

Small Business Securities Bulletin

A periodic bulletin keeping small businesses informed about current developments in securities law and related matters



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SEC Proposes Rule to Eliminate Prohibition on General Solicitation and Advertising in Rule 506 Private Offerings

On August 29, the U.S. Securities and Exchange Commission (SEC) proposed an amendment to its rules to eliminate the current prohibitions on general advertising and general solicitation from certain private placements conducted in accordance with Rule 506 under Regulation D under the Securities Act of 1933 (Securities Act). As discussed in our April 2012 Bulletin, this amendment is required pursuant to the Jumpstart our Business Startups (JOBS) Act enacted in April. As our readers are aware, any offer or sale of securities must be registered or exempt from registration under both the Securities Act and any applicable state securities laws and Rule 506, which exempts from registration (under federal and state law) offers and sales of securities made solely to “accredited investors” and up to 35 non-accredited but “sophisticated” investors, is one of the most often used exemptions for businesses selling stock to raise capital. Accredited investors generally include natural persons with income of \$200,000 or \$300,000 with their spouse or a net worth (excluding their primary residence) exceeding \$1 million, and certain entities, while a “sophisticated” investor means an “investor [that] either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment.” Currently, Rule 506 offerings must be made without “general solicitation” or “general advertising;” while there is no formal definition of these terms, examples set forth in Rule 502(c) of Regulation D and SEC interpretations over the years have provided basic guidelines as to what constitutes general solicitation and general advertising.

Proposed new Rule 506(c) would permit general solicitation and general advertising in Rule 506 offerings in which (i) the issuer takes “*reasonable steps to verify*” that all purchasers in the offering are accredited investors and (ii) all such purchasers are, or, consistent with the definition of accredited investor, the issuer reasonably believes they are, accredited investors. The existing provisions with respect to integration of exempt offerings and restrictions on resale would continue to apply to such offerings.

Although it asked for comment on the issue, the SEC is not proposing to mandate what might constitute “reasonable steps” to verify accredited investor status, preferring instead that the new exemption “provide flexibility to accommodate the different types of offerings ... and the different types of investors ... that may purchase securities.” Whether the steps taken by a company to verify accredited status are reasonable “would be an objective determination, based on the facts and circumstances of each transaction.” The proposing release does, however, discuss examples of factors that companies would consider in making such a reasonableness determination, including (i) the nature of the purchaser and the category of accredited investor under which they qualify as such, (ii) the amount and type of information about the purchaser the company has, and (iii) the nature of the offering, including the manner of solicitation, and its terms, including minimum investment amount. The SEC does allow, however, that with respect to natural persons, certain types of information - such as copies of Forms W-2 or verification of accredited investor status by a third party (such as a broker dealer, attorney or accountant) that the company has a reasonable basis to rely on - might, depending on the circumstances, be adequate to constitute reasonable steps to verify accredited investor status. Privacy concerns, however, will often be a factor in verifying a potential purchaser’s net worth or income. Companies will have to “retain adequate records to document the steps taken to verify that a purchaser was an accredited investor.” As discussed in the release, it would seem clear that the current practice whereby investors self-certify such status using a questionnaire, absent any other information about the purchaser, would generally be inadequate where purchasers are solicited by means of general solicitation or advertising.

Fortunately, the SEC does make clear in the proposing release its position that whatever such “reasonable steps to verify” accredited investor status may be, Rule 506 offerings that do not use general solicitation/advertising and otherwise comply with the existing Rule 506(b) exemption, which will be retained, will not be subject to the new verification requirement.

Companies offering securities pursuant to the proposed new Rule 506(c) exemption would need to check a box on a proposed revision to Form D to indicate that they are doing so. No other changes to Form D are being proposed at this time.

In addition, also in accordance with the JOBS Act the SEC proposed an amendment to Rule 144A under the Securities Act, which exempts certain resales of restricted securities to qualified institutional buyers. The proposed amendment to Rule 144A would eliminate the restriction limiting offers to qualified institutional buyers, thereby permitting offers to persons who do not so qualify, including pursuant to general solicitation or general advertising, as long as the securities are sold only to persons the seller and any person acting on the seller's behalf "reasonably believe" are qualified institutional buyers.

The SEC's Proposing Release for these amendments is available at www.sec.gov/rules/proposed/2012/33-9354.pdf.

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About Me

I am a former SEC attorney who also has prior "big firm" experience. I assist public as well as private companies with compliance with federal and state securities laws, including assisting public companies with their reporting obligations under the Securities Exchange Act of 1934, at competitive billing rates. Please contact me if you would like more information about my practice or to discuss how I can be of assistance to you. Visit my bio at www.ober.com/attorneys/penny-somer-greif.

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