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SEC'S Proposed Amendment to the "Accredited Investor" Standard

On January 25, 2011, the Securities and Exchange Commission ("SEC") voted to propose amendments to its rules for "accredited investors" in order to conform to the recent requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The proposed amendments exclude the value of a person's primary residence in assessing an individual's net worth to determine their accredited investor status. The amendments also clarify how the net worth of a person's primary residence will be calculated. These amendments are significant for entrepreneurs and companies seeking to raise capital in private offerings because the pool of available investors may decrease since fewer individuals will qualify as accredited investors.

Who is an accredited investor?

Companies that offer or sell securities must register their securities with the SEC or find an exception to these registration requirements. Issuers raising capital often rely on what is known as the accredited investor exemption. Accredited investors are often exempt from the regular registration requirements under the theory that they are well-versed in business transactions and have sufficient business acumen to protect their own interests. Individuals who qualify as an accredited investor under the Securities Act of 1933, Rule 501 of Regulation D include:

◆ a director, executive officer or general partner of the company selling the securities;

◆ a person with income exceeding $200,000 in each of the two most recent years or joint income with his/her spouse in excess of $300,000 for those years and a reasonable expectation of reaching the same income level in the current year;

◆ a person who has an individual net worth, either individually or jointly with investor's spouse, that exceeds $1 million at the time of the purchase.

The revised net worth standard

Previously, the $1 million net worth valuation included the value of the investor's primary residence in calculating his/her net worth for purposes of determining the accredited investor status. However, on July 21, 2010, the Dodd-Frank Act was enacted, which significantly modified the calculations for the determination of an accredited investor. Under section 413(a) of the Dodd-Frank Act, the net worth standard was adjusted by excluding the value of an individual's primary residence from the $1 million net worth calculation. Although the Dodd-Frank Act was effective immediately, the SEC was required to revise the Securities Act rules to

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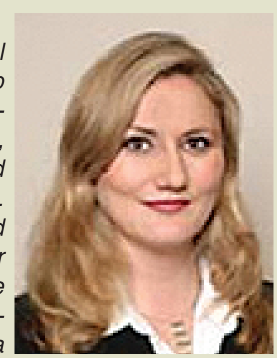

Tamara L. Dewar is a senior trial attorney with Callahan & Blaine who specializes in complex business litigation, including securities litigation, directors and officers liability and intellectual property litigation. Callahan & Blaine is known and respected as "California's Premier Litigation Firm." Callahan & Blaine has obtained record-breaking verdicts and settlements including a $934 million jury verdict in a complex litigation trial. For more information, please feel free to visit the firm's web-site at www.callahan-law.com or call (714) 241-4444.

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which significantly modified the calculations for the determination of an accredited investor. Under section 413(a) of the Dodd-Frank Act, the net worth standard was adjusted by excluding the value of an individual's primary residence from the $1 million net worth calculation. Although the Dodd-Frank Act was effective immediately, the SEC was required to revise the Securities Act rules to implement and clarify the new standard. For instance, the Dodd-Frank Act did not define the term "value" nor provide guidance regarding how mortgages and other indebtedness secured by the residence would impact the overall net value determination of the residence.

Now, under the SEC's new proposed Rule 215 and 501, an accredited investor is defined as:

Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of purchase, exceeds $1,000,000, excluding the value of the primary residence of such natural person, calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property.

The impact of the new standard

The new net worth standard must remain in effect until July 21, 2014. The SEC's new proposed rule amendment will clarify how net worth is determined since the Securities Act does not define the term. The net worth or value of an individual's primary residence will be determined by "subtracting from the estimated fair market value of the property, the amount of debt secured by the property, up to the estimated fair market value of the property." (SEC Press Release 2011-24). Thus, any mortgage debt secured by the property that exceeds the fair market value of the property (i.e. the residence is "under water") must be considered a liability and deducted from the net worth of the investor.

The Dodd-Frank Act also requires that during the first four years following the enactment of the Act, the SEC is authorized to further review the definition of accredited investor as it applies to natural persons, but it is not permitted to adjust the $1 million net worth threshold. In addition, the Dodd-Frank Act also requires that the U.S. Comptroller General conduct a study on appropriate criteria for determining the financial thresholds or any other criteria needed to qualify for accredited investor status and eligibility in investment of private funds.

Companies and funds must also be aware that they are not permitted to treat an investor as accredited who does not meet this new standard, even if the investor was previously qualified as an accredited investor when they initially invested in the company. However, the SEC is also seeking public input and comment on whether certain transition rules should be enacted to facilitate subsequent investments by an investor who had previously qualified as an accredited investor but was later disqualified by the new net worth standard.