



## California Corporate & Securities Law

# The Dodd-Frank Act's Exclusion of the "Chief School of Human Virtues"

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As has been discussed in earlier posts, Section 413(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the exclusion of the value of an investor's primary residence for purposes of the net worth determination under Securities Act Rules 215 and 501(a)(5). The Securities and Exchange Commission has provided the public with an opportunity to comment on rule changes even before it proposes them. Last week, I submitted these brief [comments](#) regarding the definitions of "accredited investor". According to the SEC's proposed [schedule](#), the SEC will propose changes to its accredited investor definitions before the end of this year.

As mentioned in my comments, the Dodd-Frank Act could affect warrant exercises. For example, some issuers may have previously offered and sold warrants on the basis that their offerings were made to all accredited investors under Rule 506. If the warrants do not become exercisable within one year, the SEC is likely to take the position that the warrant exercise is a sale that must meet the conditions of Rule 506 or some other exemption (See Compliance & Disclosure Interpretation # 126.02 for the SEC's analogous position with respect to registration). The Dodd-Frank Act's elimination of investors' primary residences from the net worth calculation may cause some of these investors to lose their accredited investor status. While the issuer could conduct a Rule 506 offering to non-accredited investors, this would impose additional burdens in meeting the specific informational requirements of Rule 502(b).

This problem shouldn't arise under the California Corporate Securities Law of 1968 because Corporations Code Section 25017(e) provides that every sale or offer of a warrant or right to purchase or subscribe to another security of the same or another issuer includes an offer and sale of the other security *only at the time of the offer or sale of the warrant or right*.

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