

SEC Proposes Eliminating Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings

The Securities and Exchange Commission (“SEC”) recently proposed amendments to Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 (“Securities Act”) to implement Section 201(a) of the Jumpstart Our Business Startups Act (“JOBS Act”).¹

- Section 201(a)(1) of the JOBS Act directs the SEC to eliminate the prohibition against general solicitation and general advertising in offerings made under Rule 506, so long as all purchasers of the securities are accredited investors, and further instructs the SEC to “require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the [SEC].”²
- Section 201(a)(2) of the JOBS Act calls for the revision of Rule 144A(d)(1) “to permit offers of securities pursuant to Rule 144A to persons other than qualified institutional buyers (‘QIBs’), including by means of general solicitation or general advertising, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.”³

The SEC’s proposed rule suggests substantive amendments to Rule 506 and Rule 144A to implement these mandated changes, as well as revisions to Form D requiring issuers to indicate whether they are using general solicitation or general advertising in a Rule 506 offering.⁴

The SEC is seeking comment on its proposed rule by October 5, 2012.

I. Proposed Amendments to Rule 506 and Form D

A. Proposed Amendments to Rule 506

Rule 506 is a commonly used, non-exclusive safe harbor under Section 4(a)(2)⁵ of the Securities Act that allows issuers to offer and sell securities, regardless of the offering amount, to an unlimited number of accredited

¹ See *Eliminating The Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, Release No. 33-9354; File No. S7-07-12 (Aug. 29, 2012), available at <http://www.sec.gov/rules/proposed/2012/33-9354.pdf>.

² *Id.* at 5 (quoting JOBS Act, Pub. L. No. 112-106, 126 Stat. 306 (2012)). Rule 501(a) of Regulation D defines the term “accredited investor” to include a person who falls within one of the definition’s enumerated categories or a person whom the issuer “reasonably believes” to fall within one of the definition’s enumerated categories, at the time the securities are sold to that person.

³ *Id.* The term “qualified institutional buyer,” as defined in Rule 144A(a)(1), “includes specified institutions that, in the aggregate, own and invest on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with such institutions. Banks and other specified financial institutions must also have a net worth of at least \$25 million. A registered broker-dealer qualifies as a QIB if it, in the aggregate, owns and invests on a discretionary basis at least \$10 million in securities of issuers that are not affiliated with the broker-dealer.” *Id.* at 5 n.12.

⁴ The SEC also proposes a number of technical and conforming amendments to Rules 502 and 506 of Regulation D. *See id.* at 33.

⁵ Until April 5, 2012 and the enactment of the “JOBS Act”, this was Section 4(2) of the Securities Act. The JOBS Act re-designated the existing Section 4 as 4(a) and added a new Section 4(b) and a new Section 4(b)(1), the first of which exempts offers and sales of securities made under Rule 506 from the registration requirements of Section 5 of the Act and

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investors and to no more than 35 non-accredited investors who meet certain “sophistication” requirements, without being subject to the registration requirements in Section 5 of the Securities Act. The availability of the Rule 506 safe harbor is currently subject to several requirements, including that the issuer or any person acting on its behalf not use any form of “general solicitation” or “general advertising” for the offer or sale of securities. “General solicitation” and “general advertising” are not defined in Regulation D; however, Rule 502(c) of Regulation D and SEC guidance indicate that general solicitation and general advertising (jointly referred to herein as “general solicitation”) include “advertisements published in newspapers and magazines, communications broadcast over television and radio, and seminars whose attendees have been invited by general solicitation or general advertising,” as well as “other uses of publicly available media.”⁶

Pursuant to the mandate of Section 201(a)(1) of the JOBS Act, the SEC is proposing new Rule 506(c), which would permit the offer and sale of securities through general solicitation under Rule 506, provided that the following conditions are met:

- The issuer takes “reasonable steps to verify that the purchasers of the securities are accredited investors.”⁷
- All purchasers of securities are accredited investors, “either because they come within one of the enumerated categories of persons that qualify as accredited investors [under Rule 501(a) of Regulation D] or the issuer reasonably believes that they do, at the time of the sale of the securities.”⁸
- All other conditions of Rules 501, 502(a), and 502(d) are satisfied.⁹

With regard to the proposed requirement that issuers using general solicitation “take reasonable steps to verify” the purchasers’ status as accredited investors, the SEC suggests that “[w]hether the steps taken are ‘reasonable’ would be a subjective determination, based on the particular facts and circumstances of each transaction,” rather than obligating issuers to adhere to “uniform verification methods that may be ill-suited or unnecessary to a particular offering or purchaser.”¹⁰ In ascertaining the reasonableness of the steps taken to verify that a purchaser is an accredited investor, the SEC proposes that issuers consider a number of factors. These factors may include:

- “the nature of the purchaser and the type of accredited investor that the purchaser claims to be” (*i.e.*, whether the purchaser claims to be an accredited investor by virtue of its status or based on a combination of its status and its total assets, or whether the purchaser is a natural person claiming to be an accredited investor based on either net worth or annual income)¹¹;

the second of which provides an exemption from broker-dealer registration for persons effecting Rule 506 offerings who meet certain other conditions.

⁶ *Id.* at 6.

⁷ *Id.* at 11.

⁸ *Id.* at 11-12.

⁹ Despite the creation of new Rule 506(c), the SEC is proposing to preserve existing Rule 506(b) in order to continue to make the Rule 506 safe harbor available to issuers who do not wish to engage in general solicitation without requiring them to take reasonable steps to verify purchasers’ accredited investor status, as well as to those wishing to sell privately to up to 35 non-accredited investors who meet the “sophistication” requirements in Rule 506(b).

¹⁰ *Id.* at 14, 25.

¹¹ *Id.* at 14-16.

- “the amount and type of information that the issuer has about the purchaser” (such as publicly available information in filings with a regulatory agency, reliable evidence from a third-party indicating that the purchaser falls within one of the enumerated categories in the definition of “accredited investor” (e.g., Form W-2), or “verification of a person’s status as an accredited investor by a third party, such as a broker-dealer, attorney or accountant” on which the issuer has a reasonable basis to rely)¹²; and
- “the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering,” (e.g., whether the purchaser was solicited through a publicly accessible website or via a database of pre-screened accredited investors created and maintained by a registered broker-dealer), and “the terms of the offering, such as a minimum investment amount” (since a purchaser’s ability to meet a high minimum investment amount could be a relevant factor in determining what verification steps would be reasonable under the circumstances).¹³

The SEC believes that an assessment of these interrelated factors would help the issuer assess the likelihood that a potential purchaser is an accredited investor, “which would, in turn, affect the types of steps that would be reasonable to take to verify a purchaser’s accredited investor status.”¹⁴ The SEC views its proposed approach as flexible enough to allow issuers to tailor their verification strategy to the circumstances. According to the SEC, requiring issuers to use specified methods of verification would be impractical, since obligatory measures could be overly burdensome in some cases and ineffective in others.

Finally, the SEC’s proposed rule confirms that so long as “the issuer took reasonable steps to verify that the purchaser was an accredited investor and had a reasonable belief that such purchaser was an accredited investor,” an issuer may rely on the proposed Rule 506(c) exemption, even if the purchaser does not actually qualify as an accredited investor.¹⁵

B. Proposed Amendments to Form D

The SEC is proposing to revise Form D (the notice required to be filed for each offering of securities made without registration pursuant to a Regulation D exemption) to add a check box for issuers to indicate whether they are claiming an exemption under Rule 506(c). Instead of the current check box for “Rule 506,” Item 6 of Form D would have one check box for “Rule 506(b)” and one check box for “Rule 506(c).”

II. Proposed Amendment to Rule 144A

“Rule 144A is a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain ‘restricted securities’ to QIBs.”¹⁶ In order to implement Section 201(a)(2) of the JOBS Act, the SEC proposes to remove references to “offer” and “offeree” from Rule 144A(d)(1), such that the

¹² *Id.* at 14, 17-19.

¹³ *Id.* at 14, 19-20.

¹⁴ *Id.* at 20.

¹⁵ *Id.* at 29. The JOBS Act and rules adopted thereunder are not expected to affect the preemption of state registration requirements with respect to Rule 506 offerings. However, states are permitted to require Form D filings and filing fees in connection with Rule 506 offerings, and issuers that use other exemptions in certain states may lose the benefit of those other exemptions if they engage in general solicitation or advertising.

¹⁶ *Id.* at 6-7 (citing Securities Act Rule 144(a)(3), which defines “restricted securities” to include, in part, “[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a chain of transactions not involving a public offering”).

amended rule “would require only that the securities are sold to a QIB or to a purchaser that the seller and any person acting on behalf of the seller reasonably believe is a QIB.”¹⁷ If this requirement is met, the resale of securities under the amended Rule 144A could be conducted with the use of general solicitation.¹⁸

III. Proposed Amendments Do Not Affect Availability of Regulation S Offering Exemption

Regulation S includes two non-exclusive “safe harbor” provisions under which certain transactions will be deemed to occur outside the United States and, therefore, will not be subject to the registration requirements of Section 5 of the Securities Act. Two general conditions must be satisfied in order for either the issuer safe harbor or the resale safe harbor to apply: (i) any offer or sale must be made in an “offshore transaction” and (ii) no “directed selling efforts” may be made in the United States in connection with any such offer or sale. “Directed selling efforts” include any activities undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market for any of the securities being offered in reliance on Regulation S. Regulation S selling activities that have been considered to be specifically prohibited included placing advertisements with radio or television stations broadcasting into the United States, and placing advertisements in publications with a “general circulation in the United States.”¹⁹

In the release proposing the JOBS Act required amendments to Rule 506 and Rule 144A, the SEC responded to comments by stating that an offering made in the United States pursuant to Rule 506 and Rule 144A, as proposed to be amended, concurrently with a Regulation S offering will not be integrated with the Regulation S offering. Thus, the use of general solicitation in making a Rule 506 or Rule 144A offering, as will be permitted once the amendments to those rules become effective, will not cause a Regulation S exemption to be unavailable to a concurrent offering made offshore pursuant to that Regulation.

IV. Conclusion

The SEC is proposing amendments intended to implement the mandate in Section 201(a) of the JOBS Act. The SEC rule proposal is a regulatory change mandated by the JOBS Act; it is expected that it will be implemented once the requisite time and comment periods for SEC rulemaking have transpired. The proposed amendments will give issuers the option to offer and sell securities through general solicitation and still avail themselves of the Rule 506 and Rule 144A safe harbors, provided that certain requirements are met.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; Yafit Cohn at 212.701.3089 or ycohn@cahill.com; or Mary Stokinger at 212.701.3430 or mstokinger@cahill.com.

¹⁷ *Id.* at 37.

¹⁸ Rule 144A offerings are not preempted by Federal law from state securities regulation. The institutional investor exemptions relied upon at the state level do not currently include a “reasonable belief” standard or expressly permit general solicitation or advertising and we expect that the states will consider aligning their exemptions with the JOBS Act.

¹⁹ See Cocchiarella, John C. and Risoleo, Robert S., Private Placements, Resales and Rule 144A and Regulation S Offerings, Practising Law Institute Corporate Law and Practice Course Handbook Series, 1600 PLI/CORP 181 at 215.