BYBEL RUTLEDGE LLP

LEGAL ALERT

July 14, 2014

New PA Securities Exemption for DRIP Plans of SEC Reporting Companies with Optional Cash Payment Feature Whose Stock is Quoted on the Over-the-Counter Bulletin Board

On June 10, 2014, Governor Corbett signed SB 1045 into law as Act 52 which amends the Pennsylvania Securities Act of 1972 (the "1972 Act"). Act 52 becomes effective on August 11, 2014.

Section 203(i.1) Exemption Expanded

Act 52 amends Section 203(i.1) which provides an issuer exemption for sales of equity securities of companies that are required by the Securities Exchange Act of 1934, as amended (the "1934 Act") to file periodic reports ("Reporting Companies") with the U.S. Securities & Exchange Commission ("SEC") and which have an effective registration statement with the SEC under Section 5 of the Securities Act of 1933, as amended (the "1933 Act").

Prior to Act 52, only equity securities that were listed on a national securities exchange or quoted on the National Market System or Small Cap Market of the Nasdaq Stock Market were eligible to rely on this exemption. Effective August 11, 2014, Reporting Companies whose equity securities are quoted on the OTC Bulletin Board ("OTCBB") will become eligible to rely on this exemption.

How Does Act 52 Affect Certain DRIP Plans?

Many companies have adopted Dividend Reinvestment and Stock Purchase Plans ("DRIP Plans") as an efficient means of raising capital and permitting shareholders to increase equity participation in the company. A DRIP Plan may be limited solely to purchasing company shares with cash dividends declared or it may permit shareholders, in addition to the cash dividends, to make optional cash payments under certain terms and conditions to purchase company shares.

The "cash dividend" only DRIP Plan generally enjoys an exemption from registration under Section 203(n) of the 1972 Act and Regulation 203.141 of the Pennsylvania Department of Banking and Securities (the "Department") as the offer is made to existing equity securityholders of the company on a pro rata basis.

The longstanding position of Department staff has been that the "optional cash payment" feature of a DRIP Plan makes the exemption in Section 203(n) of the 1972 Act unavailable because the offering is not being made on a pro rata basis to securityholders in Pennsylvania as required by Department Regulation 203.141.

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That is why Reporting Companies offering DRIP Plans with an optional cash feature whose shares only were quoted on the OTCBB had to register the shares to be issued under DRIP Plans with the Department under Section 205 or 206 of the 1972 Act.

Regulatory Relief Provided by Act 52

Effective August 11, 2014, Reporting Companies with "optional cash payment" DRIP Plans whose equity securities are quoted on the OTCBB should be able to rely on the registration exemption in Section 203(i.1) of the 1972 Act for the sales of their shares under these DRIP Plans, provided they meet all of the following conditions:

- The equity security currently is registered under Section 5 of the 1933 Act;
- The issuer is a reporting company as defined in Section 102(q) of the 1972 Act which means that the issuer is required to file and has filed all required periodic reports and annual reports with the SEC under Section 13 or 15(d) of the 1934 Act for at least 12 months;
- No stop order or refusal order is in effect and no public proceeding or investigation looking toward such an order is pending under the 1933 Act;
- The "equity security" is quoted on the OTC Bulletin Board;
- The issuer, at the time the registration statement became effective under the 1933 Act has not received an auditor's report for the immediately preceding fiscal year expressing substantial doubt about the issuer's ability to continue as a going concern if the offering is not subject to being underwritten on a firm commitment basis by a broker-dealer registered with the Department.

Section 203(i.1) permits the Department to define, by regulation, the term "equity security" for purposes of the availability of the Section 203 (i.1) exemption. Department Regulation 203.091 defines the term "equity security" for the purposes of the availability of the Section 203(i.1) exemption to include common stock, preferred stock, non-debt securities convertible into common or preferred stock, non-transferable warrants to purchase any of the foregoing and transferable warrants exercisable within not more than 90 days of issuance to purchase any of the foregoing.

Are Offers Also Exempt?

Section 203(i.1) exempts "sales" of certain equity securities by the issuer so, are offers to sell those securities also exempt? Section 203(h) of the 1972 Act provides a self-executing exemption for offers (but not sales) of securities for which a registration statement has been filed under the 1933 Act if no stop order or refusal order is in effect and no public proceeding or examination looking toward such an order is pending under the 1933 Act and no offer is made until after the registration statement is filed with the Department.

If the issuer has not filed a copy of the SEC registration with the Department, the offer most likely still would be exempt under Section 203(h) as Department Regulation 204.012 has waived the requirement that the issuer file a copy of the registration statement with the Department if the issuer has filed a registration statement with the SEC prior to the time offers are made in Pennsylvania in reliance on Section 203(h).

Need More Information?

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