

Venture Capital and Emerging Companies Alert: Dodd-Frank Act Affects Private Placements by Raising the Bar for Individual Accredited Investors

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With the enactment of the Dodd-Frank Act on July 21, 2010, the “net worth” standard for an “accredited investor” under Regulation D has been adjusted, effective immediately, to specifically *exclude* the value of a primary residence from an investor’s net worth determination under Rule 501(a)(5) of the SEC’s private placement safe harbor in Regulation D. This exclusion, immediately effective upon enactment of the Act, without any further action by the SEC, will make it more difficult for natural persons to qualify as accredited investors.

Many companies rely on the safe harbor exemption of Regulation D to permit the sale of securities in private placement transactions to accredited investors, which exempts such transactions from the registration requirements of the federal securities laws. For individuals to qualify as “accredited investors,” they must satisfy either income or net worth standards. To meet the income standard, the investor must have income that exceeds \$200,000 in each of the two most recent years or joint income with his or her spouse that exceeds \$300,000 in each of those years, and have a reasonable expectation of reaching the same income level in the current year. If the investor’s income does not exceed these thresholds, he or she must alternatively satisfy the net worth standard.

In the past, the net worth standard depended on whether the investor has an individual net worth, or joint net worth with the investor’s spouse, at the time of the investment that exceeds \$1,000,000. The value of the investor’s primary residence historically has been included as part of the individual’s net worth for purposes of determining whether the investor is accredited. With the enactment of the Dodd-Frank Act, however, the value of the investor’s primary residence will no longer be included.

Section 413 of the Dodd-Frank Act now requires individual investors to exclude the value of their primary residence in determining whether they have a net worth that exceeds \$1,000,000. The SEC has already issued guidance to the effect that any mortgage or other debt secured by the primary residence up to the fair market value of the primary residence is also excluded from the calculation of net worth. If that mortgage or debt, however, exceeds the fair market value of the primary residence, then the excess should be considered a liability and deducted from the investor’s net worth.

These changes to the net worth determination are effective immediately, so issuers, investors and others that participate in private placement transactions should make sure that their disclosure

documents, accredited investor questionnaires and subscription agreements are consistent with this new standard.

For assistance in this area please contact one of the attorneys listed below or any member of your Mintz Levin client service team.

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