

General Advertising Permitted: New Rules for Private Placements

The Jumpstart Our Business Startups Act, known as the “Jobs Act”, adopted April 5, 2012, required the Securities and Exchange Commission (the “SEC”) to amend long-standing restrictions on general solicitation and general advertising in connection with securities offerings under Rule 506 of Regulation D of the Securities Act of 1933, which provides a “safe harbor” for selling investment securities in transactions commonly known as “private placements.” Pursuant to this requirement, the SEC on July 10, 2013 approved new Rule 506(c). Under the new rule, companies interested in selling securities, commonly known as “issuers”, may offer securities through means of general advertising and general solicitation to the public, provided that the conditions of the new rule are satisfied.

Rule 506 is a non-exclusive safe harbor under the Securities Act that exempts non-public offerings from the registration requirements that would otherwise apply. Prior to the adoption of the new rule, issuers relying on Rule 506 were prohibited from conducting offerings through any form of general solicitation or general advertising, regardless of whether all of the purchasers were “accredited” under the securities laws. This prohibition imposed inherent limitations on access to certain capital markets but offered a practical alternative for many issuers given the regulatory requirements and very substantial expenses associated with registering securities for public sale. The new rule grants issuers the opportunity to use general solicitation and general advertising in connection with Rule 506 offerings, provided that (i) all purchasers in the offering are “accredited investors,” and (ii) the issuer takes reasonable steps to verify that all investors are “accredited.” The new rule does not amend the definition of who qualifies as an “accredited investor.” Generally, individuals are considered “accredited investors” if they have annual net income in excess of \$200,000 for each of the prior two years and expect such income for the current year or a net worth in excess of \$1,000,000, excluding a personal residence.

Reasonable Steps

All investors in an offering using the new rule must be “accredited.” The new rule requires that issuers of securities take “reasonable steps” to verify that each purchaser is “accredited” when conducting a Rule 506 offering involving general solicitation or general advertising. This new reasonable steps requirement is independent of the requirement that sales be limited to “accredited investors” and must be satisfied even if all purchasers are, in fact, “accredited investors.” Reasonableness is determined based on the specific facts and circumstances of the offering and is an objective determination made by the issuer. As described by the SEC in its comments on the new rule, the factors that can be used to determine whether an investor is “accredited” may include, without limitation: (i) the nature of the purchaser, including the type of “accredited investor” the purchaser of the security claims to be; (ii) the amount and type of information the issuer has about the purchaser; and (iii) the nature of the offering, including the manner of solicitation or advertising, any minimum investment amounts, and the terms of payment.

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The new rule includes four specific, although non-exclusive, methods of verifying whether individuals are “accredited investors.” These methods include:

- For verifying on the basis of income, the review of copies of any IRS form that reports income, including, but not limited to, Forms W-2, 1099, 1065, Schedule K-1s, and copies of filed Form 1040s, for the two most recent years reflecting income in excess of \$200,000, together with a written representation from the purchaser that the purchaser has a reasonable expectation of reaching that income level during the year the purchase is being made.
- For verifying one’s net worth of more than \$1,000,000, the review of one or more financial documents evidencing assets and liabilities of the purchaser, such as bank statements, brokerage statements, credit reports, and tax assessments, dated within the prior three months, together with a written representation that the purchaser has provided the issuer with all information necessary to make a determination of net worth.
- Obtaining a written confirmation from a registered broker-dealer, an SEC-registered investment adviser, a licensed attorney, or a certified public accountant, each in good standing, that such person or entity has taken reasonable steps within the prior three months to verify that the proposed purchaser is “accredited.”
- The issuer is deemed to satisfy the verification requirement with respect to any individual who invested in an issuer’s Rule 506(b) offering, prior to the effectiveness of the new rule, and remains an investor of the issuer for any Rule 506(c) offering conducted by the same issuer, provided that the issuer obtains a certification by such person at the time of sale of the security that he or she qualifies as an “accredited investor.”

An issuer has the burden of demonstrating that it is entitled to rely on an exemption from registration and therefore it is important that issuers retain adequate records documenting the “reasonable steps” taken to verify that an investor is “accredited.”

Existing Rule 506 Preserved

The new rule does not affect the availability of Rule 506 as it existed before the rule change as an exemption to registration. Issuers conducting Rule 506 offerings made without the use of general solicitation or general advertising, which is still available under Rule 506, are not subject to the new provisions relating to verification of persons as “accredited investors” as required under the new rule, although the issuer must, as in the past, have a reasonable belief that the investor is “accredited.” Once a general solicitation has been made to any potential purchaser in an offering, an issuer must comply with the new rule. Therefore, the decision as to whether an issuer will be relying upon the new rule in connection with an offering must be made before an offering commences.

Revised Form D

In connection with the adoption of the new rule,

the SEC has revised the form that must be filed with the SEC with respect to Regulation D by any issuer offering or selling securities without registering the offering with the SEC, known as a “Form D.” If required to be filed, a Form D must be filed within 15 calendar days after the first sale of securities in the offering. The revised Form D includes a new disclosure section, requiring issuers to affirm whether they are relying on the new rule exemption permitting general solicitation. In completing the revised Form D, issuers must choose between the existing Rule 506 exemption and the exemption as modified by the new rule that permits general solicitation.



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Proposed Rules Restricting Offerings Under the New Rule

On the same day the new rule was adopted, the SEC proposed further amendments to Rule 506. In its commentary in the proposed rules, the SEC notes that reporting limitations will limit the SEC’s ability to monitor and assess the market norms that will develop in implementing the new rule. To mitigate these limitations and to provide the SEC with data relevant to assessing issuers’ use of the exemption under the new rule and their compliance with related regulations, the proposed rules provide, in part, that (a) all issuers relying on the new rule would be required to file a Form D with the SEC at least 15 calendar days before any general solicitation or general advertising occurs, together with both an amended Form D, 15 calendar days after the first sale of securities in the offering, and a final amended Form D within 30 calendar days after the termination of the offering, (b) general advertising materials would be required to include certain legends and disclaimers, (c) issuers would be required, during the first two years of the effectiveness of the new rule, to submit copies to the SEC of general solicitation and general advertising materials used by the issuer, and (d) in connection with a revised Form D, issuers would be required to disclose additional information relating to the offering, such as the types of general solicitation used and the methods used by the issuer to verify the “accredited investor” status of purchasers. These proposed rules are now open to comments from the public.

Rule 506(c) becomes effective September 23, 2013. Until effective, Rule 506(c) is not available to issuers and should not be relied upon by any party. This article does not constitute legal advice and is intended only as a summary for informational purposes. Persons interested in learning more about how the new SEC rules may impact them are encouraged to contact legal counsel.

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