# CLIENT UPDATE

# JOBS ACT RULE ELIMINATING THE BAN ON GENERAL SOLICITATIONS IN CERTAIN PRIVATE OFFERINGS IS PROPOSED

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As mandated by the Jumpstart Our Business Startups Act ("JOBS Act") enacted earlier this year, the Securities and Exchange Commission ("SEC") this week proposed amendments to Rule 506 of Regulation D and to Rule 144A under the Securities Act of 1933 ("Securities Act") that would eliminate the ban on "general solicitation" and "general advertising" of private securities offerings conducted under those rules. The current ban on general solicitation and advertising has meant, among other things, that a corporation, limited partnership or other issuer making a private offering under these rules may not advertise the offering in a newspaper, speak to the press or at public conferences about the offering or make offering documents available online except on a password-protected basis. The proposed amendments would eliminate the ban and permit these previously prohibited activities in some circumstances. Note, however, that these proposed changes are not yet effective and, until the proposed rule becomes effective, general solicitations and advertisements in private offerings under the Securities Act are not permitted.

## THE PROPOSED RULE WOULD PERMIT GENERAL SOLICITATIONS AND ADVERTISING IN CERTAIN PRIVATE PLACEMENTS

Rules 506 and 144A are non-exclusive "safe harbor" exemptions from the registration requirements of the Securities Act. Rule 506 covers securities offerings to an unlimited number of "accredited investors" (as defined in Rule 501(a) of Regulation D) and a limited number of other sophisticated persons who do not meet the "accredited investor" test. Rule 144A covers the resale of certain "restricted securities" to "qualified institutional buyers" (as defined in Rule 144A) ("QIBs"). Rule 502(c) as now in effect prohibits an issuer from making a Rule 506 offering through any form of "general solicitation or general advertising." Although Rule 144A does not include an express prohibition against general solicitation or advertising, offers of securities under Rule 144A must be limited to QIBs, which the SEC acknowledged has the same practical effect.

Under the proposed changes to Rule 506(c), an issuer could utilize general solicitation or advertising in connection with a Rule 506 offering if (i) at the time of the sale of the securities, all of the purchasers are, or the issuer reasonably believes them to be, accredited investors; (ii) the issuer takes "reasonable steps" to verify that the purchasers are accredited investors; and (iii) all of the terms and conditions of Rule 501 and Rules 502(a) and 502(d) of Regulation D are satisfied. Accordingly, if Rule 506(c) is adopted as proposed, issuers (including privately-owned businesses and private equity and hedge funds) satisfying these three requirements would be able to offer their securities (including stock and limited partnership interests) without being required to register the offering under the Securities Act, while, among other things, (i) using newspaper, magazine, Internet and other forms of advertising; (ii) speaking to the press or at public conferences about the offering; (iii) mentioning the offering and investment returns on their websites; (iv) publishing tombstones while an offering is ongoing (such as after a first closing of the sale of interests in a private fund that expects to have multiple closings); (v) making offering documents available by mass mailings and online (without any requirement for password protection); and (vi) marketing to persons without worrying about the traditional requirement that there be a substantive, pre-existing relationship.

Similarly, the proposed amendments to Rule 144A provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs, including by means of general solicitation, 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.

The balance of this memorandum focuses on the amendments to Rule 506.

## INVESTOR VERIFICATION IF A GENERAL SOLICITATION IS MADE

As mandated by the JOBS Act, proposed Rule 506(c) would require an issuer making an offer using a general solicitation to take "reasonable steps" to verify that each purchaser is an accredited investor. The SEC decided not to mandate any specific set of steps that must be taken to verify that a purchaser is an accredited investor. Instead, the determination whether the steps taken are "reasonable" would be based on the particular facts and circumstances of each transaction. Specifically, the SEC noted the following factors to be considered: (i) the nature of the purchaser and the type of accredited investor that the purchaser claims to be; (ii) the amount and type of information that the issuer has about the purchaser; (iii) the nature of the offering (such as the manner in which the purchaser was solicited to participate in the offering); and (iv) the terms of the offering (such as a minimum investment amount).

So, for example, the proposing release suggests that private offerings with a low minimum investment amount involving natural persons who are solicited through a publicly-available website most likely would require heightened verification procedures. In these circumstances, the proposing release suggests that an issuer may need to review the purchaser's W-2 or other available data on the purchaser's compensation or rely upon verification by a reasonably reliable third party (*e.g.*, a registered broker-dealer, an attorney or an accountant).

By contrast, private offerings to large institutional investors making significant investments (such as offerings to pension plans making multi-million dollar capital commitments to a private fund) may require limited verification procedures. In particular, the SEC indicated that if the minimum investment amount is set high enough, the ability of the purchaser to satisfy that minimum investment amount may be sufficient evidence of the purchaser's status as an accredited investor without any verification steps other than to confirm that the purchaser is not being financed by the issuer or another third party. Therefore, under these circumstances, representations from an institutional investor concerning its accredited investor status (as is typical in a private fund subscription agreement) and the source of its funding may be sufficient under the proposed rule.

## PRIVATE OFFERINGS WITHOUT GENERAL SOLICITATION; ADDITIONAL CLARIFICATIONS

In the proposing release, the SEC clarified that, if Rule 506(c) is adopted as proposed, an issuer could make a Rule 506 offering either by means of a general solicitation (where sales are limited only to accredited investors as described above) or, alternatively, the issuer

could still make a Rule 506 offering under the existing Rule 506(b), without engaging in a general solicitation. An issuer might choose the latter course if, for example, (i) it wants to sell securities to sophisticated persons who are not accredited investors, (ii) it wants to avoid the accredited investor verification requirements required under proposed Rule 506(c), or (iii) it is concerned about other issues that a general solicitation might raise, such as an increased risk of investor claims, dissemination of proprietary information more broadly than the issuer desires, or the possible failure to qualify for a private placement exemption (or increased exposure to securities regulation and oversight) in another country where it is also seeking to raise capital.

The SEC also made clear that private funds could engage in such offerings without becoming subject to regulation under the Investment Company Act of 1940. In addition, the SEC clarified that the existing definition of accredited investor will continue to include a requirement that the issuer must have a reasonable belief that the investor satisfies the tests to qualify as an accredited investor at the time of the sale of the securities.

In the proposing release, the SEC indicated that its guidance with respect to non-U.S. offerings under Regulation S would not change. Therefore, an issuer could make an offering in the United States under Rule 506(c) using a general solicitation, and an offering outside of the United States under Regulation S without having the general solicitation in the United States constitute prohibited directed selling efforts under Regulation S.

Finally, the SEC proposed an amendment to Form D (the notice required to be filed with the SEC by an issuer claiming a Regulation D exemption) to add a check box to indicate whether an offering is being conducted pursuant to proposed Rule 506(c).

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The comment period of the proposed rule will run until 30 days after its publication in the Federal Register. Please do not hesitate to contact us with any questions.

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