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#### About Allen Matkins

Allen Matkins Leck Gamble Mallory & Natsis LLP is a California law firm with more than 230 attorneys practicing out of seven offices in Los Angeles, Century City, Orange County, Del Mar Heights, San Diego, San Francisco and Walnut Creek. The firm's broad based areas of focus include corporate, real estate, construction, real estate finance, business litigation, employment and labor law, taxation, land use, bankruptcy and creditors' rights, intellectual property and environmental. [more...](#)

## Regulation of Member Private Offerings

The Financial Industry Regulatory Authority ("FINRA") adopted new [Rule 5122](#) to require FINRA member firms, and associated persons that engage in certain private placements of its own securities or the securities of a control entity, to comply with certain disclosure and filing requirements and limitations on the use of proceeds. The private

placements subject to the new rule are known as Member Private Offerings or MPOs. FINRA adopted Rule 5122 to address concerns with regard to conflicts of interest in MPOs. Traditionally, MPOs have been excluded from the scope of existing FINRA rules that generally applied to public offerings.

### New Requirements

A member firm or associated person that engages in an MPO must:

- disclose to investors in a private placement memorandum, term sheet or other offering document the intended use of offering proceeds and the offering expenses;
- file the offering document with FINRA's Corporate Financing Department at or prior to the time it is first provided to any investor; and
- commit that at least 85% of the offering proceeds will be used for business purposes, which shall not include offering costs, discounts, commission and any other cash or non-cash sales incentives.

### Important Defined Terms

An MPO is a non-public offering of securities conducted by the member firm or a control entity in reliance on an available exemption from registration under the Securities Act of 1933. The new rule applies only if the member firm sells its own securities or those issued by a control entity in a private placement. They do not apply if the securities are instead sold by another member firm.

A "control entity" is any entity that controls or is under common control with a member firm, or that is controlled by a firm or its associated persons. "Control" means a beneficial interest of more than 50% of the outstanding voting securities of a corporation, or the right to more than 50% of the distributable profits or losses of a partnership or other non-corporate legal entity. The power to direct the management or policies of a corporation or partnership alone, absent meeting the majority ownership or right to the majority of profits, would not constitute "control" as defined in Rule 5122.

Private offerings of securities by a FINRA member firm or a control entity must comply with new disclosure and filing requirements and limitations on the use of proceeds.

and loss percentages for purpose of the rule unless they are subsequently re-invested in the partnership and increase the general partner's ownership interest above the threshold amount.

For purposes of Rule 5122, entities may calculate the percentage of control using a "flow through" concept by looking through ownership levels to calculate the total percentage of control. For example, if member firm A owns 50% of corporation B that in turn holds a 60% interest in corporation C, and A is engaged in a private offering of C's securities. A would have a 30% interest in C (50% of 60%), and thus C would not be considered a control entity under this definition.

The determination of control is to be made immediately *after* the closing of an offering. However, if an offering involves multiple closings, the test is done at the conclusion of each closing.

### Disclosure and Filing Requirements

The rule mandates that each prospective investor, whether or not accredited, be provided with disclosure of the intended use of proceeds and the offering expenses and selling compensation. The rule does not require any particular form of disclosure and the disclosure and filing requirements of the rule may be satisfied with an offering document that does not meet the requirements of Regulation D under the Securities Act of 1933.

The disclosure document must be filed with FINRA's Corporate Financing Department at or prior to the first time the disclosure document is provided to any prospective investor. Any amendments to the filed disclosure document must be filed within 10 days after it has been provided to any investor or prospective investor. Information filed with FINRA will be subject to confidential treatment. Filings with FINRA under Rule 5122 will not eliminate or replace required filings, if any, under federal or state securities laws.

### Use of Proceeds Restrictions

Each time an MPO is closed, at least 85% of the offering proceeds raised must be used for business purposes, excluding offering costs, discounts, commissions or any other cash or non-cash sales incentives. The purpose of this limitation is to address abuses where firms or control entities used substantial amounts of offering proceeds for selling compensation and related party benefits, rather than business purposes. The rule does not limit the total amount of underwriting compensation, although no more than 15% of the money raised from investors in the private placement may be used to pay underwriting expenses.

### Exemptions

There are a number of exemptions based on the type of offerings and type of investors. For example (but not all-inclusive), MPOs sold solely to institutional accounts, qualified purchasers, investment companies and banks are exempt. Offerings to employees, or pursuant to Rule 144A or in a wholesaling capacity are also exempt.

Effective Date

Document hosted at JDSUPRA™

<http://www.jdsupra.com/post/documentViewer.aspx?fid=0028142d-280a-4221-9e41-7f95b41857f4>

The rule is effective as of June 17, 2009, but will not apply retroactively to any offerings that have already commenced selling efforts as of that date.

If you are interested in learning more, please contact us.

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