise;

ii. with the expectation of profits;

iii. expected to arise solely, or substantially, from the efforts of the promoter or third party.

There are certain categories of investments that are not considered securities, including commodities and futures (governed by the Commodity Futures Trading Commission (CFTC)) and certain real estate transactions. You should speak with an experienced attorney before concluding that any form of investment relationship does not involve a security.

Securities Act of 1933

The Securities Act of 1933, often referred to as the "Securities Act," is a federal statute that governs securities at issuance including the transparency of financial statements to ensure that investors can make informed decisions about investments.

This act establishes laws against misrepresentation and fraudulent activities in the securities market. Section 5 of the Securities Act requires that all non-exempt securities issuances be registered with the SEC. The most common exemption for an issuer of securities is Regulation D, which includes Rule 504, 505, and 506 (including the new Rule 506(c)).

Securities Exchange Act of 1934

The Securities Exchange Act of 1934, often referred to as the "Exchange Act" governs securities transactions after issuance (i.e. on secondary markets) and regulates the exchanges and broker-dealers in order to protect the public. The Exchange Act imposes ongoing reporting requirements on certain companies that have registered with the SEC under the Securities Act (reporting companies).

Private issuers, including private investment funds, seek to avoid the burdensome ongoing requirements of the Exchange Act by qualifying for exemption from registration under the Securities Act (most often under Regulation D, specifically Rule 506), making such private issuers also exempt from the ongoing reporting requirements of the Exchange Act.

Side Letters

Most offering documents allow the management team to negotiate special terms (known as side letters) that are not applicable to other investors. Often the special arrangement involves better economic terms. Care must be taken, however, not to allow side letters to prejudice other investors. For example, side letters that provide additional information rights or preferential liquidity treatment can present significant liability.

Subscription Agreement

A subscription agreement is an application by an investor to engage in a debt or equity securities transaction, whereby the issuing company

agrees to sell securities at a specified price to the investor. The investor in turn agrees to pay that price for the securities. A subscription agreement for an equity transaction should be accompanied by a signature page to the company's governing documents (operating agreement, limited partnership agreement, shareholders agreement, etc.). In a debt offering, the subscription agreement should be accompanied by a promissory note. An investor questionnaire, which establishes an investor's suitability and qualification to invest in the transaction, is typically included or integrated with the subscription agreement.

Tag-Along Rights

Tag-along rights are rights that enable a minority interest holder to sell its shares to a third-party purchaser for the price negotiated by the majority interest holder and forces the third-party purchaser to purchase a proportionate share of the minority interest holder's equity interest in the company as the majority.

Tax Matters Partner

A tax matters partner is a person in a partnership designated to receive tax notifications from the Internal Revenue Service and is given the authority to enter into tax agreements on the behalf of the partnership.

Transaction-Based Compensation

Any compensation of an individual or firm in the form of commission or sale of securities for capital introduction is transaction-based compensation. Transaction-based compensation may only be paid to FINRA registered broker-dealers.

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CONTACT INFORMATION

We would be happy to discuss your private placement or answer any questions that you might have about your offering. John Lore's complete contact information is as follows:

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